# OFFICE OF THE NATIONAL PUBLIC AUDITOR

**FEDERATED STATES OF MICRONESIA**

**REVIEW OF THE**
**FSM EMBASSY IN TOKYO**
**Fiscal Years 2005, 2006, and 2007**

**REPORT NO. 2008-04**

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**National Public Auditor**

# FEDERATED STATES OF MICRONESIA

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May 23, 2008

His Excellency Manny Mori, President
The Honorable Members of the FSM Congress

**RE: Review of the FSM Embassy in Tokyo**

We completed our inspection of the FSM Embassy in Tokyo for fiscal years 2005, 2006 and 2007. Our objectives were to determine whether a) fund disbursements were in accordance with FSM laws and regulations, and b) accounting and reporting of operating activities complied with the Financial Management Regulations. We conducted our inspection in accordance with the *Quality Standards for Inspections* issued in 1993, as amended, by the U.S. President's Council on Integrity and Efficiency and the Executive Council on Integrity and Efficiency.

We found that the Embassy paid its FSM employees higher salaries and higher living allowances than permitted by regulations or authorized by Congress. For instance, the Embassy converted employee payroll salaries into yen at a higher exchange rate than the bank rate, effectively increasing employee salaries between 13 to 21 percent without budget authority or proper authorization. Employees were also granted increased living allowances at the ambassador's discretion above what was permitted by personnel or finance regulations. FSM employees also received a Foreign Service Premium (FSP) that nearly tripled their salaries, but had little relevance to a cost of living differential for which it was intended. The FSP portion, being exempt from FSM taxes, should be reevaluated considering nearly all living expenses for employees were paid by the Embassy. The unauthorized salary increases and increased allowances amounted to $142,395 over the three year period. The total FSP in question amounted to $506,352 over this same period.

The higher salaries and increased allowances, together with the Embassy expending more for travel and representation than budgeted, contributed to the Embassy overspending its total budget authorization for fiscal year 2005. Additionally, incomplete and inaccurate accounting of the Embassy's expenditures at the Department of Finance & Administration led to misleading financial records and reporting of Embassy expenditures.

We presented a draft of this report to the Secretary of the Department of Foreign Affairs and to the Secretary of the Department of Finance and Administration for their comments. Details of our findings and recommendations along with Departments' comments are presented in the attached report.

Respectfully yours,

Haser Hainrick
National Public Auditor

## TABLE OF CONTENTS

# INTRODUCTION

## Background

The FSM Embassy in Tokyo (the Embassy) was first established as an Economic Liaison Office in 1984 and later upgraded to an Embassy in 1989. The purpose of the Embassy is to represent the interest of the National Government of the FSM to the Government of Japan and other organizations, to attract foreign investment and to promote tourism and trade. The Embassy also provides consular assistance to FSM citizens residing or visiting Japan.

The Embassy has three FSM citizen staff (Ambassador, Deputy Chief of Mission, and Minister-Consular and three local staff (an executive secretary who also does the accounting, a driver for the Ambassador and a receptionist). The daily activities of the Embassy are overseen by the Ambassador. The Secretary of the Department of Foreign Affairs (DFA), as department head and allottee of the Embassy's funds, is responsible for formulating administrative policies and procedures for all overseas missions including the Embassy in Tokyo. The Secretary of the Department of Finance & Administration (DF&A) is designated as the Operating Fund custodian and is responsible for the proper accounting of the Embassy's funds.

The following table shows the total budget authorizations and expenditures for the Embassy as adjusted by Office of the National Public Auditor (ONPA) during fiscal years 2005, 2006, and 2007. See Appendix II, page 14 for details.

**Table 1: Funds Authorized and Expended by the FSM Embassy in Tokyo
Fiscal Years 2005 through 2007**

| Fiscal Year | Authorized Budget | Amount Expended | Under/(Over) Expended |
|---|---|---|---|
| 2005 | $884,577 | $953,351 | ($68,774) |
| 2006 | 884,958 | 846,799 | $38,159 |
| 2007 | 884,963 | 822,156 | $62,807 |
| Totals | $2,654,498 | $2,581,139 | $73,359 |

Source: DF&A with ONPA adjusted numbers for Amount Expended

Budgeted funds to cover the Embassy's operational costs were wire transferred from the DF&A into the Embassy's bank account (Mizuho Bank) in quarterly allotments where the funds were converted to yen at the bank's prevailing exchange rate. The quarterly allotments for FSM employee payroll were also advanced to the Embassy net of any individual withholdings such as taxes, insurance and social security.

## Objectives, Scope and Methodology

<u>Objectives</u> - This review was part of our effort to inspect all the FSM Overseas Missions as a result of our adverse findings disclosed at the FSM Embassy in Washington D.C. Our objectives were to determine whether a) fund disbursements were in accordance with the FSM laws and regulations, and b) accounting and reporting of operating activities complied with the Financial Management Regulations (FMR).

Scope - The review covered fiscal years 2005, 2006 and 2007 (October 1, 2004 through September 30, 2007). The review was conducted pursuant to the authority vested in the National Public Auditor as codified at Title 55 FSM Code, Chapter 5 which states in part:

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

The review was conducted in accordance with the *Quality Standards for Inspections* issued in 1993, as amended by the U.S President's Council on Integrity and Efficiency and the Executive Council on Integrity and Efficiency.

Methodology - The fieldwork was conducted at the Embassy, DFA, and DF&A. To accomplish our objectives, we reviewed accounting records, financial reports, and other supporting documents related to the financial transactions of the Embassy. We judgmentally selected expenditures from the operating fund and traced them to invoices and receipts to determine if FMS laws and regulations were followed. We also interviewed officials and staff at the Embassy, the DFA and the DF&A. Additionally, we traced Embassy expenditures through DF&A accounting system to verify the accuracy and completeness of accounting entries and account postings. We provided a draft of our findings to the Ambassador and Department heads of DFA and DF&A for their comments.

## Prior Audit Coverage

This review represents the fourth undertaken by the Office of the National Public Auditor (ONPA). The most recent audit covered fiscal years 1994-1997.

## CONCLUSION

The Embassy did not adhere to FSM laws and regulations when it paid its FSM employees higher salaries and higher living allowances than permitted by regulations or authorized by Congress. Employees also received a Foreign Service Premium (FSP) based on a rate that DF&A was not able to substantiate or justify considering that nearly all of an employee's living expenses were paid by the Embassy. We question the validity of the FSP premium rate used and whether the premium should continue to be exempt from FSM taxes. We further note that the Embassy did not comply with budgetary and financial management requirements when it overspent its budget authorization for fiscal year 2005. Additionally, the incomplete and inaccurate accounting of Embassy expenditures at the DF&A resulted in misleading financial records and reports.

## FINDINGS AND RECOMMENDATIONS

### 1. Higher Salaries and Increased Living Allowances Not Authorized or Justified

FSM Embassy employees received higher salaries and increased living allowances than authorized or justified, and also had their salaries increased by a FSP rate that could not be validated for being reasonable or appropriate. The high salaries and living allowances were attributed in part to: 1) use of a higher fixed exchange rate (over the bank rate) to pay employee salaries, 2) living allowances that exceeded regulations, and 3) a FSP premium rate that could not be substantiated, appeared unreasonable, and was not justified. The combined unauthorized salary increases and increased living allowances for the three FSM employees amounted to $142,395 over the past three years while the FSP premium amounted to $506,352 over the same period.

- **Higher Fixed Exchange Rate Not Authorized:** The Embassy paid its FSM employees higher salaries than either budgeted or allocated by Congress by using a higher exchange rate to pay employee salaries. Prudent government practice dictates that payments made in foreign currencies should be based on the actual exchange rate used by the bank. However, the Embassy paid FSM employees in yen that was calculated at a fixed exchange rate set at 130 Japanese yen to the US dollar. During the three years under review, the actual bank exchange averaged from 107 to 115 a year. By using a higher than actual exchange rate, the Embassy effectively increased employees' salaries from 13 to 21 percent in equivalent dollar amounts which amounted to $93,738 of additional cost over the past three years, and contributed to the Embassy overspending its operating budget in fiscal year 2005 (See Budget Authorizations Overspent on page 8).

  The Embassy had been using the high fixed exchange rate since at least 1998, even though authorization of the high rate could not be verified. For example, the DFA that overseas Embassy operations, could not provide us any Departmental correspondence approving the Embassy's use of the higher 130 yen rate for payroll salaries. The Embassy provided a letter dated June 22, 2004 from the Ambassador to the Secretary of the DFA which indicated the Ambassador's intention to use the 130 yen on a trial basis beginning July 2004 until a solution could be devised to address the currency fluctuation and the yen's appreciation to the dollar. Financial records indicate the Embassy used the higher exchange rate prior to the Ambassador's June 2004 letter and prior to the Ambassador taking his position as Ambassador to Japan in March 2004. According to the DF&A, the Embassy had been using the 130 yen fixed exchange rate since October 1998.

- **Increased Allowances Exceeded Regulations:** The Public Service System Regulations (PSSR) and the FMR detail the types of allowances that can be provided to FSM employees working at Overseas Missions. However, Embassy employees received increased allowances that exceeded these regulations and in some instances, appeared excessive in dollar terms. The following allowances were paid to two FSM Embassy employees who are governed under the PSSR. The Ambassador who as an exempt employee had fewer restrictions on the amount of allowances. See Appendix III, page 17 for details of total employee salaries and allowances for fiscal year 2006.

- **Residential utilities:** The Embassy paid residential utilities (electricity, gas and water)[1] for the two FSM staff employees that amounted to $48,657 over three years. However, PSSR Part 8.11 considers residential utility costs to be a personal in nature and not an allowable expense to be paid by the government. Also, because there was no ceiling limit as to the amount the Embassy would pay, one employee's utility bill averaged $845 a month in 2006. The Ambassador's residential utilities were paid as was the customary practice for the government to provide housing, transportation and utilities for heads of overseas offices.
- **Transportation:** Commute costs between employee residence and the Embassy were paid at an annual cost of $3,156 for citywide train passes for the two FSM employees. The PSSR Part 8.11 considers commuting costs to be personal in nature and not an allowable expense. The monthly commuter train passes allowed unlimited use throughout the Tokyo metropolitan system including weekend travels allowing the train passes to be used for other than business travels. Also, the DCM used the Embassy's second vehicle to commute to and from work. The Ambassador was afforded a full-time driver and vehicle for commute and diplomatic purposes.
- **Housing:** Monthly rental lease payments for two FSM staff employees amounted to $5,239 and $3,932 in fiscal year 2006. However, the former Ambassador did not provide documentation of housing prices to the Secretary of DF&A as required by PSSR Part 12A.8b to support and justify that the rents were typical, fair and reasonable. Also, the Embassy converted the $5,000 monthly housing allowance provided to the DCM (under contract as an exempt employee at that time) and used a higher exchange rate of 120 yen verses the prevailing rate of 107 yen to the US dollar effectively raising the dollar equivalent monthly rent above the $5,000 limit by 12 percent.
- **Home furnishings:** Furnishings provided to Embassy employees went beyond the few basic necessities (i.e., beds, refrigerators, and dining sets) allowed under PSSR Part 12B.4. The Embassy's list of government property located at employee residences, totaled $64,223 and included items such as a flat panel plasma TV ($5,039), a TV sound system ($817), silk carpet ($2,384), dinning set ($6,350), a sofa living room set ($3,300), and two chests ($2,300). Apparently, these items were acquired for the previous Ambassador, but from a cost perspective, the furnishings appeared excessive and beyond basic necessities authorized by regulations.
- **Education:** Education expenses paid by the Embassy for two employee families amounted to $73,135 over three years. With no regulatory limit on the education amount allowed per family, one employee's education expenses totaled $70,020 for three years to send his three children to a private school.
- **Medical:** Employee medical expenses were paid upfront through a separately funded impress account (up to 90% reimbursed through individual medical plans). As of July 2007, the imprest account balance had been depleted down to $212 with $19,580 of

[1] Beginning FY2007, the Ambassador required FSM Embassy employees to pay 20% of their residential utility bills.

unsettled medical and dental claims paid from the imprest account but still outstanding (not yet replenished) from either the DF&A or the medical insurance plan (MiCare).

- **High Foreign Service Premiums Not Justified:** Although prudent government practice dictates that payments should be based on documented need, FSM employees of the Embassy had their salaries increased by 280 percent based on an FSP rate that the DF&A could not justify as being reasonable or appropriate. Furthermore, we found that while the FSP premium was intended to be based on the cost of living in the place of assignment, nearly all of an employee's major living expenses were paid for by the government. Also, the wide difference in FSP rates between the Tokyo Embassy (280 percent) and the New York Mission (95 percent) raised a further question on the relevancy and appropriateness of the FSP rates. The fluctuations and appreciation of the yen to the US dollar had been cited as justification for the FSP, however, during the past three years, the yen's lowered valuation against the dollar actually contributed to lowering the Embassy's overall operating costs (in dollar terms) both in 2006 and 2007.

  - **FSP Rates Not Supported**
    We found little support or documentation to justify the FSP rates that Congress included in their budget appropriations bills. While the PSSR under FSMC Title 52 allows for a cost of living premium to be paid to an employee who is a citizen of the FSM and who is assigned to a permanent duty station outside the FSM, the PSSR did not provide for how the premium would be calculated or what economic parameters would be used. The FSP rate for Tokyo has been fixed at 280 percent since 1993. The FSM Attorney General (AG) in a legal opinion confirmed that the Public Service Salary Act of 1979 as amended did not set forth specific guidelines for establishing the FSP. And, accordingly, the AG wrote that "in some cases, employees receiving the premium receive what may appear to be excessive compensation in light of the additional benefits they receive."

    The DF&A conducted a follow-up study in 2002 and recommended increasing the FSP rates, which was not enacted. A memorandum by the Secretary of DF&A (November 2002) described the study as being based on labor market conditions that involved collecting salary data from 32 localities in the United States. The memo concluded that 280 percent was the median range Market Place Differential (MPD) for those 32 locations with recommendations to increase the FSP for Tokyo, Guam and for U.S. locations. We believe that compiling salary data for various U.S. locations did not appear relevant for determining an appropriate cost of living differential for FSM citizens living and working in overseas locations. The DF&A was unable to provide us the original study from where they made their recommendations or the study upon which the original rates were based. Being unable to verify the rates or how they were developed, we question the justification of the FSP rate used for Tokyo and the resulting $506,352 premium paid to employees over the past three years.
  - **Living Expenses Largely Paid For**
    The FSP was intended to address the high cost of living in overseas locations, yet nearly all of the employee's major living expenses were already being paid directly out of the Embassy's budget. Major out-of-pocket outlays for housing, utilities, transportation,

education, and medical expenses were provided through employee allowances and benefits (excluding home furnishings) that totaled nearly $300,000 in total for fiscal year 2006 (see Appendix III on page 17). Because nearly all cost of living expenses were paid for, we question the reasonableness of the FSP premium.

- **Wide Rate Difference between Tokyo and New York City**
  Officials at DF&A could not provide a reason for the wide difference in FSP rates between the Embassy in Tokyo (280 percent) and the New York Mission (95 percent) other than to say that the rates were formulated some 15 to 20 years ago. The rate difference between the two cities leads us to further question the relevancy and appropriateness of the FSP rates. See Appendix III on page 17, Total Employee Salaries and Allowances for Tokyo Embassy and New York Mission for a comparison of salaries and living allowances.
- **Yen Appreciation and Exchange Rate Fluctuation**
  The Japanese yen's appreciation against the US dollar as well as the fluctuating exchange rate had been cited in the past by Embassy officials as a reason for having the FSP. The fluctuating exchange rate affects the spending power of the dollar. However, over the past three years 2005 to 2007, the yen's value actually depreciated against the dollar, allowing the US dollar to buy more yen (from an average of 107 yen to 115 yen). The stronger dollar to yen conversion contributed to lowering the Embassy's operating costs in 2006 and 2007. However, towards the end of 2007, the yen began to strengthen against the dollar and further yen appreciation may be anticipated. This had been a long-standing issue with talk of a "hedge" fund being proposed to adjust for any shortfall resulting from the yen's appreciation, but the DF&A has not addressed this issue.

- **No FSM Income Taxes or Social Security Withholdings on FSP:** FSM Income Tax Law [FSMC, Title 54, subchapter I, §112 (11), (l)] exempts FSP from being taxed meaning that the majority of Embassy employee salaries were not assessed FSM taxes or social security withholdings. Over the past three years, Embassy employees received $646,022 in total salaries, but paid income and social security taxes on only their base salary of $139,670 (22 percent). Had the FSP premium been taxable, the government would have collected $70,889 of additional taxes over this period. Of further note, the increased salaries paid to employees from the higher yen conversion ($93,738) were also not taxed. The FSP is currently not needed to pay living expenses and like the Professional Premium, is part of an employee's whole salary that should be subject to income and social security taxes.

## Cause and Recommendations

The causes of the Embassy staff receiving higher salaries and allowances were that:

- The Ambassador had wide latitude in managing the Embassy's operating funds and permitted the higher salaries and benefits to be paid.
- The DFA and the DF&A failed to provide adequate attention and oversight to the Embassy's financial operations. Specifically, the DFA and DF&A knew of the Embassy's practices through the Embassy's monthly and quarterly financial and performance reports and from earlier audit reports. However, neither the DFA nor the DF&A took necessary actions to

seek justification of the Ambassador's discretionary use of these funds or the validity of the higher salaries and allowances.

- The PSSR did not provide guidance for how the FSP premium would be calculated, what economic parameters would be used, the impact of cost of living allowances already provided, or whether 'exempt' employees are entitled to a FSP.
- Congress accepted the FSP premiums in the Embassy's annual budget proposals and passed the Embassy's annual budget without a thorough and careful analysis of its reasonableness.

We recommend that the President:

1. Direct the Secretary of the DF&A together with the Assistant Secretary for Personnel to:
   a. Provide guidance for how the FSP premium would be calculated, what economic parameters would be used, and how often premium rates should be reviewed and revised.
   b. Review, assess, and recommend FSP rates that reflect cost of living differentials appropriate and relative to various overseas locations. The rates should consider cost of living benchmarks, fluctuations in exchange rates, and cost of living allowances or benefits already provided to employees. The developed rates should also be independently verified.

We recommend that the Secretary of DFA:

1. Restrict the Ambassador from applying an exchange rate other than the bank exchange rate for FSM employee salaries.
2. Review and initiate a new salary contract with the Ambassador in Tokyo that is not tied to the FSP, but similar to contracts used for other FSM ambassadors (See notes to Appendix II – Total Employee Salaries and Allowances for Tokyo Embassy and New York Mission).
3. Monitor finance and operations reports to track expenditures to the Embassy's budget, and fluctuations in the exchange rates that may impact available operating funds.
4. Requires that the Ambassador adhere to the PSSR in limiting the amount of employee benefits allowed under the PSSR.

We recommend that the Secretary of DF&A together with the Assistant Secretary for Personnel:

1. Revise the PSSR that addresses employee allowances to establish ceiling limits or maximum allowances for such items as housing, house furnishings, and education.
2. Clarify and enact policies on whether exempt employees working overseas are entitled to Public Service System benefits, such as FSP.
3. Address the yen conversion and currency fluctuation impacting the Tokyo Embassy and recommend a solution to resolve this long-standing issue.
4. Establish a process for periodic review and revision of the FSP.
5. Evaluate whether the FSP warrants exemption from FSM income and social security taxes.

**2. Budget Authorizations Overspent**

The Embassy overspent its total budget authorization for fiscal year 2005 by paying employees higher salaries and living allowances and expending more funds on travel and representation than budgeted. From our review of Embassy expenditures we computed $68,774 of overspent funds for 2005, a violation of the Financial Management Act (FMA) and budgetary laws (See Table 2 below). The FMA and the budget laws restrict Departments and operating entities from overspending their budget authorizations and in particular, the Personnel category for payroll where funds cannot be added or subtracted except through a Congress amendment. Over the past three years, however, the Embassy's exceeded its budget authorizations for Personnel by $38,446 in fiscal year 2005; $10,007 in 2006; and $13,765 in 2007 by using funds from other budget categories, a violation of the appropriations law and the FMR. As described in the previous finding, the overspending of Personnel funds was caused by the Embassy's conversion of payroll salaries into yen using a higher fixed conversion rate than the bank exchange rate.

The Embassy also overspent its Travel budget in fiscal years 2005 and 2006 by $26,992 (127 percent) and $10,917 (52 percent) without requesting or receiving reprogramming approval from the DFA. The Embassy's spending on representation (for public relations) also exceeded its budget in 2005 by $15,430 (103 percent) and in 2007 by $23,040 (161 percent). In contrast, for fiscal years 2006 and 2007, we computed Embassy expenditures to be under spent by $38,159 and $62,807. See Appendix I - Tokyo Embassy Detailed Budget and Expenditures, page 12.

**Table 2: Tokyo Embassy's Budget Authorizations and Expended Amounts By Budget Category for Fiscal Years 2005 – 2007 (as adjusted by ONPA)**

| Fiscal Year | Budget Category | Authorized Budget | Expended Amounts | Under/(Over) Expended |
|---|---|---|---|---|
| 2005 | Personal | $245,096 | $283,543 | ($38,447) |
| | Travel | 21,200 | 48,192 | ($26,992) |
| | Consumable | 82,900 | 78,346 | $4,554 |
| | Contractual | 535,381 | 543,271 | ($7,890) |
| **Totals** | | **$884,577** | **$953,351** | **($68,774)** |
| 2006 | Personal | $249,678 | $259,685 | ($10,007) |
| | Travel | 21,000 | 31,917 | ($10,917) |
| | Consumable | 78,900 | 71,763 | $7,137 |
| | Contractual | 535,380 | 483,434 | $51,946 |
| **Totals** | | **$884,958** | **$846,799** | **$38,159** |
| 2007 | Personal | $249,678 | $263,443 | ($13,765) |
| | Travel | 21,000 | 11,841 | $9,159 |
| | Consumable | 78,900 | 58,021 | $20,879 |
| | Contractual | 535,385 | 488,851 | $46,534 |
| **Totals** | | **$884,963** | **$822,156** | **$62,807** |

Source: ONPA figures generated from data provided by the DF&A and the SBOC

## Cause and Recommendations

The causes of the overspending of the budget authorizations are:

- The Ambassador did not carry out his responsibility of ensuring that operating expenditures were kept within budget authorizations for the Tokyo Embassy. Nor did the Ambassador follow financial management requirements that required him to obtain approval and authorization to reprogram available funds from other budget categories (contractual services and consumables).
- Both the DFA and DF&A were aware the Embassy was using a higher fixed exchange rate to convert employee salaries to yen, but neither Department took action to correct the unauthorized action.
- The DF&A did not properly record the increased salaries in Personnel salary account (8010) but recorded the salary differential under a special Contractual Services account (8499) titled "Discount" (due to yen conversion). As a result, the overspending of the Embassy's Personnel budget was not visible or apparent from the DF&A financial records (See following section on Incomplete and Inaccurate Accounting of Expenditures and Assets).
- The Embassy's overspending on increased salaries, travel, and representation plus providing additional employee allowances (i.e., utilities and transportation), was enabled in part because of excess funds from the Embassy's other budget categories (consumables and contractual services) or from unspent funds from prior years. See Appendix I – Tokyo Embassy Detailed Budget and Expenditures, page 12. A comparison between budgeted funds and expended funds revealed sizable under-spending and excess funds available from budgeted items like communication, professional services, and education.

We recommend that Congress:

1. Require the Secretary of DFA to provide detailed financial data in support of the Tokyo Embassy's annual budget submission allowing Congress members and staff to examine the Embassy's detailed operating budget compared with prior year's expenditures.

We recommend that the Secretary of DFA:

1. Monitor the Tokyo Embassy's financial and operations reports to ensure that Embassy's expenditures are in line with its budget and that any deviations from anticipated budget spending are justified and approved;
2. Conduct a budget analysis on the Tokyo Embassy's annual budget submissions comparing previous years actual spending against budgeted line items and examine any variances, including the impact of currency fluctuations; and,
3. Assess the impact of currency fluctuations and develop a solution to propose to Congress.

We recommend that the Ambassador:

1. Follow the appropriation guidelines and laws regarding managing and spending funded allotments to ensure spending is held within the allotted budget; and,
2. Properly account for unspent funds at year-end and return it back to FSM General Fund as required.

## 3. Incomplete and Inaccurate Accounting of Expenditures

The DF&A, being responsible for the accurate accounting of Embassy funds, did not provide an accurate or complete accounting of the Embassy's expenditures leading to financial records and reports that were inaccurate, incomplete or misleading. For instance, DF&A did not 1) record and report complete and accurate employee salaries paid by the Embassy; 2) properly reconcile and adjust the Embassy's fiscal year-end balances; and, 3) identify and record all expenses into their proper accounts. As a consequence, Embassy expenditures were understated in fiscal year 2005 and overstated in 2006 and 2007. See Appendix I – Tokyo Embassy Detailed Budget and Expenditures, page 12. We noted the following:

- **Employee Salaries Not Properly Recorded:** The DF&A recorded the increased salary differential, resulting from the Embassy's use of a higher fixed exchange rate, through a journal voucher entry adjusted at year end. The DF&A Accounting Advisor told us they accounted for the salary differential in a separate account (8499) listed as "Discount" as in "discount due to yen conversion" A proper recording of actual salaries paid into the Personnel/salary account (8010) would have disclosed overspending in that account and revealed the higher salaries paid to employees.

- **Year-end Reconciliation Not Complete:** The year-end reconciliation of the Embassy's fiscal year 2006 expenditures were not entered into the financial records according to the Accounting Advisor for DF&A. The adjusting journal entries that should have been recorded included $44,831 that DF&A attributed to the salary differential for 2006 (noted above) and a $43,524 reverse adjustment to remove an expense error in professional services (account 8408). Reconciliation and accurate recording of Embassy expenditures at year-end allows DF&A to properly identify any unspent funds that should be returned to the General Fund. Inaccurate accounting of Embassy expenditures prevented this from occurring.

- **Expenditures Not Accurately or Properly Recorded:** The Embassy's expenditures were not always accurately or properly recorded into their respective expense accounts resulting in inaccurate and misleading reporting of Embassy expenditures. In particular, we found discrepancies in expense accounts for salaries (8010), utilities (8307), professional services (8408), leased housing (8431), leased building (8432), and medical claim (8322). We noted also that DF&A: 1) incorrectly entered expenditures into wrong accounts, 2) did not adjust for expenditures paid in the following year for previous year's expenses, 3) made unexplained journal voucher adjustments between expense accounts without supporting vouchers or justification, and 4) recorded a single expenditure payment to one expense account when the payment covered multiple expenses (leased building). The net affect of these discrepancies, resulted in DF&A under reporting Embassy expenditures by $77,585 for fiscal year 2005 and over reporting expenditures by $37,493 in 2006 and $31,565 in 2007. Specific exceptions are noted in Appendix I – Tokyo Embassy Detailed Budget and Expenditures, page 12.

## Cause and Recommendations

The DF&A did not maintain complete and accurate accounting of Embassy expenditures because: 1) payment receipts, bank records, lease agreements and other supporting documents from the Embassy were often written in Japanese, thus, limiting the DF&A staff's ability to assess and determine the proper expense account; 2) one staff member, responsible to input monthly financial data for all seven Overseas Missions, did not receive proper supervision or management oversight; 3) no summary trial sheets were submitted by the Embassy to ensure all expenditures were properly and accurately recorded; and 4) journal voucher adjustments were not always cross referenced to original journal entries that would explain the reason for the correction.

We recommend the Secretary of DF&A direct the Assistant Secretary for National Treasury to:

1. Record all salary disbursements by the Tokyo Embassy into the proper Personnel expense account 8010.
2. Reconcile the DF&A's monthly input data totals with the Embassy's financial reports by expense account.
3. Properly supervise and oversee the staff who inputs the monthly financial data for all overseas missions to ensure accurate and complete financial data is recorded.

Appendix II

**Tokyo Embassy Detail Budget and Expenditure**
**Comparison of DF&A Expenditures vs ONPA Adjusted Embassy Expenditures**
**For Fiscal Year 2005 to 2007**

| | | 2005 | | | | | 2006 | | | | | 2007 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Description | Account | Budget | Embassy | √ | Finance | Difference | Budget | Embassy | √ | Finance | Difference | Budget | Embassy | √ | Finance | Difference |
| | | | | | | (Embasy Vs. Fin) | | | | | (Embasy Vs. Fin) | | | | | (Embasy vs Fin) |
| **Personnel** | 8001 | | | | | | | | | | | | | | | |
| Salaries | 8010 | $ 229,083 | $ 229,083 | i | $ 219,178 | $ 9,887 | $ 229,083 | $ 229,083 | | $ 215,602 | $ 13,481 | $ 229,063 | $ 229,083 | | $ 229,085 | $ (2) |
| Benefits | 8014 | 18,033 | 8,228 | | 8,228 | - | 20,615 | 8,280 | | 8,280 | - | 20,615 | 9,235 | | 9,235 | - |
| Increase Salary using a fixed rate at 130 Yen | | - | 48,251 | a | - | 48,251 | - | 22,342 | a | | 22,342 | - | 25,145 | a | | 25,145 |
| **Total Personnel** | 8001 | **245,096** | **283,542** | | **227,404** | **56,138** | **249,678** | **259,685** | | **223,882** | **35,803** | **249,678** | **263,443** | | **238,300** | **25,144** |
| | | | | | | | | | | | | | | | | - |
| **Total Travel** | 8119 | **21,200** | **48,192** | | **38,448** | **9,744** | **21,000** | **31,917** | | **30,526** | **1,391** | **21,000** | **11,841** | | **13,013** | **(1,171)** |
| | | | | | | - | | | | | - | | | | | - |
| **Consumable** | 8301 | | | | | - | | | | | - | | | | | - |
| Office Supplies | 8303 | 2,000 | 3,552 | | 3,477 | 75 | 2,000 | 2,747 | | 2,938 | (191) | 2,000 | 1,402 | | 2,493 | (1,091) |
| Rental Services | 8304 | - | 82 | | 82 | - | - | 513 | | 513 | - | - | - | | | - |
| Repair Services | 8305 | - | 91 | | 91 | - | - | - | | - | - | - | - | | | - |
| Communication | 8306 | 31,400 | 20,581 | b | 20,581 | - | 27,400 | 13,837 | | 13,372 | 465 | 27,400 | 12,956 | | 12,894 | 62 |
| Utilities | 8307 | 17,000 | 29,734 | c | 21,122 | 8,612 | 17,000 | 30,288 | c | 22,174 | 8,114 | 17,000 | 21,801 | c | 14,972 | 6,829 |
| Printing | 8308 | 8,000 | 3,809 | | 3,809 | - | 8,000 | 2,377 | | 2,398 | (21) | 8,000 | 2,944 | | 2,145 | 799 |
| Freight(Delivery) | 8310 | 4,000 | 3,203 | | 3,203 | - | 4,000 | 1,194 | | 1,194 | - | 4,000 | 2,188 | | 1,825 | 363 |
| POL (Fuel) | 8311 | 10,000 | 5,080 | | 5,080 | - | 10,000 | 5,252 | | 9,132 | (3,880) | 10,000 | 4,132 | | 4,496 | (363) |
| Books/Library | 8313 | 1,500 | 932 | | 1,005 | (73) | 1,500 | 813 | | 813 | - | 1,500 | 1,814 | | 1,814 | 0 |
| Subsidies/ Contribution | 8318 | - | - | | | - | - | | | | - | - | 65 | | 65 | - |
| Wire transfer fee | 8319 | - | 1,080 | d | 962 | 118 | - | 161 | d | 51 | 110 | - | 286 | d | 243 | 44 |
| Medical Claim | 8322 | - | - | | | - | - | - | e | | - | - | - | e | 4,551 | (4,551) |
| Misc. (Transport.) | 8399 | 9,000 | 10,252 | | 16,881 | (6,629) | 9,000 | 14,781 | | 13,774 | 1,007 | 9,000 | 10,633 | | 10,633 | - |
| **Total Consumable** | 8301 | **82,900** | **78,346** | | **76,243** | **2,103** | **78,900** | **71,763** | | **66,159** | **5,604** | **78,900** | **58,021** | | **55,929** | **2,092** |
| | | | | | | - | | | | | - | | | | | - |
| **Contractual Services** | 8401 | | | | | - | | | | | - | | | | | - |
| Office & Property Maintenance | 8405 | 22,500 | 12,869 | f | 7,467 | 5,402 | 22,500 | 12,692 | f | 8,293 | 4,399 | 22,500 | 15,981 | f | 11,475 | 4,506 |
| Professional Services | 8408 | 125,000 | 136,986 | | 139,472 | (2,486) | 125,000 | 115,490 | g | 147,721 | (32,231) | 125,000 | 107,226 | | 107,226 | - |
| Leased Housing | 8431 | 205,860 | 214,063 | h | 194,651 | 19,412 | 205,860 | 199,020 | h | 221,628 | (22,608) | 205,860 | 190,809 | h | 190,653 | 156 |
| Leased Building | 8432 | 114,021 | 119,521 | i | 99,444 | 20,077 | 114,020 | 112,080 | i | 145,734 | (33,654) | 114,025 | 107,944 | i | 144,636 | (36,693) |
| Insurance | 8442 | 8,000 | 6,531 | | 6,531 | - | 8,000 | 5,042 | | 5,042 | - | 8,000 | 4,622 | | 4,622 | - |
| Representation | 8449 | 15,000 | 30,430 | | 20,627 | 9,803 | 15,000 | 12,782 | | 8,979 | 3,803 | 15,000 | 38,040 | | 39,128 | (1,088) |
| Education Allowance | 8452 | 45,000 | 22,869 | | 22,869 | - | 45,000 | 26,037 | | 26,037 | - | 45,000 | 24,229 | | 24,229 | (0) |
| Medical Referral | 8460 | - | - | | - | - | - | 291 | | 291 | - | - | - | | | - |
| Discount | 8499 | - | - | j | 42,610 | (42,610) | - | - | k | - | - | - | - | j | 24,509 | (24,509) |
| **Total Contractual Services** | 8401 | **535,381** | **543,271** | | **533,671** | **9,600** | **535,380** | **483,434** | | **563,725** | **(80,291)** | **535,385** | **488,851** | | **546,480** | **(57,629)** |
| | | | | | | - | | | | | - | | | | | - |
| **Grant Total** | | **$ 884,577** | **$ 953,351** | | **$ 875,766** | **$ 77,585** | **$ 884,958** | **$ 846,799** | | **$ 884,292** | **$ (37,493)** | **$ 884,963** | **$ 822,156** | | **$ 853,722** | **$ (31,565)** |
| **Difference from Budget** | | | **$ (68,774)** | | **$ 8,811** | | | **$ 38,159** | | **$ 666** | | | **$ 62,807** | | **$ 31,241** | |

√ **Notes:** Embassy expenditures were adjusted by ONPA based on Embassy records and noted exceptions below
a Increased salaries using Embassy's 130 yen exchange rate. DF&A recorded salary increases in account 8499 (see note j).
b Embassy communication expenditures were paid from leftover Compact I funds according to DF&A and not charged against the Embassy Operation Budget.
c Utilities added; moved from leased building
d Bank fee added; moved from leased building and housing
e Medical claim are paid out of the imprest fund
f Cleaning fee added; moved from the leased building
g Posting error of $43,524 to Professional Services account was not removed by DF&A at year-end
h Leased housing is adjusted to reflect actual expenditure for leased housing; moving bank fee to account wire transfer fee
i Leasing building is addjusted to reflect the actual expenditure for leased building; move cleaning, utilities, bank fee to maintenance, utilities, and wire transfer respectively
j Discount is the account used by Finance to account for the increase in salary using a higher yen exchange rate than the bank exchange rate
k No posting was entered for 2006 to record increased salary due to higher yen exchange rate
l See discrepancies noted for particular expense accounts listed on page 14

## Appendix I (continued)

**Tokyo Embassy Detailed Budget and Expenditures**
**Comparison of DF&A Recorded Expenditures vs. ONPA Adjusted Embassy Expenditures**
**For FY 2005, 2006, 2007**

*(The table is located in page 12 of this report)*

Discrepancies noted in DF&A's accounting of Embassy expenditures:

- Personnel/salary account 8010 – Salary expenses of $9,887 (FY2005) and $13,462 (FY2006) were improperly recorded in other Mission accounts (UN Mission in New York and the Honolulu Consulate) thereby understating this account. DF&A did not reverse the expenditures back to the Tokyo Embassy account.

- Consumable/utilities account 8307 – Utility expenditures were understated by $23,660 over three years because the Embassy utility payments were not included in this account (only employee residential utility expenses). The Embassy utilities were recorded with the building lease payments (account 8432) instead of under the utility account.

- Contractual/professional service 8408 – The monthly posting for the Japanese employee staff salaries was not recorded for April 2005. However, a journal voucher adjustment made for the April 2005 omission, overstated the expense by $2485. The monthly posting for July 2006 was also omitted, but in this case, there was no adjustment made for the July 2006 omission. In May 2006, an expense entry error was booked for a (net) amount of $43,524 without supporting documents explaining or verifying the purpose for the journal entry. A journal voucher adjustment to remove the error at year-end was not properly executed as noted on page 11 (Year –end Reconciliation Not Complete). .

- Contractual/leased housing 8431 – House lease payments were recorded when actually paid rather than adjusted to the applicable month and year resulting in differences in lease expenditures at the beginning and ending of each year.

- Contractual/leased building 8432 – Building lease payments were overstated by $37,055 over the past three years because the lease payments included other monthly expenses such as utility charges, cleaning service fees, and bank transaction fees (specified in Japanese writing).

- Contractual/discount 8499 – This account was used to record the higher salary differential paid to FSM Embassy employees resulting from the Embassy's use of a fixed yen exchange rate (130 yen to US dollar). DF&A figures were marginally different from ONPA numbers (recorded under the Personnel account 8001) with the exception of fiscal year 2006 where DF&A failed to record their salary differential of $44,831 into this account. In contrast, we computed the salary differential to be $22,342 (see above Year-end Reconciliation Not Completed, page 11).

- Consumable/medical claim 8322 – A medical claim expense of $4,551 was incorrectly recorded to the Tokyo Embassy's 2007 operating account instead of to the Embassy's imprest account. The entry was also not supported with an Embassy expense voucher. Incorrect recording of medical expenses to the Embassy's operating account serves to undermine the proper accounting and replenishment of the Embassy's imprest account for medical expenses (See below).

Imprest Fund at the Tokyo Embassy:

- Imprest Account Nearly Depleted: The imprest account, used primarily to pay employee and their families medical expenses, has been depleted ($212 balance as of 7/31/07) over the past years as a result of medical and dental claims paid from the imprest fund, but not yet replenished by the DF&A. The DF&A processes the claims to the government medical plan provider (MiCare) for their determination and approval on covered claims and what portion is reimbursable. Total unpaid medical claims outstanding from the DF&A and the insurance provider amounted to $19,580.38. FSM employees owed the Imprest account a total of $829.79 for their share of uncovered claims processed by the insurance provider.

## Appendix II

### Total Employee Salaries and Allowances
### For Tokyo Embassy and New York Mission
### FY2006

| TOKYO EMBASSY | | | | | | | |
|---|---|---|---|---|---|---|---|
| Cost | Ambassador | note | DCM | note | Minister-Consular | note | Subtotal |
| Base Salary | 25,000 | | 21,467 | | 13,813 | | 60,280 |
| FSP 280% | 70,000 | a | 60,108 | | 38,675 | | 168,783 |
| Benefit | 3,085 | b | 2,548 | | 2,647 | | 8,280 |
| **Total Salary** | 98,085 | | 84,123 | | 55,135 | | 237,343 |
| | | | | | | | |
| **Allowances** | | | | | | | |
| Housing | 89,057 | | 62,849 | | 47,136 | | 199,042 |
| Utilities | 5,240 | d | 10,134 | d | 6,700 | d | 22,074 |
| Commute | 33,901 | e | 1,320 | e | 1,836 | e | 37,057 |
| Education | - | | 24,836 | f | 1,201 | | 26,037 |
| Home Furnishings | 14,989 | g | 30,205 | g | 19,029 | g | 64,223 |
| Medical | 3,029 | h | 319 | h | 5,944 | h | 9,292 |
| **Total Allowances** | 146,216 | | 129,663 | | 81,846 | | 357,725 |
| **Grand total** | 244,301 | | 213,786 | | 136,981 | | 595,068 |

| NEW YORK MISSION | | | | | | | |
|---|---|---|---|---|---|---|---|
| Cost | UN Permanent Representative | | DCM | | Second Secretary | | Subtotal |
| Base Salary | $70,000 | | $20,302 | | $36,000 | i | $126,302 |
| FSP 95% | exempt | a | 19,287 | a | Non-FSM | | $19,287 |
| Benefits | 2,765 | c | 3,051 | | | | $5,816 |
| **Total Salary** | **$72,765** | | **$42,640** | | **$36,000** | | **$151,405** |
| | | | | | | | |
| **Allowances** | | | | | | | |
| Housing | $72,536 | | $65,747 | | 0 | | $138,283 |
| Utilities | 2,404 | | 989 | | 0 | | 3,393 |
| Commute | 20,358 | e | 0 | | 1,950 | j | 22,308 |
| Education | 0 | | 180 | | 0 | | 180 |
| Home Furnishings | unknown | | unknown | | 0 | | 0 |
| Medical | unknown | | unknown | | 0 | | 0 |
| Total Allowances | $95,298 | | $66,916 | | $1,950 | | $164,164 |
| **Grand total** | **$168,063** | | **$109,556** | | **$37,950** | | **$315,569** |

Source: Tokyo Embassy Reports and New York QuickBooks

Note:
a. The Tokyo Ambassador received a base salary plus FSP per his contract while the Permanent Representative (PR) received a straight base salary (no FSP was specified in his contract).
b. Contributions for social security, life and health benefits were assessed only on base salaries.
c. The PR's salary did not include a FSP; however, payroll contributions indicated that nearly half his salary was considered a FSP that was not taxed.
d. Utilities (water, gas, electricity) were fully paid by the Embassy until 2007 when employees (except the Ambassador) started to pay 20% of their utility bills.
e. The Ambassador and PR were provided personal drivers for commuting, official business trips and errands. The cost included the drivers' annual salaries. Commute cost for other employees were based on monthly train passes annualized for the year.
f. Education expense allowed for one employee to send his three elementary school children to a private school.
g. Home Furnishings are total dollar value of government property located at each residence.
h. Medical expense claims were paid out of the Embassy's Imprest Fund.
i. New York's Second Secretary is a non-FSM contract employee included for salary comparison only.
j. Second Secretary's employment contract authorizes commute cost

## Appendix III:

## Response from Former Ambassador and Current Ambassador

**Government of the Federated States of Micronesia**
P.O. Box PS-53 • Palikir, Pohnpei FM-96941 • T: (691) 320-2228/2649 • F: (691) 320-278

**OFFICE OF THE PRESIDENT**

**CHIEF OF STAFF**

ONPA - Administration RECEIVED Date 04/17/08

RECEIVED 16 APR 2008 FSM DEPT OF FOREIGN AFFAIRS

April 16, 2008

**MEMORANDUM**

TO: Secretary, Department of Foreign Affairs

FROM: Chief of Staff

SUBJECT: **Comments on Draft Audit Report (FSM Embassy in Tokyo)**

I am happy to be given this opportunity to comment on the draft audit report on the operations of the FSM Embassy in Tokyo

First of all, I want to commend the staff of the Audit Office who made the trip to Tokyo and conducted the audit on site. I thought they did their job in a professional manner and with little disruption to the daily activities of the Embassy during their stay. They were also persistent without being obnoxious in making requests for more information, and they got along quite well with all of us.

Based on my review of the draft audit report, I wish to offer the following:

On page 3, this statement is found that "The Embassy paid its FSM employees higher salaries than either budgeted or allocated by Congress by using a higher exchange rate to pay employee salaries."

See Note 1 ONPA reply in APPX V

I find this statement to be highly questionable because as far as I am concerned employee salaries were paid based on the approved budgets by Congress. The fixed exchange rate of 130 Japanese yen to the US dollar used in computing employee salaries was established long before my posting in Tokyo, and was sanctioned by both the Executive Branch as well as Congress through annual budgetary appropriations. To accuse the Embassy of irresponsibly inflating employee salaries was an exaggeration and misleading because we did not just make up our own salaries but followed the budgets as well as the appropriate compensation rates as approved by Personnel or in employee contracts. The fix exchange rate is not a creation of the Embassy and should not be blamed for it.

See Note 2 ONPA reply in APPX V

On the same page, this statement on allowances is made that "The Public Service System Regulations (PSSR) and the FMR detail the types of allowances that can be provided to FSM working at Overseas Missions. However, employees received increased allowances that exceeded these regulations and in some instances, appeared excessive in dollar terms."

## Appendix III:

**Comments on Draft Audit Report (FSM Embassy in Tokyo)**
April 16, 2008
Page 2

I agree that given the very high cost of living in Tokyo and our concern for the welfare of our Micronesian diplomats and their families, we may have provided our employees increased allowances that may have exceeded the amounts mandated in the PSSR. But, it was done simply to help our employees and not to circumvent the regulations or defraud the government. We had always tried to be in compliance and to live within our means whenever we can but we could not close our eyes to the urgent needs of our staff.

- Residential utilities: I agree a residential utility cost is personal in nature and should not be the responsibility of the government. But given the very high cost of living in Tokyo, there is the question as to whether our diplomats can make ends meet without assistance from the government to meet some of their costs like for utilities. Recently, the embassy shifted some utility costs by assigning a certain percent of it to employees for payment.

- Transportation Perhaps it is time to revisit this issue. Again, the concern here is if our diplomats can "survive" living in Tokyo without the assistance of the government. Paying commuting costs for employees is a standard practice in Japan. However, it does not mean we have to follow it.

- Housing: In assigning housing, we consider certain factors as size of family, proximity to work site/embassy, accessibility to subway service, stores, etc. But one important consideration is that our diplomats must be able to entertain important quests at their respective residences whenever there is a need to do so, so they should be provided decent housing that will allow that. I do not think that we were extravagant in selecting the residences of the current diplomats. Of course, we may be able to save some money if we look hard enough for alternative housing.

- Home furnishing Most of the current inventory is perhaps more than 5 years old if not older. The most recent time that new furnishings were purchased was when the then new ambassador arrived at post in 2004 due to the fact that additional furnishings were needed to replace old or broken ones. We must not overlook the fact that diplomats especially the ambassador must be provided decent furnishings due to the fact that as chief diplomat for our country in Japan he needs to do entertaining regularly at his residence. Perhaps "basic necessities" in terms of furnishing may be adequate to meet the needs of employees in the FSM but certainly not our diplomats overseas.

**Appendix III (continued):**

**Comments on Draft Audit Report (FSM Embassy in Tokyo)**
April 16 2008
Page 3

- Medical: Using the imprest fund to pay upfront medical/dental costs for employees in the Tokyo Embassy is the only way to help employees meet exorbitant medical/dental costs here. There are two problems as I see it: getting reimbursements from MiCare in a timely manner and getting reimbursed from employees for their portion of the medical/dental costs.

I feel some of the following may have contributed to the situation in the overseas missions including our Embassy in Tokyo.

1. The lack of close oversight and monitoring by the Departments of Foreign Affairs and Finance & Administration over the overseas missions.
2. The applicability of policies and regulations that are designed primarily for our governmental operations in-country Some of these are impeding our work overseas.
3. The lack of a comprehensive review by an independent professional of the foreign service in terms of compensation, benefits, etc. The government has tried to address some of these long standing issues in a piecemeal fashion and it has not worked at all. We have yet to successfully address issues like FSP, exchange rate, etc.
4. The lack of clear directions/instructions from home on these issues. This results in the overseas missions having to make decisions on their own on a number of things in order to address some of their urgent needs.

I regret that I am unable to comment on the other things including the recommendations this time. Hopefully, I can submit additional comments on the other issues when I return from Palau.

Thank you

Kasio E. Mida
Chief of Staff

**Appendix III (continue):**

# Embassy of the Federated States of Micronesia

2nd Floor, Reinanzaka Building 1-14-2, Akasaka, Minato-ku, Tokyo, 107-0052 Japan

April 11, 2008

MEMORANDUM

To: National Public Auditor

From: FSM Embassy, Tokyo

Subject: Comments on the Review on FSM Embassy in Tokyo

We sincerely appreciate the opportunity provided to comment on the findings of the review conducted by your good office on the FSM Embassy in Tokyo for fiscal years 2005-2007.

See Note 3 ONPA reply in APPX V

We are also pleased with your view to realign Overseas Missions personnel and in particular the ambassadors so they can carry out the goals and objectives of overseas missions efficiently and effectively. In recommending the realignment of personnel in Overseas Missions, especially to reposition the Tokyo ambassador to Fiji for cost savings, the report committed the fallacy of assuming that Japan's assistance throughout the years will remain essentially unchanged. Records have shown that assistance provided by Japan Government through its ODA scheme and also private sector contributions (fisheries and tourism) as well as NGOs (donations) is increasing significantly over the years. The recommendation seems to suggest that the reason for maintaining a diplomatic mission is just to get money from abroad and ignore other important areas of cooperation. If cost savings is the sole reason for your proposal to designate a Nonresident or Roaming Ambassador from the Suva Office, then the matter needs to be seriously discussed again by our leaderships. Let us be reminded that the third Audit Report of the Embassy recommended closure of the Embassy,



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**Appendix III (continued):**

instead the leaderships increased the budget for the Embassy operation in the following FYs.

Japan views our physical presence in Tokyo an important attachment to the strong and friendly relationships currently assist between the two governments, therefore had decided to upgrade its mission in Pohnpei to ambassadorial level post in 2008. This is an important decision and FSM government should not take this lightly.

The draft report also enumerated the *following findi*ngs and identified the cause for such and proposed recommendations to correct them. 1) used of a higher fixed exchange rate (130 yen to one USD) to pay employee salaries, 2) living allowance that exceeded regulations, 3) a high Foreign Service Premium (FSP) that was not justified, not reasonable, and exempted from taxes, and 4) overspending of authorized funds.

- **Higher Fixed Exchange Rate Not Authorized**: The report claimed that during the three Fiscal Years under review, the actual bank exchange averaged from 107 to 115 a year, and by using a higher exchange rate (130), the Embassy effectively increased employees' salaries. Before commenting on this first finding, we thought it would be helpful to take a look at how the Government addressed the problem and the solution offered to assist the Embassy with the ER problem over the past ten years or so.

  Prior to FY 1998 the then Office of Administrative Services (OAS) devised a schedule of FSP rates for the Embassy to use to pay its FSM employees. A percentage range of fluctuation was at 280% minimum when the rate is 142 yen per one USD up to 496% when the rate is 80 yen per one USD of the base salary (see attached memo of December 1996 from Acting Director of OAS, which was also based on the opinion issued by the Assistant AG in attached memo on November 1988). But for FY 1998, the same OAS issued another memo requiring the Embassy to use a fixed exchange rate of 116.5 to a USD to pay its FSM employees. The memo did supersede the approved system used in prior FYs but maintained the 280% FSP.

  The next FY' 99, Congress in its Standing Committee Report 10-190 authorized the Department of Finance and Administration to use the

**Appendix III (continued):**

amount approved for the FY'99 Budget ($717, 962) to purchase ¥93, 335,040. This is equivalent to 130 yen per one USD, and it should be mentioned here that the exchange rate at the time the Committee was deliberating on the SCR 10-190 was 137 yen per one USD. Recognizing this ER the Committee required that the remaining of the $717,962 to be purchased shall laps immediately. This of course, was an assumption that the exchange rate would be floating between 130 to 140 yen per one USD during the whole FY'99. But it did not occur the way Congress forecasted, and the purchase was not implemented and funds authorized for FY'99 were wired transferred on a quarterly basis to the Embassy account as done in previous operation years. In addition to that, the fixed 130 rate was used for the personnel category but not the other categories, which continued to use the exchange rate of the day when funds were received by the bank in Tokyo.

The intent of SCR 10-190 was never implemented but the Department of Finance and Administration, not the Embassy itself.

From FY'99 until the current FY, the Embassy has been using the "locked-in" ER conversion to pay its FSM employees in yen. Congress has repeatedly called on the Department of Finance and Administration and Department of Foreign Affairs to device a scheme to solve the ongoing problem. Congress had recommended a "hedge fund" be set up to remedy the long-standing problem that adversely affected the operation of the budget of the Embassy, the Department in charge has yet to implement the instruction by the Congress. Therefore, the Embassy left with no choice but continue sticking to the intent of the Congress in the SCR 10-190. The Embassy views the intent of the Congress as a positive move to provide a solution to the problem and the "locked in ER of 130" is still used by the Embassy until today.

See Note 4 ONPA reply in APPX V

Therefore, the claim that the Embassy has used a fixed rate not authorized is not true and should be corrected for the record.

**Foreign Service Premium Not Justified:** The Department of Finance is in a better position to comment on this finding. FSP was extended to FSM employees of this Embassy since the creation of the Embassy. But one thing still holds true until today---the 280% was

3

**Appendix III (continued):**

See Note 5 ONPA reply in APPX V

assigned to correspond with the ER of 142, according to the system initially adopted by the Office of Administrative Services.

If the first, second, and third Audit Reports on the Embassy found the FSP justifiable then the Office provides conflicting findings on the same item.

**Increased Allowances Exceeded Regulations**: Some of the unauthorized allowances the report cited had been paid to the FSM employees were also flagged in the previous Audit Reports, like commuting costs, school allowances, home furniture, and house rent. We will not dwell on these items but allow the good Office to revisit the prior Audit Reports. But the recommendation made in regard to utilities for the two FSM employees is one all concern should re-assess and re-evaluate. Consideration has to be made to FSM employees assigned to localities where coping with extreme weather is no longer considered a "personal in nature" but a "need" for survival. Yes, the famous PSSR that we always refer to considers residential utility costs to be a personal in nature. We all believe the regulation was drafted to cover housing for National Government employees working in FSM and it was never intended to cover FSM employees working abroad, especially in a country like Japan where things are relatively expensive. The Embassy repeatedly called for the Government to consider allowing such special case as it did with commuting costs of FSM employees but no one really thinks this is an important matter, and no action is taken until recent time.

True, the present language of the PSSR does not accommodate the actual situation elsewhere than in the FSM. Decision by Managers of the Embassy to carry out an action outside the language of the PSSR was a move to assist with the hardship experience by the diplomatic staff of the Embassy. The cost of utilities continue to increase every year and for the diplomatic staff to turn off the air cooling or heating system to save costs is exposing our families to further health risk.

**Overspending Of Authorized Funds**: There are two reasons for the excessive funds as cited by the Report. These are primarily resulted from 1) the locked-in ER as stipulated earlier, and second is from

**Appendix III (continued):**

unanticipated activities that were not budgeted for, especially in FY'05. These expenditures are reflected in the Embassy's financial expenditures reports.

The embassy was under the impression that, with the newly established performance budgeting system, reprogramming of funds is no longer necessary. We agree with the recommendations and shall continue our efforts to comply.

I thank the Office of Public Auditor for accepting our request to extend the date to provide our comments and please let me know if I need to provide clarifications to support the comments to the findings of your good Office on the review of the Embassy.

Thank you.

John Fritz
Ambassador

XC: Secretary of Foreign Affairs
Secretary of Finance and Administration
Chief of Staff (Former Ambassador)

5

## Appendix IV:

## Response from the Department of Finance and Administration

GOVERNMENT OF THE
FEDERATED STATES OF MICRONESIA
Department of Finance and Administration
P.O. Box PS 158
Palikir, Pohnpei FM 96941
Tel: (691) 320-2640 Fax: (691) 320-2380
E-mail: fsmsofa@mail.fm

Secretary of Finance
&
Administration

ONPA - Administration
RECEIVED
Date 4/11/08

April 11, 2008

Mr. Haser Hainrick
National Public Auditor
Office of the National Public Auditor
Federated States of Micronesia
Palikir Pohnpei FM 96941

Dear Mr. Hainrick:

This is our formal comments on the report on the Review of the FSM Embassy in Tokyo, Japan, financial activities for FY05-FY07.

The report made a finding to the effect that there was an "Incomplete and Inaccurate Accounting of Expenditures" based on the following observations:

1) Employees salaries not properly recorded
2) Year end reconciliation in FY06 not complete
3). Expenditures not accurately or properly recorded

We disagree on the report insofar as it makes a general conclusion that there was incomplete and inaccurate accounting of expenditures.

Here are our comments.

1) Employees salaries not properly recorded:

On the finding that the employees salaries were not properly recorded, this was made merely on the suggestion that the salary differential (in the conversion rate from dollar to yen) should have been recorded into the "Personnel/salary Account instead of the "Discount due to Conversion" account being used by the DOF&A.

See Note 6 ONPA reply in APPX V

It must be made known that "Discount due to Conversion" account was created by the Assistant Secretary for National Treasury in consultation with the external auditor. The account was created for the purpose of setting an account properly identified to reflect the difference in exchange rate so as to have a basis in the future for budget purposes. The creation of the account was a management decision with concurrence of the external auditor.

## Appendix IV (continued):

See Note 7 ONPA reply in APPX V

In short, the recording of salary differential into the "Discount due to Conversion" account was proper because the use of the said account was with the authority of the management and with concurrence of the external auditor.

See Note 8 ONPA reply in APPX V

The use of the "Personnel/salary Account" to record the salary differential is not a finding but merely a suggestion. At the time the review was made, "Personnel/Salary" account was not authorized, and therefore to classify it as the "proper" account, and to make conclusion out of it, is without basis.

See Note 9 ONPA reply in APPX V

On the suggestion that "Personnel/salary Account" be use to record salary differential will be evaluated in the future by the management on whether it is the proper account or not.

2. Year end reconciliation in FY06 not complete

See Note 10 ONPA reply in APPX V

It must be emphasized that the review covers three years period of FY05 to FY07. This finding is limited only to FY 06. No similar finding is made on FY 05 and FY 07. To make a general conclusion that there was incomplete and inaccurate recording is therefore not supported by this finding.

Actually this finding is misleading. It seems to indicate that the year end reconciliation in FY 06 is not complete. This is not the case. The year end reconciliation of the books of account was complete.

See Note 11 ONPA reply in APPX V

The year end reconciliation in FY06, which according to the report is not complete, refers only to a bank reconciliation statement. It does not refer to the book of accounts. Again, it must be emphasized that the book of accounts was reconciled in FY 06.

See Note 12 ONPA reply in APPX V

The year end bank reconciliation items which was suggested in the report to have been made, was totally insignificant. In fact, there was a zero effect on the books. Simply because the year end reconciliation consist merely of reclassification and correction from one expense to another expense leaving a zero effect.

To explain further below are the reconciling items:

| | |
|---|---|
| To reverse JVC0199 | $ 43,523.68 |
| To reverse JVC 0497 | ( 6,153.08) |
| To record loss on exchange rate | (35,566.09) |
| Net Effect | $ 0.00 |

The non adjustment referred to above did not have any effect in the fund balance. DOF&A could still properly identify any unspent funds that should be returned back to the general fund contrary to the statement in the report

## Appendix IV (continued):

3. Expenditures not accurately or properly recorded.

It must be explained that the accounting of FSM embassies and consulate offices are accounted and recorded on a monthly basis based on reports submitted by the FSM embassies and consulate offices. The accountant classifies and summarizes the reports and put this in a journal voucher for recording in the accounting system. The basis of recording is the check register of each embassy and is accounted for each month.

See Note 13 ONPA reply in APPX V

On this premise, the statement in the report that DOF&A under recorded the expenses in FY05 and over recorded FY06 and FY07 is without basis because DOF&A simply record, classify, and summarize the expenditures based on the monthly reports submitted to it by the FSM embassies. We have requested from the auditor on several occasion to provide us documents, reference or any documents material that would substantiate their claim in order for us to verify the unrecorded and over recorded expenditures but such has not been provided until today. Until such time that the auditor would provide the reference, documents, or any material that would support the claim we disagree on the report on increase and decrease from the current reported expenditures. The auditors provided report but we could not determine from the report which transactions are not recorded and over recorded.

We, however agree that Journal Voucher No. JVB0256 in FY05 was recorded twice and the reversal entry resulted to erroneous posting to different expense account.

Details of this JV are as follows:

| Account no. | Account Description | Original Entry | Recorded As | Incorrect Posting |
|---|---|---|---|---|
| 8110 | Travel and transportation | 186.20 | 186.20 | - |
| 8303 | Office Supplies | 102.95 | 102.95 | - |
| 8306 | Communications | 1,705.73 | 1,705.73 | - |
| 8307 | Utilities | 1,567.36 | 1,567.36 | - |
| 8308 | Printing | 16.24 | 16.24 | - |
| 8305 | Repair and Services | 90.99 | 90.99 | - |
| 8311 | POL | 1,288.35 | 1,288.35 | - |
| 8313 | Books an Library | 72.65 | 145.30 | (72.95) |
| 8399 | Miscellaneous expense | 1,255.99 | 1,183.34 | 72.65 |

**Appendix IV (continued):**

| | | | | |
|---|---|---|---|---|
| 8405 | Contractual Services | 543.31 | 1,086.62 | (543.31) |
| 8408 | Professional Services | 12,284.57 | 24,025.83 | (11,741.26) |
| 8431 | Leased Housing | 17,646.12 | 17,646.12 | - |
| 8432 | Leased Building | 10,982.23 | (1,302.34) | 12,284.57 |
| 8449 | Representation | 467.63 | 467.63 | - |
| | | 48,210.32 | 48,210.32 | |

We also agree that the billings presented as lease was recorded in lease account (8432) in its entirety without knowing that the billing includes utilities (8307), cleaning services fees, and the bank transaction fees because the billings were written in Japanese language. DOFA interpreted the billings as for the leased agreement.

We also agree that medical expenses were recorded in the operating funds because it was disbursed through operation fund account and not through the imprest fund account.

We disagree that salary expense charges of $3,443 in FY05 and 744 in FY06 were incorrectly recorded in Tokyo embassy. These expenses are correctly recorded to FSM Tokyo Embassy account as these salary charges were received by employees working at FSM Embassy Tokyo, these are not employees of FSM Embassy Washington DC. The fund organization for Tokyo Embassy is correct but cost center was improperly used.

Below are the employees charged to salary expense in FSM Tokyo Embassy:

| | | |
|---|---|---|
| FY05 | Renster Andrew | $ 1,487.53 |
| | John Fritz | 1,955.69 |
| Total | | $ 3,443.22 |
| FY06 | Renster Andrew | $ 743.76 |

In our opinion, the reported financial activities of FSM Tokyo Embassy from FY05 to FY07 are fairly recorded and accurately reflective of the financial conditions with exceptions as stated above. The financial reports could be use as to basis in making decisions.

**Appendix IV (continued):**

We wish to thank you for the opportunity given to us to review and comment on the Review of the FSM Embassy in Tokyo Japan financial activities for FY05-FY07.

Sincerely,

Finley S. Perman
Secretary

10:52 AM
FAXED

## Appendix IV (continued):

GOVERNMENT OF THE
FEDERATED STATES OF MICRONESIA
Department of Finance and Administration

P.O. Box PS 158
Palikir, Pohnpei FM 96941
Tel: (691) 320-2640 Fax: (691) 320-2380
E-mail: fsmsofa@mail.fm

Secretary of Finance
&
Administration

ONPA - Administration RECEIVED Date 5/5/08

May 3, 2008

Haser 5.5.2008

Mr. Haser Hainrick
National Public Auditor
Office of the National Public Auditor
Federated States of Micronesia
Palikir Pohnpei FM 96941

Dear Mr. Hainrick:

We have reviewed the additional payroll report provided by your office concerning the Review of the FSM Embassy in Tokyo, Japan, financial activities for FY05-FY07.

Below are our comments.

| FY | Account | Description | Per NPA | Per FINANCE | (over) under Difference | % |
|---|---|---|---|---|---|---|
| 2007 | 8010 | Personnel | 229,063.00 | 229,065.00 | (2) | (0.00) |
| 2006 | 8010 | Personnel | 229,063.00 | 215,602.00 | 13,461 | 0.06 |
| 2005 | 8010 | Personnel | 229,063.00 | 219,176.00 | 9,887 | 0.04 |

a. FY07 was accurately reported

b. FY06 was inaccurately reported with a difference of $13,461 or 6%.

The difference of $13,461 was due to change of account in payroll from FSM Tokyo Japan to FSM Embassy Honolulu in September 18, 2005 as requested by Secretary of Foreign Affairs. FSM Finance failed to return back the original account for FSM Tokyo Japan for ambassador Kasio Mida during the first quarter of FY06. Please refer to attached documents.

| Last | First | Ref. | PP | Amount |
|---|---|---|---|---|
| MIDA | KASIO | FS | 21 | 2,692.31 |
| MIDA | KASIO | FS | 22 | 2,692.31 |
| MIDA | KASIO | FS | 23 | 2,692.31 |

## Appendix IV (continued):

| | | | | |
|---|---|---|---|---|
| MIDA | KASIO | FS | 24 | 2,692.31 |
| MIDA | KASIO | FS | 25 | 2,692.31 |
| | | | | 13,461.55 |

c. FY05 payroll was reported with difference of $ 9,887 or 4%.

The difference of $9,887 was due to change of account in payroll from FSM Tokyo Japan to FSM Embassy Honolulu in September 18, 2005 as requested by Secretary of Foreign Affairs for the following employees:

a.) Kasio Mida b.) John Friz c.) Resnter Andrew

We have also reviewed the reports provided for the other category accounts:

| FY | Account Description | Per NPA | Per Finance | (over)under Difference | % |
|---|---|---|---|---|---|
| 2007 | Travel and transportation | 11,841 | 13,013 | (1,172) | (0.10) |
| 2007 | Consumable | 58,021 | 55,929 | 2,092 | 0.04 |
| 2007 | Contractual | 488,851 | 521,971 | (33,120) | (0.07) |
| 2007 | Disc. to conversion | 25,145 | 24,509 | 636 | 0.03 |

The figures under National Public Auditor (NPA) were extracted from FSM Tokyo Japan office which was the basis of comparison with FSM Finance records.

As reflected in the above report, the contractual account appears to be inaccurately reported with FSM Finance reported more than $ 33,120 or 07% of the total amount obtained by NPA at FSM Tokyo Japan Office.

| FY | Account Description | Per NPA | Per Finance | (over) under Difference | % |
|---|---|---|---|---|---|
| 2006 | Travel and transportation | 31,917 | 30,526 | 1,391 | 0.04 |
| 2006 | Consumable | 71,763 | 66,159 | 5,604 | 0.08 |
| 2006 | Contractual | 483,434 | 563,725 | (80,291) | (0.17) |
| 2006 | Disc. due to conversion | 22,342 | | 22,342 | 1.00 |

## Appendix IV (continued):

The above report significantly shows differences in contractual and Discount due to conversion. FSM Finance appears to have recorded $80,291 or 17% more than the NPA figures obtained from FSM Tokyo Japan office.

FSM Finance failed to record the discount due to conversion in FY06 due to erroneous recording of JVC0199 which was not corrected in FY06.

| FY | Account Description | Per NPA | Per Finance | (over) under Diffrence | % |
|---|---|---|---|---|---|
| 2005 | Travel and transportation | 48,192 | 38,448 | 9,744 | 0.20 |
| 2005 | Consumable | 78,346 | 75,756 | 2,590 | 0.03 |
| 2005 | Contractual | 543,271 | 491,061 | 52,210 | 0.10 |
| 2005 | Disc. due to conversion | 46,251 | 42,610 | 3,641 | 0.08 |

The above report significantly shows differences in all categories showing under recording in the book of FSM Finance as compared with the records obtained by NPA at FSM Tokyo Japan office.

See Note 14 ONPA reply in APPX V

As previously stated above, the figures under NPA were extracted from FSM Tokyo Japan office for which FSM Finance was not able to verify as of todate. We otherwise, agree if FSM Tokyo Japan concur with the numbers stated above.

In view of the qualification stated above, we would like to suggest that in the next audit of FSM Embassy and Consulate office, a staff from FSM Finance will be represented in the audit.

We are also providing the document signed by Ms. Rose Nakanaga supporting the creation of account "8499-discount due to conversion" and the calculation each year of the said account.

To address the recommendation made regarding the recording of exchange rate difference into personnel account, this is taken seriously pending the discussion with Department of Foreign Affairs. We will inform you of the development and any agreement that we may have.

**Appendix IV (continued):**

We wish to thank you for the opportunity given to us to review and comment on the Review of the FSM Embassy in Tokyo Japan financial activities for FY05-FY07.

Sincerely,

Juliet Jimmy
Acting Secretary

Attachment

**Appendix V: ONPA Reply to Department Comments**

**ONPA's Reply to Former Ambassador's Comments**

Note 1 - *In reference to the statement that "The Embassy paid its FSM employees higher salaries than either budgeted or allocated by Congress by using a higher exchange rate to pay employee salaries," the Ambassador commented that he found this statement to be highly questionable because (as far as he was concerned) employee salaries were paid based on the approved budgets by Congress.*

ONPA's Reply – We agree employee salaries should be based on the approved budget by Congress. The issue is not the approved budget, but the exchange rate the Embassy used to convert payroll salaries from US dollars into Japanese yen. The Embassy bank (Mizuho) converted the Embassy's payroll allotments (from National Treasury) based upon the bank's floating exchange rate that averaged between 107 and 115 yen to the US dollar. The Embassy, on the other hand, used a higher fixed exchange rate of 130 yen to pay salaries, effectively increasing salaries in dollar value by $93,738 over a three year period. This led to a shortfall in budgeted funds for salaries that eventually impacted the Embassy's operating funds. The Embassy made up the shortfall by using funds from other budgeted operation accounts to pay for the salary differentials.

Note 2 - *The Ambassador commented that to accuse the Embassy of irresponsibly inflating employee salaries was an exaggeration and misleading because we (the Embassy) did not just make up our own salaries but followed the budgets as well as the appropriate compensation rates as approved by Personnel or in employee contracts.*

ONPA's Reply – The budgeted payroll was based on approved Personnel Actions and employee contracts yet it was the Embassy's use of a higher exchange rate that allowed more funds to be paid for salaries than budgeted. This contributed to the overspending of the Embassy's budget in fiscal year 2005. The Embassy's practice of using a higher fixed exchange rate preceded the appointment of this Ambassador. Yet, the Ambassador continued to allow the use of an exchange rate that far exceeded the going bank rates, thus permitting employees to benefit unfairly to the extent that they received salary levels beyond what was specified by Personnel or in their employee contracts. Currently, the bank exchange rate is around 103 yen to the US dollar (as of 5/21/08), meaning that Embassy employees receive a 26 percent premium (higher salary in US dollars terms) after the Embassy converts their salaries into yen using the higher 130 yen rate.

**Appendix V (continued):**

**ONPA's Reply to Current Ambassador's Comments**

Note 3 – *"In recommending the realignment of personnel in Overseas Missions, especially to reposition the Tokyo Ambassador to Fiji for cost savings."*

ONPA's Reply – Our intent was to foster further discussion and examination for placing ambassadors in locations where they can be more effective and efficient. After further consideration, we have removed our suggestion for realigning personnel in Overseas Missions.

Note 4 – *"The claim that the Embassy has used a fixed rate not authorized is not true and should be corrected for the record."*

ONPA's Reply – The reference given by the Ambassador to a Standing Committee Report 10-190 that authorized the Embassy's use of the 130 yen exchange rate was in reference to Congress approving the Embassy's operating budget for a single fiscal year 1999, not in reference to establishing a fixed exchange rate to pay employee salaries that continues even to this day. We stand with our original finding that the fixed rate was not authorized by Congress.

Note 5 - *"If the first, second, and third audit reports on the Embassy found the FSP justifiable then the Office provides conflicting findings on the same item."*

ONPA's Reply – Previous ONPA audit reports did not address the justification of the FSP, only the questions on whether 'exempt' employees were entitled to the FSP and whether employees were entitled to FSP while away from their mission posts. Clarity of the FSP is an issue that still needs to be addressed.

**ONPA's Reply to DF&A's Comments**

ONPA received two responses from DF&A. After receiving the first letter (see page 24), staff members from ONPA and DF&A Finance met to go over differences in expenditure numbers recorded by each. We provided DF&A our supporting documents and references which clarified our accounting figures. The Assistant Secretary submitted a second letter (see page 29) which essentially did not disagree with our numbers.

Note 6 - *DF&A commented that the "Discount due to Conversion" account was created for the purpose of setting an account properly identified to reflect the differences in exchange rate so as to have a basis in the future for budget purposes.*

ONPA's Reply - The "Discount (due to conversion)" account was not clear and transparent in that it failed to identify (1) the source (salaries) from where the conversion issue arose, (2) the nature for the difference in conversion rates (fixed at 130 yen verses the going bank rate), and (3) the meaning of the word "discount" relative to a favorable or unfavorable exchange rate. The lack of clear and transparent accounting contributed to the Embassy's use of a higher exchange

**Appendix V (continued): ONPA's Reply to DF&A's Comments**

rate being hidden from view; salaries that continually exceeded their dollar allotments; and the improper use of funds from other budget categories to pay for the higher salary costs. We could not see how this account helped the budget process or how DF&A intended on addressing these issues.

Note 7 - *DF&A commented that the recording of salary differential into the "Discount due to Conversion" account was proper because the use of said account was with the authority of the management and with concurrence of the external auditor.*

ONPA's Reply - Management has the responsibility to ensure that spending of public funds are properly recorded with clarity and transparency, more so where expenditures are questionable in nature. We do not feel this was accomplished with this account.

Note 8 - *DF&A commented that the use of the "Personnel/salary Account" to record the salary differential is not a finding but merely a suggestion. At the time the review was made, "Personnel/Salary" account was not authorized, and therefore to classify it as the "proper" account, and to make conclusion out of it, is without basis.*

ONPA's Reply – DF&A currently records all employee salaries into account 8010 under the budget category for Personnel. The additional salaries paid to employees (resulting from the higher conversion rate) is recorded in a separate Contractual Services account 8499 labeled "Discount" that serves to obscure the additional costs and the higher salaries paid. Recording the salary differential into an account other than Personnel/salary account (8010) is misleading and therefore is a "finding" with significant consequences.

Note 9 - *DF&A commented that on the suggestion that "Personnel/salary Account" be used to record salary differential will be evaluated in the future by the management on whether it is the proper account or not.*

ONPA's Reply – Proper recording of expenditures provides the visibility and transparency on government spending of funds while providing assurance that management can rely on accurate financial records to make proper management decisions. Improper recording can result in inaccurate and misleading financial figures such as the overspending of budget accounts that go undetected.

Note 10 - *DF&A commented that it must be emphasized that the review covers three years period of FY05 to FY07. This finding is limited only FY06. No similar finding is made on FY05 and FY07. To make a general conclusion that there was incomplete and inaccurate recording is therefore not supported by this finding.*

**Appendix V (continued): ONPA's Reply to DF&A's Comments**

ONPA's Reply - At year-end FY06, the DF&A did not follow through with recording journal voucher adjustments to correct errors and omissions to the Embassy's final expense ledger leading to incomplete and inaccurate recording of Embassy expenditures at year-end. While this may have occurred in FY06 alone, we were unable to reconcile wide variances in the Embassy's total expenditures for all three fiscal years using DF&A own expense records.

Note 11 - *The DF&A commented that the year-end reconciliation in FY06, which according to the report is not complete, refers only to a bank reconciliation statement. It does not refer to the book of accounts. Again, it must be emphasized that the book of accounts was reconciled in FY06.*

ONPA's Reply - The bank reconciliation is an integral part of adjusting the book of accounts reconciliation at year-end to reflect a complete and accurate accounting of Embassy expenditures.

Note 12 - *DF&A commented that the year-end bank reconciliation items, which were suggested in the report to have been made, was totally insignificant. In fact, there was a zero effect on the books.*

ONPA's Reply - Concluding that offsetting expenses cancel one another and therefore the effect is zero and insignificant for the bottom line, does not address the issues that created the errors nor does leaving the errors uncorrected provide confidence or reassurance that expenditures are properly recorded and can be relied upon as complete and accurate.

Note 13 – *DF&A commented that until such time that the auditor would provide the reference, documents, or any material that would support the claim we disagree on the report on increase and decrease from the current reported expenditures.*

ONPA's Reply – Staff of ONPA and DF&A Finance subsequently met to go over differences between the accounting numbers recorded by each. After providing DF&A our supporting documents and references we were able to clarify our position with DF&A. The Assistant Secretary (FSM Finance) submitted a second letter dated May 3, 2008 (see page 29) which essentially did not disagree with our numbers.

Note 14 – *DF&A commented that the figures under NPA were extracted from FSM Tokyo Japan office for which FSM Finance was not able to verify (to date). We otherwise, agree if FSM Tokyo Japan concur with the numbers stated above.*

ONPA's Reply – The figures we relied upon were taken from FSM Finance's own records as well as from the Embassy's building leases and rental agreements. During our meeting with the Assistant Secretary and her staff, they agreed the majority of errors can be attributed to posting errors and adjusting journal entry errors made by the Department.

## NATIONAL PUBLIC AUDITOR'S COMMENTS

We wish to thank the staff at FSM DFA, DF&A, and Tokyo Embassy for their assistance and cooperation during the course of the review.

The ONPA will perform a follow-up review within the next 12 months to ensure that the DFA, DF&A and the Embassy have taken corrective measures to address all the findings and recommendations provided in this report.

In conformity with general practice, we presented our draft findings and recommendations to the Secretary of the DFA, and to the Tokyo Ambassador for comment. We also sent a copy of the draft to the Secretary of DF&A for comment. Their written comments to the draft report are attached to this report.

We have provided copies of this report to the President and Members of the Congress for their use and information. 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 ONPA and staff who made major contributions to this report.

Haser H. Hainrick
National Public Auditor

May 23, 2008

## ONPA CONTACT AND STAFF ACKNOWLEDGEMENT

| | |
|---|---|
| **ONPA CONTACT** | Haser H. Hainrick, National Public Auditor<br>Phone: (691) 320-2862/2863<br>Email: hhainrick@fsmopa.fm |
| **ACKNOWLEGEMENTS** | In addition to the contact named above, the following staff made key contributions to this report:<br><br>Donald Yamada, Audit Supervisor<br>Yolanda Leben, Auditor-In-Charge |
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