

RENEWABLE ENERGY DEVELOPMENT PROJECT

ASIAN DEVELOPMENT BANK - GRANT NUMBER 0680-FSM(SF)

FINANCIAL STATEMENTS AND INDEPENDENT AUDITORS' REPORT

FOR THE PERIOD DECEMBER 03, 2019 TO SEPTEMBER 30, 2021

**RENEWABLE ENERGY DEVELOPMENT PROJECT
FOR THE PERIOD DECEMBER 03, 2019 TO SEPTEMBER 30, 2021**

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FEDERATED STATES OF MICRONESIA

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INDEPENDENT AUDITORS' REPORT

Honorable Eugene Amor
Secretary, Department of Finance & Administration
Federated States of Micronesia:

Report on the Financial Statements

We have audited the accompanying financial statements of the Renewable Energy Development Project which comprise the statement of financial position as of September 30, 2021, and the related statement of financial performance for the period December 03, 2019 to September 30, 2021, and the related notes to the financial statements.

Management's Responsibility for the Financial Statement

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Renewable Energy Development Project as of September 30, 2021, and the results of its operations for the period December 03, 2019 to September 30, 2021 in accordance with accounting principles generally accepted in the United States of America.

We draw attention to Note 2 of the financial statement, which describes the basis of accounting.

Other Matters

In accordance with *Government Auditing Standards*, we have also issued our report dated July 4, 2022, on our consideration of the Project’s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and the grant agreement. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Project’s internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Project’s internal control over financial reporting and compliance.



Haser Hainrick
National Public Auditor

Palikir, Pohnpei
July 4, 2022

**RENEWABLE ENERGY DEVELOPMENT PROJECT
ASIAN DEVELOPMENT BANK – GRANT NUMBER 0680-FSM (SF)**

**Statement of Financial Performance
For the Period December 03, 2019 to September 30, 2021**

	(\$)
Revenues	
Grant Revenue from ADB	160,569
Total Revenues	<u>160,569</u>
Expenditures	
Project Management and Other Expenses	
Output 1: Yap Renewable Energy	-
Output 2: Kosrae Main Grid Renewable Energy	-
Output 3: Pohnpei Utilities Corporation SMO	94,939
Output 4: Efficient Project Management	65,630
Total Expenditures	<u>160,569</u>
Excess (deficiency) of revenues over expenditures	<u>-</u>

See accompanying notes to the financial statements.

**RENEWABLE ENERGY DEVELOPMENT PROJECT
ASIAN DEVELOPMENT BANK – GRANT NUMBER 0680-FSM (SF)**

**Statement of Financial Position
As of September 30, 2021**

	(\$)
Assets	
Current Assets	
Receivables	
Project Coordinator Receivables	6,075
SMO Consultant Receivables	10,198
Total Assets	<u>16,273</u>
Liabilities	
Current Liabilities	
Payables	
Project Coordinator Payables	6,075
SMO Consultant Payables	10,198
Total Liabilities	<u>16,273</u>
Net Position	<u><u>-</u></u>

RENEWABLE ENERGY DEVELOPMENT PROJECT
ASIAN DEVELOPMENT BANK - GRANT NUMBER 0680-FSM (SF)

Notes to Financial Statements
For the Period December 03, 2019 to September 30, 2021

(1) Organization

On December 03, 2019, the Federated States of Micronesia entered into a grant agreement (Grant Number 0680-FSM(SF)) with the ADB in the amount of \$15 million for the Renewable Energy Development Project (*the Project*), with the grant closing date of August 31, 2023, or such other date as may from time to time be agreed between both parties.

The impact is increased renewable energy generation in the States of Yap and Kosrae in line with the energy targets to achieve 30% renewable energy contribution in Year 1 of operation in each State and increased access to electricity in the State of Kosrae with the electrification of Walung Village.

The outcome is increased generation and utilization of renewable energy in the States of Yap and Kosrae.

The Secretary of Finance and Administration of the Federated States of Micronesia (FSM) National Government is designated as the representative of the FSM.

(2) Summary of Significant Accounting Policies

The accompanying financial statements of the Project have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The Governmental Accounting Standards Board (GASB) is the recognized standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of the Project's accounting policies are described below.

Basis of Accounting

The Project's financial statements are reported using the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Receivables

The Project's receivable is recognized when the Project has received invoices from the consultants (external party) in accordance with agreed conditions/requirements, and is entitled to receive the agreed funding. Where uncertainty exists in relation to the receipt of grant funding, a receivable (and associated revenue) would not be recognized unless it was more probable than not that payment would be made hence allowances for uncollectible amounts is not necessary.

**RENEWABLE ENERGY DEVELOPMENT PROJECT
ASIAN DEVELOPMENT BANK – GRANT NUMBER 0680-FSM (SF)**

**Notes to Financial Statements
For the Period December 03, 2019 to September 30, 2021**

Payables

Payables refers to consultants (external party) invoices received as of September 30, 2021 and yet to be paid.

Reporting Period

The accompanying financial statements cover the period from December 03, 2019 to September 30, 2021. An extended fiscal year was utilized because no withdrawal applications were requested or recorded during the period December 03, 2019 to September 30, 2020.

For financial reporting purposes, the Project was administered and executed by the Department of Finance and Administration and implemented by the Department of Resources and Development of the FSM National Government, and it is a standalone and a separate donor-funded project from the FSM National Government funds and activities. The FSM National Government funds are separately audited and issue their own financial statements. These statements may be obtained by directly contacting the FSM National Government or obtaining them directly from the Office of the National Public Auditor:

P.O. Box PS05
Palikir, Pohnpei State, FM 96941

Presentation of currency

The FSM currency is the US Dollar. In the presentation of the financial statements, cost estimates and financing plan, the Project uses the US Dollar.

(3) Direct Payments made by ADB

Direct payment procedures are used for civil works, consulting services, and equipment. Project management unit (PMU) support such as the project coordinator, consultant and project steering committee meeting costs are reimbursed.

The executing agency and/or implementing agency covered the PMU support costs directly, and submitted withdrawal applications to ADB for reimbursement.

From inception (December 03, 2019) to September 30, 2021 direct payments by ADB to the consultant amounted to \$160,569.

(4) Procurement of Goods and Consulting Services

The procurement of goods, works and consulting services were based on an ADB-approved Procurement Plan (version 2 dated September 14, 2021 with a duration of 18 months). The Plan requires International Competitive Bidding.

**RENEWABLE ENERGY DEVELOPMENT PROJECT
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**Notes to Financial Statements
For the Period December 03, 2019 to September 30, 2021**

(5) Withdrawals from Grant Account

The proceeds of the grant were allocated to items of expenditure, and disbursement on the basis of withdrawal percentage for each item of expenditure.

From December 03, 2019 to September 30, 2021, Outputs 3 & 4 had contracts with the FSM. No taxes and duties were imposed on goods or works acquired during the period.

Description (Invoice no)	Withdrawal Application No.	Date	Amount (\$)	Payee
2020-01	WA002	07/28/21	10,000.00	Palikir Consulting Services (PCS)
2020-02	WA002	07/28/21	5,474.99	PCS
2021-01	WA002	07/28/21	2,914.99	PCS
2021-02	WA002	07/28/21	5,634.99	PCS
2021-03	WA002	07/28/21	5,014.99	PCS
2021-04	WA002	07/28/21	4,714.99	PCS
2021-05	WA002	07/28/21	5,934.99	PCS
2021-06	WA002	07/28/21	5,044.99	PCS
Invoice 1	WA002	09/02/21	43,805.28	Tetra Tech, Inc
Invoice 2	WA002	09/02/21	11,090.14	Tetra Tech, Inc
Invoice 3	WA002	09/02/21	6,750.52	Tetra Tech, Inc
Invoice 4	WA002	09/02/21	6,991.61	Tetra Tech, Inc
Invoice 5	WA005	09/30/21	16,103.93	Tetra Tech, Inc
2021-07	WA003	09/30/21	8,614.99	PCS
2021-08	WA004	09/30/21	7,204.99	PCS
2021-09	WA006	11/18/21	5,074.99	PCS
Invoice 6	WA008	Dec 21	10,197.96	Tetra Tech, Inc
			160,569.34	

(6) Contract and Disbursement S-Curve

The graph below shows the quarterly contract awards and disbursements for FY 2021. The S-Curve is only for ADB financing and it does not include in-kind contributions as there were no taxes or duties imposed on the goods or works acquired during the period.

Contract Awards and Disbursements		
Category Code	Allocation	Contracts Awarded
3201	US \$15,000,000	US \$1,730,240

Breakdown:

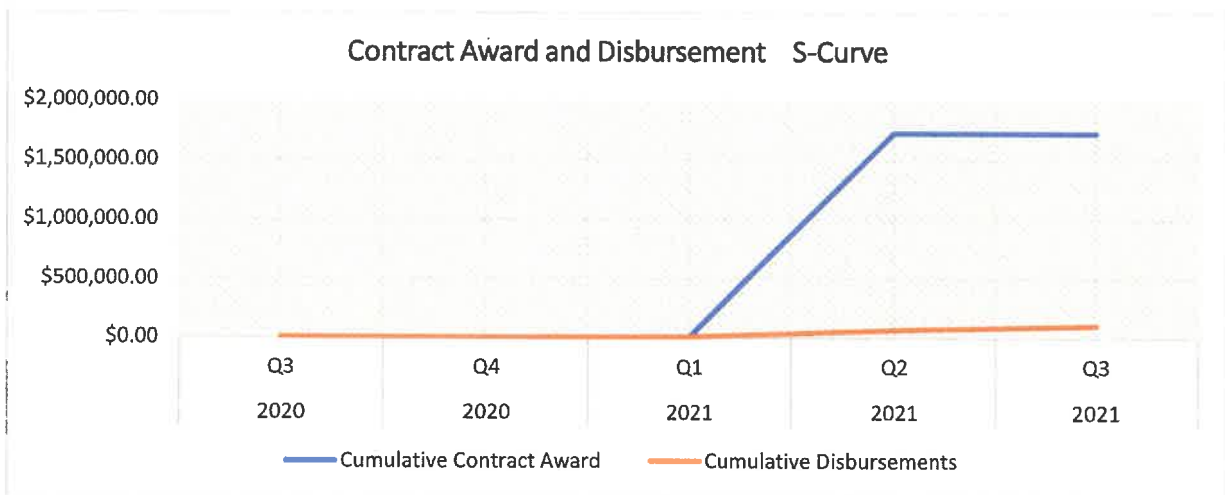
Palikir Consulting Services, Project Coordinator	US \$130,240
Tetra Tech, ES Inc: SMO	US \$730,000
Hydro Electric Corporation trading as Entura	US \$870,000

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**Notes to Financial Statements
For the Period December 03, 2019 to September 30, 2021**

(6) Contract and Disbursement S-Curve (cont'd)

FY Quarter	2020 Q3	2020 Q4	2021 Q1	2021 Q2	2021 Q3	2021 Q4
Cumulative Contract Awards	-	-	-	1,730,240	1,730,240	1,730,240
Cumulative Disbursements	-	-	6,4745	66,845	103,381	160,569



(7) Procurement

All procurement of project goods and works were undertaken in accordance with ADB's Procurement guidelines (2015, as amended from time to time).

An 18-month procurement plan indicating threshold and review procedures, goods, works, and consulting service contract packages and national competitive bidding guidelines includes the following:

Method	Threshold
International Competitive Bidding for Works	Above \$3,000,000
International Competitive Bidding for Goods	Above \$1,000,000
National Competitive Bidding for Works	Below or Equal to \$3,000,000
National Competitive Bidding for Goods	Below or Equal to \$1,000,000
Shopping for Works/Goods	Below or Equal to \$300,000

**RENEWABLE ENERGY DEVELOPMENT PROJECT
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**Notes to Financial Statements
For the Period December 03, 2019 to September 30, 2021**

(8) Statement of Budgeted versus Actual Expenditures

The schedule below shows the estimated project cost and actual expenditures incurred in FY 2021.

Particulars		Budgeted	Actual Expenditures	Variance
Yap				
1	BESS at power station	1.31	-	1.31
2	Ground mount solar photovoltaic array near power station	4.47	-	4.47
3	Rooftop solar photovoltaic extension at sports center	0.49	-	0.49
4	Upgrade to power station SCADA and controls	0.31	-	0.31
	Total Capital Expenditure (CAPEX)	6.58	-	6.58
	Total Import Taxes and Duties	0.26	-	0.26
	Total for the Yap Project	6.84	-	6.84
Kosrae				
1	KUA Main Grid	3.69	-	3.69
2	Walung mini-grid and solar home system	1.16	-	1.16
	Total Capital Expenditure (CAPEX)	4.85	-	4.85
	Total Import Taxes and Duties	0.20	-	0.20
	Total for the Kosrae Project	5.05	-	5.05
Pohnpei				
1	SMO Consultant	0.74	0.09	0.65
	Total for the Pohnpei Project	0.74	0.09	0.65
FSM				
1	Project Implementation Consultants (PIC)	0.87	0.07	0.80
2	Project Management Unit (PMU) Support	0.23	-	0.23
	Total Project Management Support	1.10	0.07	1.03
	Contingency	1.78	-	1.78
	Total Project Costs	15.51	0.16	15.35

**RENEWABLE ENERGY DEVELOPMENT PROJECT
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**Notes to Financial Statements
For the Period December 03, 2019 to September 30, 2021**

(9) Cost and Financing

The Project is financed as follows: Equipment, Works, Project Implementation Consultants, and Supplemental Management Operations from ADB Supplemental Fund in the amount of \$15 million and FSM Government in-kind counterpart financing consisting of exemptions from import taxes and duties estimates of \$0.51 million. No in-kind disbursement from the FSM Government was paid during the period and no import duties were recorded in FY 2021.

Detailed Estimates Financier	Cost by	ADB		Government		Total Costs	
		Amount	% of cost category	Amount	% of cost category	Amount	Taxes and Duties
Output 1: Yap Main Grid Renewable Energy							
1	BESS	1.31	96%	0.05	4%	1.36	0.05
2	Ground PV	4.47	96%	0.18	4%	4.65	0.18
3	Roof PV	0.49	96%	0.02	4%	0.51	0.02
4	Upgrade control system	0.31	96%	0.01	4%	0.32	0.01
	Total	6.58	96%	0.26	4%	6.84	0.26
Output 2: Kosrae Main Grid Renewable Energy							
1	Main Grid PV and BESS	3.69	96%	0.15	4%	3.84	0.15
2	Walung Mini-grid and solar home system	1.16	96%	0.05	4%	1.21	0.05
	Total	4.85	96%	0.19	4%	5.05	0.19
Output 3: Pohnpei Utilities Corporation SMO							
1	SMO Consultant	0.74	100%	-	-	0.74	-
	Total	0.74	100%	-	-	0.74	-
Output 4: Efficient Project Management							
1	PIC	0.87	100%	-	-	0.87	-
2	PMU Support	0.23	100%	-	-	0.23	-
	Total Support	1.10	100%	-	-	1.10	-
	Subtotal (A)	13.27	97%	0.45	3%	13.73	0.45
	Contingency						
1	Physical	1.33	97%	0.05	3%	1.37	0.05
2	Price	0.40	97%	0.01	3%	0.41	0.01
	Subtotal (B)	1.73	97%	0.06	3%	1.78	0.06
	Total (A + B)	15.51	97%	0.51	3%	15.51	0.51

**RENEWABLE ENERGY DEVELOPMENT PROJECT
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**Notes to Financial Statements
For the Period December 03, 2019 to September 30, 2021**

(10) Risk Management: COVID-19

The Project faces risks in carrying out its mandate, including operational risks due to COVID-19. The FSM remained vigilant and resilient in FY 2020 and FY 2021 in managing risks and close monitoring the pandemic as well as assessing its impact on the project. In response to COVID-19, the FSM implemented protective measures to prevent the spread of the virus.

(11) Subsequent Events

- The Project's payables comprised of invoices for output 3 and output 4.

Description	September 2021 Consulting Services (\$)
Output 3: Pohnpei Utilities Corporation SMO	
3.1: SMO Consultants	<u>10,198</u>
Output 4: Efficient Project Management	
4.1: Project Implementation Consultant	6,075
less Advances	<u>1,000</u>
Net	<u>5,075</u>
	<u>15,273</u>

- Contracts awards as of May 2022 have increased by 409.18%, a significant rise for implementation in the near future, an anticipated positive outcome despite COVID-19 pandemic.

Existing Contracts as of May 2022	EURO Amount (\$)	USD Amount (\$)
Tetra Tech, ES Inc	-	730,000
Palikir Consulting Services	-	130,240
Hydro Electric Corporation trading as Entura	-	870,000
Vergnet SA, France – Lot 1 (Euro to USD conversion)	1,867,103	2,113,934
	-	1,351,176
Vergnet SA, France – Lot 2 (Euro to USD conversion)	2,281,559	2,583,182
	-	1,031,447
		<u>8,809,979</u>

- On December 17, 2021 additional funding of \$4 million was approved by ADB with the objective to increase sustainable generation and utilization of renewable energy in all four states of the recipient.



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INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Honorable Eugene Amor
Secretary of Finance & Administration
FSM Department of Finance & Administration:

Report on the Financial Statements

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in the *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Renewable Energy Development Project (the Project), which comprise the statement of financial position as of September 30, 2021, and the related statement of financial performance for the period December 03, 2019 to September 30, 2021 and the related notes to the financial statements, and have issued our report thereon dated July 4, 2022.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Project's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Project's internal control. Accordingly, we do not express an opinion on the effectiveness of the Project's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statement will not be prevented, or detected and corrected on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have

not been identified. We consider the deficiency in the accompanying Schedule of Findings and Responses as item 2021/02 to be a significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Project's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the financial statements. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed an instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards* and which is described in the accompanying Schedule of Findings and Responses as item 2021/02.

The Project's Response to Findings

The Project's response to the findings identified in our audit is described in the accompanying Schedule of Findings and Responses. The Project's response was not subjected to the auditing procedures applied in the audit of the financial statement and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Project's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Project's internal control over financial reporting and compliance. Accordingly, this communication is not suitable for any other purpose.



Haser Hainrick
National Public Auditor

Palikir, Pohnpei
July 4, 2022



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INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH THE FINANCIAL COVENANTS AND OTHER REQUIREMENTS OF THE GRANT AGREEMENT

Honorable Eugene Amor
Secretary of Finance & Administration
FSM Department of Finance & Administration:

Report on Compliance with the Financial Covenants and Other Requirements of the Grant Agreement

We have audited the Renewable Energy Development Project (*the Project's*) compliance with the types of compliance requirements described in the Grant Agreement dated December 03, 2021, with the Asian Development Bank, that could have a direct and material effect on the Project for the period December 03, 2019 to September 30, 2021.

Management's Responsibility

Management is responsible for compliance with the financial covenants and other requirements of the grant agreement.

Auditors' Responsibility

Our responsibility is to express an opinion on compliance with the financial covenants and other requirements of the grant agreement referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of the Grant Agreement. Those standards and the Grant Agreement require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on the Project occurred. An audit includes examining, on a test basis, evidence about the Project's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our qualified opinion on compliance with the financial covenants and other requirements of the grant agreement. However, our audit does not provide a legal determination of the Project's compliance.

Basis for Qualified Opinion

As described in Finding 2021/01 in the accompanying Schedule of Findings and Responses, the Project did not comply with the requirements of Section 15 of the Grant Agreement dated December 03, 2019, with the Asian Development Bank, regarding the financial covenants. Compliance with such requirements is necessary, in our opinion, for the Project to comply with the requirements applicable to the financial covenants of the grant agreement.

Qualified Opinion

In our opinion, except for the noncompliance described in the Basis for Qualified Opinion paragraph, the Project complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on the Project for the period December 03, 2019 to September 30, 2021.

Other Matters

The results of our auditing procedures disclosed one other instance of noncompliance which is required to be reported in accordance with the Grant Agreement and which is described in the accompanying Schedule of Findings and Responses as item 2021/02. Our opinion on the Project is not modified with respect to this matter.

The Project's response to the noncompliance findings identified in our audit is described in the accompanying Schedule of Findings and Responses. The Project's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

Report on Internal Control over Compliance

Management of the Project is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Project's internal control over compliance with the types of requirements that could have a direct and material effect on the Project to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance and to test and report on internal control over compliance in accordance with the grant agreement, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Project's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a grant agreement on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance, such that there is reasonable possibility that material noncompliance with a type of compliance requirement for the grant agreement will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of the grant agreement that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, we did identify a deficiency in internal control over compliance, described in the accompanying Schedule of Findings and Responses as item 2021/02, that we consider to be a significant deficiency.

The Project's response to the internal control over compliance findings identified in our audit is described in the accompanying Schedule of Findings and Responses. The Project's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

The Project is responsible for preparing a corrective action plan to address each audit finding included in our auditors' report. The Project's corrective action plan was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on it.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the grant agreement. Accordingly, this report is not suitable for any other purpose.



Haser Hainrick
National Public Auditor

Palikir, Pohnpei
July 4, 2022

**RENEWABLE ENERGY DEVELOPMENT PROJECT
ASIAN DEVELOPMENT BANK - GRANT NUMBER 0680 (SF)**

**Schedule of Findings and Responses
September 30, 2021**

2021/01: Non-Compliance with Financial Covenants

Criteria: Section 15 of Schedule 4 of the grant agreement dated 12/03/19 states that the recipient shall ensure that each Project Beneficiary achieves and maintains, from 31 December 2020 and annually thereafter, *an operating ratio of at least 1.0*. Operating expenses means expenses, including taxes, depreciation, maintenance but excluding interest and charges on debt directly related to the project beneficiary's operations and services. Operating revenue means revenues from all sources related to the Project Beneficiary's operations, after making adequate provisions for uncollectible debts.

The requirements of the ratio were revised in the Additional Funding Grant Agreement dated 12/17/21 to *"an operating ratio not exceeding 1.0."*

Condition: From our review of the operating ratio of the project beneficiaries for the year ended 31 December 2020, we noted that one of the project beneficiaries did not achieve the required ratio. Refer to table below for details:

Project Beneficiaries	Operating Ratio Achieved
Pohnpei Utilities Corporation	0.98
Kosrae Utilities Authority	1.07
Yap State Public Service Corporation	0.94

Note 2 of the financial statement under the reporting period states that there were no withdrawal applications requested or recorded during the period December 03, 2019 to September 30, 2020. While Note 5 of the financial statements shows that minimal transactions occurred from September 30, 2020 to December 31, 2020, however the time period for compliance with the financial covenant was not amended to begin after the project was completed or at least substantially started.

Root-Cause: (i) The ratios were planned in 2019 to show how the operations of the project beneficiaries improve with investments and did not take into account the impacts of COVID-19 which would ultimately influence the ratios for the project beneficiaries.

(ii) The grant agreement does not specify how the Department of Finance & Administration (DOFA) and Department of Resources and Development (DORD) of the FSM National Government can assist the project beneficiaries in complying with the financial covenants as both Departments do not have any controls over the operations of the project beneficiaries.

Effects: The above resulted in non-compliance to the financial covenants of the grant agreements.

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Recommendations:

We recommend that the financial covenant requirements of the grant agreement be reviewed to specify how the Departments (DOFA and DORD) of the FSM National Government can assist the project beneficiaries in complying with the financial covenant requirements.

Management Responses:

Project Beneficiary Operational Ratios. As your staff are aware, this was initially reviewed during the course of negotiating the Additional Financing component of the REDP in late 2021, and this covenant – Section 15 of Schedule 4 – was updated to accurately reflect the original intent for the Project Beneficiaries – Kosrae Utilities Authority (KUA), Yap Public Service Corporation (YSPSC) and Pohnpei Utilities Corporation (PUC) – to maintain “an operating ratio not exceeding 1.0”. This financial covenant was a deliberate requirement as this is an intended outcome from the investments being made under the REDP for each project beneficiaries so that the investments ultimately lead to more sustainable operations: for KUA and YSPSC to maintain their operating ratios under 1.0 through investments in renewables and thereby achieving corresponding reductions in fossil fuel costs (accounting for depreciation of those assets of course), and more importantly, for the National Government to support PUC, as the largest utility corporation in FSM, to work toward achievement of an operating ratio not exceeding 1.0 specifically through the roughly \$1.5 million allocated (to date) toward the Supplemental Management Operations (SMO) work with PUC under the REDP. The SMO work is replicating previous, similar successful work that was supported by the US OIA and ADB to assist the Chuuk Public Utilities Corporation (CPUC) go from consistently exceeding an operating ratio of 1.0, to one that now consistently operates under a ratio of 1.0 (operating profit).

Although the COVID pandemic and boarder closure seriously hampered efforts throughout the course of 2021 to most effectively implement the SMO work toward this end (the SMO work calls for an international team of experts to serve as shadow management structure within PUC on a day-to-day basis), we continue to place an emphasis on righting the PUC operations across a number of operational, technical, financial and strategic fronts through at least 2021 in order to achieve this intended outcome of the project. Ongoing actions under the SMO are moving us in the right direction: pending draft legislation to amend Title 34 of the Pohnpei Code to allow PUC more flexibility in setting its tariffs, and finalization of a PUC Corporate Business Plan, including benchmarking against Key Performance Indicators for each Department.

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We agree with your recommendation on this finding and will continue to review how we can assist the project beneficiaries comply with the financial covenant requirements. Although we do not have any direct influence over the day-to-day operations of the utilities, we do have influence over allocations of funding to assist the SMO work to PUC, along with coordinating other development partner and technical assistant support to the utilities, and this is how we intend to meet the requirements under the financial covenants of the project.

2021/02: Non-Maintenance of separate accounts and records for the Project

Criteria: Section 4.02 of Article IV of the grant agreement dated 12/03/19 states that the recipient shall maintain separate accounts and records for the project.

Condition: DOFA as the executing agency did not maintain separate accounts specifically for the project, therefore relied on the Asian Development Bank Client Portal for Disbursements to prepare the financial statements for REDP. We also noted that the Fundware was not updated even though an account number has been allocated for the project.

Nevertheless, we acknowledge the efforts by DORD and DOFA to recruit an Officer to track the project expenditure and disbursements and maintain project accounts.

Root-Cause: Lack of resources at DOFA to designate a position with the responsibility of maintaining the project records and updating project accounts including Fundware.

Effects: Non-compliance with the requirements of the grant agreements.

Recommendations:

We recommend that DOFA and DORD expedite the recruitment of the Officer and ensure that Fundware and other project records are properly updated within specified timelines.

Management Responses:

The finding is accurate and one that we have already identified internally and have started to process to improve our performance in this area. One shortfall of the project was in the allocation of funds and appropriate level of national staffing to Output 4: Efficient Project Management. There was an original focus on international staffing to provide the outside expertise required to support the project technical aspects (the contract for the Project Implementation Consultants, Entura), and with one National Coordinator on a part-time basis.

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In mid-2021 DOFA and DORD noted the need to enhance the local PMU based at DORD with additional staff, including a priority focus on a Finance & Administration Officer (FAO) who should look after all contracts, keep manual and electronic ledgers of payments and other similar financial duties – including working with DOFA to set up and maintain Fundware related to the recently approved Advice of Allotment for the project – to support the National Coordinator effectively implement the project. The ADB agreed and approved this additional staffing to the PMU.

We agree with your recommendation and expect to have the FAO in place by the end of June 2022, and who will work closely with DOFA to ensure that all financial project records are accurately maintained on a timely basis, and who will also enable more efficient and timely annual project audits.