

Assurance and Advisory
Business Services
December 2003



Democratic Republic of Timor-Leste Management Report

30 June 2003



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INTRODUCTION

We have completed our audit of The Government of the Democratic Republic of Timor-Leste ("The Government") for the financial year ended 30 June 2003 and have issued a qualified audit report. The reasons for the audit qualifications are explained below.

Scope and responsibilities

We conducted an independent audit of the financial report in order to express an opinion on it to the President and Honourable Members of the National Parliament of Timor-Leste. Our audit was conducted in accordance with International Standards on Auditing in order to provide reasonable assurance as to whether the financial report is free of material misstatement.

Our procedures included examination, on a test basis, of evidence supporting the amounts and other disclosures in the financial statements. Our audit also includes assessment of the accounting principles used and the significant accounting estimates made by management, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinion. The nature of an audit is influenced by factors such as the use of professional judgement, selective testing, the inherent limitations of internal control, and the availability of persuasive rather than conclusive evidence. Therefore, an audit cannot guarantee that all material misstatements have been detected.

The Ministry of Planning and Finance, Office of the Treasury is responsible for preparing a financial report that presents fairly the financial position and performance of the government and the consolidated entity. This includes responsibility for the maintenance of adequate accounting records and internal controls that are designed to prevent and detect fraud and error, and for the accounting policies and accounting estimates inherent in the financial report.

Independence

We are independent of the government, and have met the independence requirements of international professional ethical pronouncements.



EXECUTIVE SUMMARY

Key Financials

The consolidated entity achieved revenues of \$83.16 million for 2003, an increase of 53.6% over the 2002 revenues of \$54.13 million. The majority of this increase relates to donor grants (up by \$9.78 million in the 2003 year) and Timor Gap tax revenues (which have risen by \$19.92 million in the 2003 year). Total expenditure incurred during the year amounted to \$73.82 million, an increase of 35.5% over 2002. As indicated in the table below, the majority of this increase relates to expenditure on goods and services, which increased by \$13.05 million in the 2003 year.

In total, the Government of the Democratic Republic of Timor-Leste recorded an excess of revenue over expenditure of \$9.34 million in 2003, in comparison to a deficit of \$0.35 million in 2002.

Summary of financial performance, whole of government (in millions of \$US)

Item	<u>2003</u>	<u>2002</u>	<u>Change</u>
Revenue	83.16	54.13	53.6%
Less expenditure			
Salaries	22.07	18.90	16.7%
Goods and Services	37.63	24.58	53.1%
Capital	<u>14.12</u>	<u>11.00</u>	<u>28.4%</u>
Total expenditure	73.82	54.48	35.5%
Surplus (deficit)	<u>9.34</u>	<u>(0.35)</u>	

As at 30 June 2003 the Government held cash and cash equivalents totalling \$40.39 million (30 June 2002 \$24.10 million). Outstanding commitments recognized by the government at 30 June 2003 totalled \$14.87 million (30 June 2002 \$10.59 million).



Audit report qualifications

We have issued a qualified audit report. The qualifications, and the rationale for issuing them, are listed below:

1. As noted in the prior year a number of deficiencies in the Power Invoicing Management System "PIMS" utilised by the Power Authority of the Government of the Democratic Republic of Timor- Leste. The "PIMS" system is used to calculate Power Service charges for Timor-Leste, due to the deficiencies in the system we are unable to determine whether the amounts invoiced for Power Service charges are accurate and reliable. Our audit relating to Power service charges has been limited to ensuring that the amounts banked for Power service charges were properly recorded in the accounts. Accordingly, we are unable to express an opinion on whether power service receipts amounting to \$2,871,098 represent the full amount that should otherwise have been received and we cannot determine the effects of such adjustments, if any, as might have been determined to be necessary had this limitation not existed.
2. Our audit found that revenue collection policies for revenue retention agencies are not being adhered to, for example the Ministry of Justice, Ministry Education, Culture, Youth and Sports, and the Civil Aviation Authority were not banking all receipts received. Our audit relating to income was therefore limited to ensuring that the amounts banked were properly recorded in the financial report. Accordingly, we do not express an opinion on whether all income has been banked and we cannot determine the effects of such adjustments, if any, as might have been determined to be necessary had this limitation not existed.

Key audit findings

Our examination for the year ended 30 June 2003 disclosed a number of other matters, which are appropriate to be brought to your attention, these are included in the accompanying report.

The most important items highlighted during our audit are as follows:

- During our audit we noted a number of serious deficiencies in the Power Invoicing Management System ("PIMS") used by the Power Authority.
- The audit identified serious breaches of Procurement Policy in relation to procedures for single source procurement.
- Monies collected and recorded as revenue by treasury are not reconciled by the revenue collecting agencies to the invoices owed by customers.



Please refer to the attached schedules for further details regarding our most important audit findings. Note that a separate schedule of relatively minor audit issues has also been prepared and presented to management. The schedule of minor matters does not form part of this Audit Closing Report.

We acknowledge that the Democratic Republic of Timor-Leste is only in its third year of operations and is still in the formulation process of policies and procedures. We further understand that this is a significant task for the new government especially as the level of international staff assistance continues to be reduced.

We are pleased to note that a number of significant improvements have recently been made to the Government's accounting processes. In particular, we note the following issues arising out of the 2002 audit which have been addressed by the Government in the intervening period:

- Individual agencies are maintaining asset registers, although as detailed below, significant improvements can be made to these registers,
- The administration of the procurement processes have been improved during the year ended 30 June 2003 with the implementation of the Freebalance Procurement Module. Commitment and Payment Vouchers ("CPVs") can now be directly linked with the corresponding purchase orders, ensuring it is much easier to review outstanding commitments,
- Payroll section has improved their system of internal controls with respect to ensuring that payroll transactions are appropriately authorised, and
- The capacity of the Internal Audit department has been enhanced over the year.

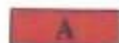


MATTERS ARISING

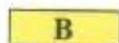
The following schedules set out further details of issues arising from our audit. A number of the issues identified were also raised in the prior year. We have colour coded our priority ratings to enable major weaknesses to be easily identifiable. The key to the colour ratings is listed below the matters arising.

Schedule	Audit Issue	Rating	Issue Raised in Prior Year
1	1.1 Integrity of PIMS system	A	√
	1.2 Power Meters	B	√
	1.3 Power Debt Collection	B	√
2	Procurement		
	2.1 Breach of Procurement Policy	A	
	2.2 Inadequate Documentation of Tender Process	A	
	2.3 Lack of Process to close outstanding CPV's	B	
3	Interest Revenue Timor Gap Royalties	A	√
4	Revenues not banked by agencies	A	
5	Assets		
	5.1 Asset register	B	√
	5.2 Classification of capital items	B	
6	Unallocated Stock		
	6.1 Obsolete Stock	B	
	6.2 Value of Donated Stock	B	
7	Bank Reconciliations	B	√
8	Accounts payable/commitments	B	

Ratings



A major weakness that you must address soon.



An important matter that will significantly improve the control environment, the accounting system or the operations of the business.



GENERAL

The comments above made do not imply any lack of integrity or honesty on the part of the management committee and employees of the government. We have received comments on our management letter from the management and they are incorporated in this report.

As part of our examination, we made a study and evaluation of the Central Fiscal Authority's system of internal control to establish the level of our reliance on the system in determining the nature, timing and extent of other auditing procedures necessary to enable us to express our audit opinion. Our audit was not extended to individual Agencies systems of internal controls, but rather concentrated on Central Fiscal Authority systems and controls. This work is not primarily directed towards the discovery of weaknesses or the detection of fraud or other irregularities and should not, therefore, be taken to assure that no other weaknesses exist. Accordingly, the comments in this letter refer only to those matters, which have come to our attention during the course of our normal audit work and do not attempt to indicate all possible improvements, which a special review might develop.

We wish to take this opportunity to thank you and your staff for the assistance given to us during the course of our audit.



DETAILED SCHEDULES

1. POWER AUTHORITY

Summary of Audit Issues

The following points relate to the Power Authority. It should be noted that these issues were also raised in the prior year. During our audit we noted a number of serious deficiencies in the Power Invoicing Management System ("PIMS"), these deficiencies are detailed in the schedules below.

Due to the serious nature of these deficiencies, we have been unable to determine whether the charges calculated for power service are accurate and reliable. This has resulted in a qualification on our audit report.

1.1 INTEGRITY OF POWER INVOICING MANAGEMENT SYSTEM ("PIMS")

Audit issue

The total billing for power charges amounting to US\$12,754,110 calculated by PIMS cannot be relied upon.

Observation and Effect

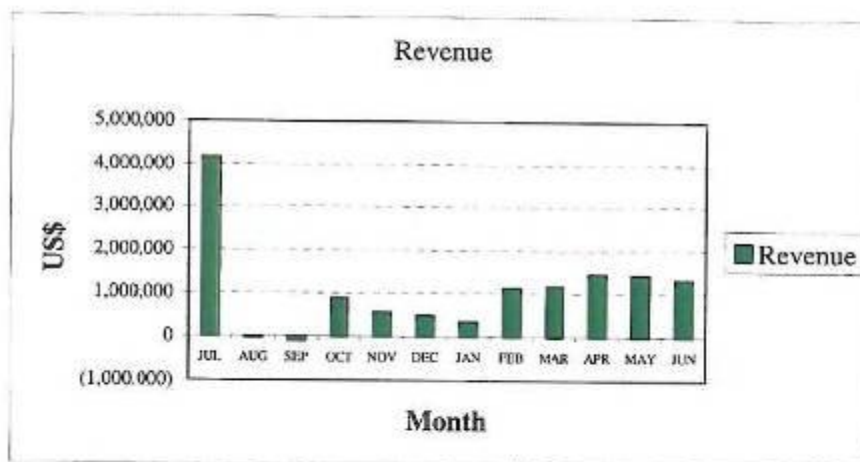
The billing report generated from the PIMS does not appear to be reliable, due to the following:

- inaccurate meter readings as discussed in point 1.3;
- meter reads are manually input into PIMS, during our audit we found cases in which the meter read did not agree to what was entered into PIMS;
- PIMS does not produce exception reports which would highlight large or unusual meter reads, furthermore no manual review of meter reads is undertaken to ensure input into PIMS is reasonable.



1.1 INTEGRITY OF POWER INVOICING MANAGEMENT SYSTEM (PIMS)(CONTINUED)

The chart below shows the power charges calculated by PIMS on a month-by-month basis. There are large variances particularly from March to June, with August and September recording negative reads for the month.
(source ADB Summary Report)



Due to the problems described above we are not able to determine the exact extent of the inconsistencies within the billing records of PIMS, nor are we able to quantify the errors. It is not possible to determine whether the government is collecting all the power revenue that it is entitled to.

Recommendation

We acknowledge that you are aware of the problems associated with the Power Authority. We strongly recommend a complete review of the PIMS system be undertaken to ensure that the parameters of the system can enable the calculation of accurate information. Particularly we would recommend that the report writer within PIMS is set up to be able to calculate exception reports, which will highlight any unusual power usage, such as negative reads.

We further recommend that a complete review of the power receivables be undertaken to determine the validity and collectability of the outstanding amount.

(Rating A)



1.1 INTEGRITY OF POWER INVOICING MANAGEMENT SYSTEM (PIMS)(CONTINUED)

Management Response

Following incessant deliberations by various stakeholders in the power sector, including the government and development partners, it was resolved that to address perennial woes afflicting this sector long term and sustainable solutions were required. To begin with Dili area revenue collection will be based on prepaid meters, which have now been sourced. At the time of writing this report the first batch of prepaid meters has been received.

Besides the prepaid meters, a new management contract is in the offing and this is intended to be a panacea for the management shortcomings that beset the Power Authority. Whole of the functional aspects plus the economical facets of the authority will hopefully be covered and hence usher in a new organization with workable vision, goals and strategy.

Audit Conclusion



1.2 POWER METERS

Audit issue

The meter recording worksheets are not effectively indicating which meters are missing or not in operation.

Observation and Effect

We noted cases in which the meter reading has remained the same over several months, without any action taken to verify whether or not the meter was missing or not in operation.

The meter reading worksheet has a space to write in last month's reading as well as the current month's reading. It is apparent that last month's readings are rarely if ever recorded on the worksheets. Because last month's figure is not recorded, there is no immediate indication that the meter has not moved and that it may be broken.

Since domestic and social customers with broken meters are invoiced for only US \$1/month (the nominal charge for the first 25 kwh), it is possible that they have been undercharged relative to their actual power usage.

We also noted that the technicians and engineers who repair the meters are not able to locate the meters from the map and identification method adopted by the Power Authority.

Recommendation

We recommend that a review of power meters is carried out to ensure that they are functioning correctly. The first step in achieving this will be to ensure that an accurate and easily identifiable map of all meters is developed. This will ensure that not only meter readers, but also technicians and engineers can easily locate meters for repairs and reading.

Last month's meter reading should be recorded next to the current month's reading on the meter worksheet, and where there is no movement these customers should be targeted for meter testing.

(Rating **B**)



1.2 POWER METERS (CONTINUED)

Management Response

As mentioned above at 1.1, the installation of prepaid metres will go a long way in solving this problem. The existing meters will be repaired and calibrated. The review of the PIMS system will be undertaken in due course by the Power Authority Management.

Audit Conclusion

While we accept that action is currently being taken to address this issue, we note that the installation of prepaid meters, and repair of existing meters, is currently at a relatively early stage of completion. This issue will be reviewed at the next audit.



1.3 POWER DEBT COLLECTION

Audit issue

There is currently no formalised debt collection policy for outstanding debtors or a formalised process to allow for disconnection of power on non-payment of invoices.

Observation and Effect

The amount of billing calculated per PIMS to 30 June 2003 was \$12,754,110 whilst the payments collected and banked for power services amounted to \$2,811,513. This suggests that there is approximately \$10 million of uncollected power revenue. Due to apparent inaccuracies in the PIMS system, however, the level of accounts receivable cannot be estimated with any confidence. We were unable to verify the balance of outstanding power invoices.

The PIMS system does not produce an aged report of outstanding power invoices, so it is not possible to easily determine how long debtors have been outstanding. Furthermore it appears that the staffing numbers at the Power Authority are not adequate, as an example there is no staff members dedicated to debt collection.

Recommendation

A formalised debt collection policy will ensure that payments are received on a regular basis whilst also identifying and limiting potential bad debts. Invoices should be amended so customers are aware that any breaches may result in disconnection of the power supply.

We would also recommend that a review of the staffing structure be undertaken to determine the positions required and the training needs for the Power Authority to operate effectively and efficiently.

(Rating **B**)



1.3 POWER DEBT COLLECTION (CONTINUED)

Management Response

The response in 1.1 adequately covers this issue. Once the new management contract is in place, this issue will be addressed by the management team suitably in its own interest.

Audit Conclusion

Refer to schedule 1.1.



2. PROCUREMENT

The following schedules highlight the issues regarding procurement documented during our audit.

2.1 BREACH OF PROCUREMENT POLICY

Audit issue

Procedures for the single source procurement as set out in the *Public Procurement Manual for Civil Administration in Timor-Leste* are not consistently being adhered to.

Observation and effect

Section 10.10 of the procurement manual allows procurement from a single source when there

- is a lack of competition;
- the product or service is unique or has superior capabilities;
- where items are required for testing; or
- where compatibility with existing equipment is a paramount consideration.

Sole source procurement may also be justified under emergency conditions (10.14) or for certain specific categories of goods and service (11.1) including books and other copyright materials, conferences, taxes, refund on insurance, membership fees, postage fees, expert witness service and public utilities. Requisitions for single source procurement must be accompanied by a written justification (form PU-2), which must be approved by the Chief of the Procurement Unit (Section 10.11 of the procurement manual).

During our review two sole source procurement contracts were identified where neither the prescribed PU-2 form nor any other written justification of the decision to use single source procurement was provided on file.

Vendor	Type of product	Value	User
Mandira Internusa Technologies	Computer database	\$100,000	Police Ministry
Timor Loro Sac Supplies	Motor vehicles	\$708,500	Police Ministry



2.1 BREACH OF PROCUREMENT POLICY (CONTINUED)

Based on subsequent discussion and review of documentation with Procurement Section, we understand that the vehicle purchase was justified as a sole source procurement due to emergency conditions at the time. No explanation has been provided for the use of single source procurement on the computer database contract.

In addition, the following other matters have been noted with respect to the procurement process:

- Section 10.13 of the procurement manual specifies that single source procurements valued at more than \$50,000 should be advertised in the government gazette.
- Single source purchases of more than \$100,000 should be subject to review by the Contract Assessment Committee (10.11).

Both of these procedures are not currently being adhered to.

If sole source procurement is used under inappropriate circumstances, and without the appropriate degree of transparency, there is a risk that the government will pay a higher price for goods and services that will otherwise be the case.

Recommendation

We recommend that an independent review be carried out into all single source procurement contracts completed on behalf of the Ministry of Police during the 2003 financial year.

We also recommend that the following procedures specified in the Public Procurement Manual should be strictly adhered to:

- single source procurements valued at more than \$50,000 should be advertised in the government gazette,
- single source purchases of more than \$100,000 should be subject to review by the Contract Assessment Committee.

(Rating **A**)



2.1 BREACH OF PROCUREMENT POLICY (CONTINUED)

Management Response

In view of the urgency in getting the Police department organised especially with the departure of extremely big numbers of the United Nations Police this had taken place. Acquisition of the items mentioned, therefore, not only became urgent but expedient in order to render the Police department effectively functional. New Procurement Regulations are being finalised and these will be followed to the letter.

Audit Conclusion



2.2 INADEQUATE DOCUMENTATION OF TENDER PROCESS

Audit issue

Where a bid is selected on a basis other than price the selection criteria must be described.

Observation and effect

Of the twelve procurement contracts audit found one instance where no justification was provided on file for the selection of the highest priced tender:

Vendor: Mitra Utama

Product: Police Uniforms

Value: \$160,998

Mitra's rate was up to 2.5 times that of the lowest priced tenderer.

Based on further discussion with procurement staff we understand that the decision to award the contract to Mitra was as a result of their evaluation of the samples provided by the tenderers. While we accept that the use of such criteria is consistent with guidelines in the procurement manual, it is essential that the evaluation process is properly documented to ensure that the tendering process remains fair and transparent.

Recommendation

We recommend that procurement staff fully document the reasons for selection of a particular tender, where the successful bid is not also the lowest price.

(Rating **A**)

Management Response

Audit recommendation is noted for compliance.

Audit Conclusion



2.3 LACK OF PROCESS TO CLOSE OUTSTANDING CPV'S

Audit issue

There is currently no formal process to identify and close redundant open CPV's.

Observation and affect

Procurement section currently does not periodically review the list of open CPV's to identify those which have lapsed, are no longer required, or for which the funds have been fully spent. At the end of the financial year treasury staff are required to manually go through the CPV listings with procurement staff and identify commitments which should be closed.

If commitments are not closed when they become redundant the following problems may arise:

- Management's ability to accurately estimate the monetary value of outstanding commitments, and therefore to gauge future cash flow requirements, will be impeded,
- There is an increased risk that funds may be missapropriated or used for unauthorised purposes.

Recommendation

Procurement section should formally review the list of open CPV's on a monthly basis, and close those that are no longer required.

(Rating **B**)

Management Response

The Treasury exercises adequate controls and the system provides safeguards against misappropriation of fund. However, staffs in Procurement department are constantly being trained to close the requisitions that have lapsed, fully utilised or no longer required.

Audit Conclusion



3. INTEREST REVENUE TIMOR GAP ROYALTIES

Audit issue

Timor Gap royalty monies held are receiving minimal interest revenue.

Observation and Effect

As of 30 June 2003 there was in excess of ten million dollars of Timor Gap royalties held in a bank account. This money is earning interest at a rate of less than 1%.

These monies could be earning a significantly higher amount of revenue if they were invested in a higher yielding account.

Recommendation

We would recommend that the Timor Gap royalty monies are invested in a higher interest yielding account.

(Rating **A**)

Management Response

The Audit recommendation is noted and the matter will be taken up with the concerned authorities for taking necessary action.

Audit Conclusion



4 REVENUES NOT BANKED BY AGENCIES

Audit Issue

Some revenue retention agencies have breached revenue collection policies by not banking all revenue receipts.

Observation and Effect

The following cases in which revenues were not banked by agencies came to the attention of the audit team:

- *Civil Aviation Authority*
Cash revenues totalling approximately \$27,000 were not immediately banked into the Civil Aviation bank account. Instead these monies were retained in the CAA offices and were used both to pay operational expenses and for employee loans.
- *Post Office*
As indicated in an internal audit report the Post Office did not bank \$2,820 for the month of August, spending it instead on the procurement of goods and services.
- *Ministry of Justice*
District courts and the Dili court collect court fees, which are retained by each court and not banked to the Treasury account. We understand that the Ministry of Justice is still waiting a new regulation related to court fees which will authorise them to retain a certain percentage of court fees to meet operational expenses.
- *University and Ministry of Foreign Affairs and Cooperation*
Based on our discussion with staff of these agencies we understand that fees are collected but not paid into official government bank accounts.

The instances described above appear to be directly in breach of Section 5 of UNTAET regulation 2001/13, which mandates that

- an agency cannot hold public money unless authorised by the Head of the Central Fiscal Authority or by separate legislation (Section 5.1), and
- public moneys received by an agency must be promptly deposited into an official bank account (Sections 5.2 and 5.3).



4 REVENUES NOT BANKED BY AGENCIES (CONTINUED)

These breaches are also problematic, because, as noted above, the Government's financial records are maintained on a cash basis and therefore the Government only records receipts when they are banked. In the absence of an effective process for reconciling revenue receipts between Treasury and the individual agencies, revenues which are not banked may not be recorded on the Central Fiscal Authority's financial records, a situation with two critical consequences:

1. The risk that funds may be stolen or used for inappropriate purposes is very high.
2. There is currently no way to accurately estimate the quantum of funds which may have been received by agencies and not banked, although we accept that in cases where this is known to have occurred the amount of funds are relatively small.

As a result, our audit relating to income was limited to ensuring that the amounts banked were properly recorded in the financial report. Accordingly, we do not express an opinion on whether all income has been banked and we cannot determine the effects of such adjustments, if any, as might have been determined to be necessary had this limitation not existed.

Recommendation

In addition to carrying out monthly revenue reconciliations as recommended in Point 5.1 above, agencies need to be made aware of their responsibility to bank all revenue received under regulation 2001/13. Adherence to this regulation should be made a key focus of the internal audit program.

(Rating **A**)

Management response

The Audit recommendation is noted. This issue will be pursued during the year. More checks and controls will be exercised to ensure that the money received by the agencies is banked in time.

Audit Conclusion



5 ASSETS

The following issues were identified with respect to assets.

1. The full listing of assets has not been completed and no complete physical verification of the assets of the Government was undertaken during the year.
2. Correct classification of capital items in the general ledger.

5.1 Asset Register

Audit Issue

Asset registers require additional work to ensure they are as free of discrepancies, as complete, and secure as possible.

Observation and Effect

The following issues were identified in regards to assets held by the Government:

- The detailed listing of assets has not been completed to include all assets purchased or donated to the Government;
- Land and Buildings and infrastructure assets have not been recorded or valued;
- The detailed listing of assets is maintained on an Excel spreadsheet, without adequate backup or procedures to maintain the security of the register;
- In some cases new assets are not being assigned asset identification numbers;
- Our audit of the available listing highlighted a number of errors in either the description, serial number, cost or location of the assets;
- Most Government agencies have prepared detailed listings of assets, however these listings have not been reconciled to actual purchases of assets for the year;
- Individual agency asset listings have not been crosschecked to the full listing of assets;
- No regular check/count of assets had occurred; and
- No depreciation has been charged against the assets.

If assets are not recorded on a detailed asset register and identified by way of an asset number the risk of assets disappearing increases. Furthermore if the Government adopts accrual accounting it will prove to be a very time consuming task to compile a detailed listing of all assets.



5.1 ASSET REGISTER (CONTINUED)

We understand that you are in the process of finalising the asset register and when the register is completed the details will be downloaded into Freebalance asset module.

Recommendation

We recommend that a full physical verification of all assets be undertaken prior to the listing being downloaded into Freebalance. Asset registers should be maintained for all agencies and regular counts of assets should be undertaken to ensure that the asset still exists and is in good working order.

We would further recommend that additions to the asset register be reconciled to the capital expense at least annually, to ensure that all assets purchased during the year are recorded in the asset register.

In addition the Government should develop a policy in relation to assets, this policy should at a minimum include the following:

- depreciation rates for classes of assets;
- setting of a threshold for assets to be capitalised;
- attractive and portable assets below the capitalisation threshold, which need to be accounted; and
- valuation requirements.

(Rating **B**)

Management response

- The detailed listing of Assets covering over 16000 items was completed in Excel format and shared with the auditors as well. As procurement/acquisition of assets is an ongoing process, this listing is being updated on a monthly basis. This data is being adequately backed up in the server, every Friday, with the support of ITU in the MOPF.
- Already Assets in excess of 12,000 items have been uploaded into the Free Balance system and these are being constantly updated, and reconciled with their physical verification details.
- It is true that assets that were being procured during the 1st quarter of the year were not initially bar-coded because the bar codes were out of stock. However, all serial numbers have since been captured and these assets are now bar coded.
- Land, buildings and infrastructure assets are not included in this Assets Register as these separately fall under the mandate of Lands & Property Department in the Ministry of Justice.



5.1 ASSET REGISTER (CONTINUED)

- The Assets Management staffs have been assisting the Government departments to establish their individual Asset registers.
- The policy issues related to the Assets will be addressed while preparing the Manual of Assets Management (and Property Disposal), which will be undertaken during the current year.
- The auditors are already aware of the efforts undertaken by the Treasury to reconcile the capital expenses with the Assets register. This reconciliation shall be undertaken at least annually so that all items treated as capital are recorded in the Asset Register with the Government.

Audit Conclusion



5.2 CLASSIFICATION OF CAPITAL ITEMS

Audit issue

Correct classification of capital items in the general ledger

Observation and affect

Costs associated with the purchase of capital items (four trucks, value \$127,800) were allocated into the Other Misc. Services general ledger account, rather than into a capital expense account. Discussion with Treasury officials revealed that the reason for this allocation was because the truck purchase related to a bridge refurbishment project. Management therefore considered that it would be appropriate to classify the expense of the trucks together with the other bridge construction costs. Although the trucks were expensed in the ledger, they were included on the asset register.

As Treasury moves towards accrual, rather than cash accounting, it will be required to correctly classify capital items in order to comply with International Accounting Standards.

Furthermore, if capital items are not correctly classified in the general ledger account it will not be possible to reconcile the Freebalance ledger account with the register of fixed assets. Under these circumstances, the risk that theft or loss of assets may go undetected by management increases.

Recommendations

Expenses associated with the purchase of fixed assets should be posted to the capital accounts, regardless of the purpose for which they are procured. The Freebalance capital accounts and the asset register should be reconciled on a regular basis.

(Rating **B**)

Management response

Following mid-year budget review the fund was set aside for the repair and maintenance of roads and bridges under goods and services. It was clarified by the agency that the repair and maintenance work could not be undertaken without the trucks. As reported by the agency, in the mean time the floods had swept away part of roads and it made this an emergency repair work.



5.2 CLASSIFICATION OF CAPITAL ITEMS (CONTINUED)

Accordingly, in view of clarification provided by agency in the various meetings, the trucks were bought as part of repair and maintenance work.

However, after the dump trucks were procured they were reflected in the asset register. In the future the agency will be required to provide detail justification while proposing budgetary allocation in classifying the expenditure.

Audit Conclusion



6. UNALLOCATED STOCK

Our review of unallocated stores identified the following two significant issues, which have been discussed in further detail in the attached schedules:

- 6.1 Obsolete stock was not written out of the unallocated stores listing during the year.
- 6.2 Procedures are required for recognising the value of donated stores and including it on the unallocated stores listing.

6.1 OBSOLETE STOCK

Audit Issue

No Procedures exist for writing off the value of obsolete stock

Observation and effect

Two stock items (8200 27 Fujitsu scanner) and (8200 28 Fujitsu computer servers), total value \$157,986 were listed on the inventory catalogue as obsolete. Obsolescence of this equipment was confirmed during the stock take. However, the write down in of these items had not been reflected either on the unallocated stores listing or on the Freebalance ledger.

All obsolete stock identified during the year should be written off at its cost or book value prior to 30 June. Otherwise, the value of inventory will be overstated and management may make incorrect decisions regarding the appropriate levels of inventory to be maintained on hand.

Recommendation

Review the inventory stores on a regular basis to identify obsolete stock. All items that identified as obsolete should be written down to their estimated recoverable value.

(Rating **B**)



6.1 OBSOLETE STOCK (CONTINUED)

Management Response

The Fujitsu scanners and Fujitsu computer servers (both totalling US\$ 157,986) are part of the old stock that are redundant/non-moving items, but are functional. They are reflected in the catalogue. Procurement Unit is developing a property disposal procedure for handling such non-moving/obsolete stocks items.

In the meantime, the non-moving items are being stored in Supply warehouse pending disposal. Supply and Inventory Management Unit has no authority to write-off such items.

Audit Conclusion



6.2 VALUE OF DONATED STOCK

Audit issue

Procedures are required for recognising the value of donated stores and including it on the unallocated stores listing.

Observation and effect

The stores inventory at 30 June 2003 included approximately \$100,000 (this figure is an estimate by warehouse staff) of motor vehicle parts donated by UNMISSET. These items were not contained on the unallocated stores listing. In addition, the value of this donation, and the associated inventory, has not been reflected by entries into the general ledger accounts in Freebalance.

If donated inventory is excluded from the unallocated stores listing, there is a danger that management will make incorrect decisions about inventory procurement. Furthermore, the ability of management to detect the theft or loss of such items may be compromised.

Recommendations

We recommend that procedures are introduced to allow donated stock to be valued, recognized on the unallocated stores listing and recorded in on the general ledger in Freebalance.

(Rating **B**)

Management Response

In many cases the donor organizations have not disclosed values of the donated items. Donated items are listed in a catalogue separate from the unallocated stores catalogue. Procedures for their issuance are being published in the Supply and Inventory Operations Manual currently under development.

Audit Conclusion



7. BANK RECONCILIATIONS

Audit issue

The following issues were noted in relation to the Bank Reconciliations:

1. The ledger balance of the bank accounts for the Civil Aviation, Maritime Port Authority and Banking Payments and Authority have not been updated and agreed to the reconciliation amount.
2. There are a large amount of unrepresented payments in the BPA bank reconciliation.

Observation and Effect

The bank reconciliation for the 2003 financial year was carried out while the audit was in progress. It had not been finalised, despite recommendations made after the 2002 audit and the 2003 interim audit.

The Bank Reconciliation for the Treasury BPA account does not agree to the General Ledger, as there is an unexplained or unrecognised reconciling item of \$22,840. This means that either or both the General Ledger and the Bank Account are misstated.

Recommendation

We recommend that bank reconciliations should be carried out on at least a quarterly basis, and preferably monthly. This will enhance the ability of management to detect error or fraud, and decrease the possibility of discrepancies occurring between the general ledger and the bank account.

We further recommend that a review of unrepresented cheques on the main bank account be undertaken and any adjustments necessary by undertaken.

(Rating **B**)

Management Response

Bank Reconciliation is carried out by the Treasury on a regular basis, quarterly, monthly and if necessary, sometimes on a daily basis. It is not correct to state that no bank reconciliations had previously been completed for the 2003 financial year. Had the Audit team looked in details into the bank reconciliations carried out by the Treasury, it would have been evident that the results of all the



7. BANK RECONCILIATIONS (CONTINUED)

bank reconciliations during the 2003 financial year were in place during the period of audit. In fact it may be observed that the final unreconciled amounts are much smaller this year as compared to that of the last year.

The reconciling item in the BPA account has been identified and necessary effects would, accordingly, be given in the General Ledger.

Audit Conclusion

While we accept that the monetary amounts which could not be reconciled are not necessarily material, the apparent failure of a key internal control is very concerning.



8. ACCOUNTS PAYABLE/COMMITMENTS

Audit issue

There may be a considerable time lag between the time at which a purchase order is created and a vendor or service provider is selected

Observation and affect

The Public Procurement Manual for Civil Administration in East Timor manual regulation 32.1 states that "The Procurement Unit issues a Purchase Order (Form PU-7) or other form of contract...to the vendor after acceptance of an offer". Of a total of \$14.9million of commitments listed at 30 June 2003, there were no vendors identified against a total of \$5.6 million of these commitments. Our observations suggest that the majority of commitments with no vendor at 30 June 2003 reflect situations in which the purchase order has been drawn up before the vendor is selected, in contravention of the procedures outlined in the procurement manual.

As of early September 2003 the audit team identified a number of commitments dating from 30 June 2003 where a vendor still had not been selected. Most of these commitments related to contracts for building construction and refurbishment. We understand from discussions with procurement staff that this lag occurs because expenditure decisions are made, and PO's approved, before the technical specifications for the works are provided by the department which requested the expenditure.

If commitments are recognised before project specifications are complete:

1. The dollar amount of future expenditure commitments as a whole may be grossly misstated,
2. It will be more difficult for management to estimate and control future cash flows, and,
3. Funds committed for individual projects may be grossly inaccurate.

There is also an increased risk that funds could be spent inappropriately or fraudulently against the purchase order concerned.

Recommendations

We recommend that paragraph 32.1 of the procurement manual is adhered to, and that purchase orders are drawn up only once a vendor is selected and has accepted the offer.

(Rating **B**)



8. ACCOUNTS PAYABLE/COMMITMENTS (CONTINUED)

Management response

These refer mainly to the capital projects, which management knew for sure that they would be implemented any time from the beginning and during the new fiscal year. Thus it was prudent to commit the funds. Controls that are in place at the Treasury cannot let any funds be spent inappropriately.

Audit conclusion