

Audit on Lelu Town Government

A Report to the
Governor
and the
Legislature of
the State of Kosrae



Stoney S. Taulung
PUBLIC AUDITOR



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October 30, 2018

The Honorable Governor, Lyndon H. Jackson
The Honorable Speaker, Tulensa W. Palik
The Honorable Members, 11th Kosrae State Legislature
Kosrae State Government
Kosrae State, Federated States of Micronesia 96944

Re: Performance Audit on Lelu Town Government

EXECUTIVE SUMMARY

We respectfully submit this Performance Audit, PA 01-2018, on Lelu Town Government covering the period of FY 2017-February 28, 2018.

The audit was performed in accordance with auditing standards generally acceptable in the United States of America and the standards applicable to performance audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. The audit was also conducted pursuant to Title 10 Chapter 4 of the Kosrae State Code. Furthermore, Lelu Town Financial Management Act and Lelu Town Charter were used as criteria for compliance.

The objectives of the audit were to determine whether (1) Lelu Town Government cash balances are accurate and complete, (2) Lelu Town Government disbursements made during the covered period are valid, complete and accurate, and (3) Lelu Town Government cash receipts are complete, accurate, properly recorded and timely deposited.

With reference to the specific objectives, we noted the following; (1) Lelu Town Government was not able to provide adequate documentation of its cash balances, 2) Lelu Town Government internal control did not ensure that disbursements made are authorized and adequately documented, and 3) Internal controls over collections are weak.

Based on our findings, we recommend (1) LTG to ensure that all supporting documents for disbursements are verified and approved prior to payment and council to pass a resolution to have an ordinance for financial management, (2) LTG Executive and Councils to reorganize the existing procedure on the cash handling with the consideration of the internal control on the segregation of duties and reporting, and (3) LTG to set up and maintain its book of accounts; individual ledgers to accommodate transactions on each type of assets, liabilities, revenues and expenditures to permit preparation of its financial statements.

Details of our examination are discussed in the findings and recommendations section of this report.

The Office of the Public Auditor provided draft copies of this report to the Mayor of Lelu Town Government and the Chairman of Lelu Town Government Council for review and comment on October 8, 2018. Attached with the report, as annex 1, is the Lelu Town Government management response, concurring to the auditors findings, dated October 29, 2018.

Respectfully submitted,


Stoney S. Taulung
Public Auditor

TABLE OF CONTENT

EXECUTIVE SUMMARY.....1

INTRODUCTION.....4

BACKGROUND.....4

Audit Objective.....5

Audit Scope.....6

Audit Methodology.....6

Conclusion.....7

FINDINGS AND RECOMMENDATIONS.....7

Finding 1.....8

Finding 2.....9

Finding 3.....11

MANAGEMENT RESPONSE.....12

PUBLIC AUDITOR’S COMMENT.....17

OPA ACKNOWLEDGEMENT AND CONTACT.....18

INTRODUCTION:

The Kosrae State Office of the Public Auditor (OPA) received a request from Lelu Town Government Council, as Resolution No. 10-61, to conduct an audit on Lelu Municipal Government in compliance with laws, regulations, and policies on the operational and financial activities.

BACKGROUND

Lelu is one of the four municipalities of Kosrae. The municipal governments are provided for in Title 8 of the Kosrae State Code. The Lelu Town Government has a charter, which provides for the structure and operation of a democratic government and other matters within its jurisdiction in a manner consistent with the law. The charter of a municipality remains in effect until amended or repealed. If a charter provision is inconsistent with a higher provision of law, the higher provision substitute for the charter provision. An affirmative referendum vote shall amend, repeals, or adopts a new charter. If not, ordinance may establish a procedure.

Like the other municipalities, Lelu Town Government has three branches of government and they are; the Executive, the Legislative, and the Judiciary. The executive authority of Lelu Town Government shall be vested in the Mayor. The Mayor shall be elected by majority of the qualified voters of the municipality at a general election. Mayor serves a term of 3 years and is responsible for the execution of ordinance and other functions established under the Lelu Town Government Constitution.

The legislative authority of Lelu Town Government is vested in the Municipal Council. The Council shall be composed of 7 members, who shall be elected at the general election by the qualified voters and shall serve a term of 3 years. It is the responsibility of the Council to set, provide policies and guidelines through the office of the mayor.

The Lelu Town Government has its own Manual of Administration. LTG's Manual of Administration was updated and in effective in October 2005. The manual is designed to provide policy and guidelines for the operation of Lelu Town Government. It contains policies for employment, personnel management, and related administrative functions. This manual is subject to change by the office of the Mayor but must have prior approval by the Lelu Town Government Council.

In the Manual, the accounting of all LTG fund is vested in the Treasurer. The Treasurer shall ensure that all transactions of funds are in compliance with the approved uses. The Treasurer is

required to provide financial accounting report to the Mayor and Council for all fund types on a regular basis. Moreover, the Treasurer shall submit monthly financial reports to the Mayor and Council. Such financial reports should include; the Statement of Condition (Balance Sheet), Statement of Revenue & Expenditures and LTG Property (Fixed Asset) Inventory Sheet. Treasurer must also provide detail reports upon request by the Mayor and Chairman. There are three types of funds for the Treasury, which the Treasury shall maintain as prescribed by ordinance; the Local Revenue Fund¹, Development Fund² and Jan/18 & Sept/8 Fund³.

A Cash Receipt voucher is prepared upon receipt of cash from any source. Such receipt must be posted on a daily basis by the Treasurer. Copies of all cash receipts must be stored in a safekeeping location. Treasurer must prepare a summary report on all cash receipt on a monthly basis. Disbursement of cash must first have a document authorizing the expense. For payroll expense, timesheet must be submitted and approved prior to disbursement. For all other expenses, an expense receipt must be kept to justify the release of funds. Treasurer shall not release any LTF fund without supporting documents.

LTG Revenue & Expense policy is accounts should be established for all revenue sources to ensure all income (revenue flows) are identified as; Restricted Income are grants, projects and donations for specific purposes and Unrestricted Income are license fees, revenue shares, transfer from state and national government, donations without specific purposes and other miscellaneous income. Expenditures policies must be in accordance with approved budget for a given fiscal year. Restricted income should be expended in accordance with applicable rules governing the funding source.

LTG Treasurer should carry a Chart of Accounts to account for all funding and its uses. Treasurer shall structure the accounts with numeric codes to include Asset, Liabilities, Equity, Revenue and Expenses. New accounts may be added if determined necessary.

AUDIT OBJECTIVE

The objectives of our audit are to determine;

1. Whether the Lelu Town Government cash balances are Accurate and Complete;
2. Validity, Completeness and Accuracy of disbursements made during the period;
3. Whether cash receipts are Complete, Accurate, Properly Recorded, and Timely Deposited.

¹ Business licensing fees, State revenue sharing, State operation subsidies, and other miscellaneous income such as rental payments, lease payments, etc.

² Kosrae State Government funds, FSM National Government funds, Foreign Assistance

³ Special Revenue Fund- contributions from private businesses, citizens and governments both locally and abroad to promote Jan/18 and Sept/8 activities.

AUDIT SCOPE

The audit scope covers period of FY 2017 to February 28, 2018. We have summarized all the disbursements for the period and noted incompleteness of documents submitted for review and evaluation. However, we examined available receipts and disbursements for the period covered. We gathered information from the office of Lelu Town Government. This is the second time an audit has been conducted on Lelu Town Government. We conducted the inspections pursuant to Kosrae State Code Title 10, section 4 which stated in part:

- “(a) The Public Auditor shall inspect and audit personally, or by his duly authorized assistants, all account, books, and other financial records of the State Government, to include but not be limited to, every branch, department, office, political subdivision, board, commission, agency, other public legal entity (owned, or partially owned by the state), whether they receive public funds or not, and nonprofit organizations that received public funds from the State Government;
- (b) Inspect and audit personally, or by his duly authorized assistants, the fiscal books, records and accounts of all allottees and other custodians of public funds, making independent verification of all assets, liabilities, revenues, expenditures and obligations of the State Government, entities owned in whole or part by the State Government, and agencies of the State Government;
- (c) Inspect and audit personally, or by his duly authorized assistant, the fiscal books, records, and other financial records associated with any project, program and activity receiving funding in whole or in part from public funds of the State Government, including the records of any contractor performing public work on a cost-reimbursement-type contract in order to verify the cost charged to the public contractor;
- (d) Inspect and audit personally or by his duly authorized assistants, the books, records, accounts, and other financial records associated with business sales that may be used for sales assessment for tax collection purposes”

AUDIT METHODOLOGY

The audit was conducted in accordance with generally accepted government auditing standard (GAGAS). Those standards requires that we plan and perform the audit to obtain, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

In planning our examination, we obtained sufficient understanding of the internal controls that is material to the audit objectives to plan the engagement and design the audit procedures. Based on this assessment, we reviewed documents and records relevant to the project.

We considered compliance to the state laws and regulations to be able to render an opinion to our audit objectives. Our procedures were also designed to identify weaknesses on internal controls that are material to the expression of an opinion to our audit objectives.

Audit procedures included, but were not limited to, interviews of Lelu Town Government employees. We also review their transaction processes and documentations. In addition, we perform assessment on the implementation of a previous audit. The audit criteria used to develop the required audit tests were based on (1) the State Financial Management Regulation, (2) the Lelu Town Government Manual of Administration and 3) Lelu Town Government Charter.

PRIOR YEAR AUDITS/REVIEWS

This is the second time that a separate audit / examination was conducted with the Lelu Town Government.

CONCLUSION

Based on the audit objectives, we concluded that:

1. Lelu Town Government was not able to provide adequate documentation of its cash balances.
2. Lelu Town Government internal control did not ensure that disbursements made are authorized and adequately documented.
3. Internal controls over collections are weak.

FINDINGS AND RECOMMENDATIONS

Finding Number 1: Lelu Town Government disbursement does not comply with the LTG Financial Management Regulations and Manual of Administration resulting to questionable transactions.

Condition: Our examination was applied to all disbursements made by the Municipality for the period covered and noted the following findings:

- a. Checks issued files are incomplete for the covered period. Forty-eight percent (48%) or 10 pcs out of 21 pcs of void checks does not have original copy on file.
- b. Thirty-three percent (33%) of the total amount of disbursements aggregating to \$25,093.55 were completely unsupported by the required disbursement documents.
- c. Included in the unsupported check voucher are 3 checks drawn in the name of the Mayor amounting to \$1000 per check (\$3000) apparently should be classified as cash advance to purchase supplies in Pohnpei during his travel. The treasurer confirms that there is no liquidation for this amount up to the time of the audit.

Criteria: 1. Article IV of the Lelu Town Government Financial Regulation Act subsections provide that the Treasurer shall (a) 1. *Public money raised or received by the LTG shall be deposited within the Lelu Town Government Treasury. No money shall be withdrawn from the LTG Treasury except in accordance with appropriations or authorizations by law; and (2) The Treasurer shall have full responsibility on Collection, administration, & safekeeping of all funds in the LTG treasury and for disbursements from the treasury.* Therefore, maintaining detailed records of funding status, revenues, and disbursement of Municipal funds.

2. LTG manual of administration Part II provision 12.10 provides *disbursement must first have a document authorizing the expense. For all the expenses, an expense receipt must be kept to justify the release of fund. Treasurer shall not release any LTG fund without supporting documents.*

Cause: Failure of the management and the Treasurer to impose and comply with the responsibilities set forth in the Municipal Charter and Manual of Administration

Absence of an ordinance to provide detailed policies and procedures (*e.g. Financial Management Act*) to deal with specific control procedures, books of accounts, filing system, document retention period, consequences of non-compliance and etc.

Effect: Arising from this condition, the auditors were unable to determine whether funds disbursed were valid or authorized. Matters of propriety and legality of unsupported disbursements cannot be determined. Loss of government funds for unauthorized disbursements.

Recommendation: We recommend compliance to the provisions of the Municipal Charter.

We also strongly recommend that the council pass a resolution to have an ordinance for financial management. Financial management rules and procedures that will include specific functions of the treasurer, books of accounts, preparation of bank reconciliation schedules, document filing system and retention period of disbursement documents such as disbursement voucher, vendor's receipts and invoices and other supporting documents.

The municipality should ensure that all supporting documents for disbursements are verified and approved prior to payment. Pre-numbered voucher should indicate clear and detailed purpose of disbursement with the certification of what budget or appropriation to be charged with. Voucher numbers therein should be the basis of filing along with all supporting documents. By doing so, a systematic filing of disbursement documents can be easily achieved. Approval of check vouchers should be delegated to the Treasurer and/or Mayor and/or a representative of the council and should be in accordance with proper internal control system.

Finding Number 2: Weak Internal Control on Cash Transactions.

2.1 No Segregation of Duties

2.1a Collection

Condition: During our examination, we have noted that the municipality has no formal control procedures over collections. Review of the internal controls over cash receipts, we noted that the Mayor is responsible for the collection and deposit of funds and subsequently updating the cash receipts journal. These collections are from ordinances imposing taxes and all other revenues or reimbursements collected based on fines, fees, licenses, interests, rents or government services. And we noted in most cases that these collections are being paid in cash which is vulnerable to misappropriation.

The auditors noted and verified that the collection process is basically conducted by the mayor office. The mayor's secretary receives collection and prepares receipts for collection while mayor keep the money, do the deposit, keep the receipt stubs, deposit slips and bank statements. All the documents for cash transactions were kept by the Mayor and submitted to the Treasurer for recording, but not in the regular manner.

In addition, no cash book is being maintained to record amounts collected. Schedule of deposits showing the receipts used to match with the validated deposit slip amount are not being prepared. Further, there are no review procedures to check if funds collected were properly and timely deposited.

2.1b Disbursement

Condition: Disbursement and approval function are not segregated from recording function. The Mayor/staff handles the preparation of check disbursement and at the same time performs the recording in the disbursement journal. Only Individual ledger was being maintained by the treasurer. Yet, the Mayor is one of the authorized signatories for the checks, approving officer at the same time for purchasing activities.

2.2 No Procedural Control on Checks and Cash Items

Condition: During fieldwork, the auditors observe and confirm that blank check stock and cash collection were being maintained by the Mayor in his desk drawer with no locks and sometimes at Mayor' house. In addition, no physical inventories of blank check stock periodically conducted by person independent from the cash disbursement function.

2.3 No Procedural Control on Detail Accounting of Cash and Cash Items

Condition: Lelu Town Government does not have procedures to ensure that collections and disbursements are accurately and promptly recorded. No periodic checking and review is being made for cash transactions. Hence, LTG did not performed Bank Reconciliation for the period covered.

Criteria: Best practice in Internal Control Procedure dictates control on segregation of duties on custodianship, authorization and recording functions for a transaction.

Cause: The condition resulted from inability of the management of Lelu Town Government to establish and implement a policy to include prudent internal controls.

Effect: High probability of abuse of authority and mishandling of fund.

Recommendation: That the executive and councils of LTG reorganize the existing procedure on the cash handling with the consideration of the internal control on the segregation of duties and reporting such as:

1. Schedule of deposits showing the cash receipts used must be prepared and filed in every deposit transaction along with the validated deposit slip. We also recommend that a person not connected with the collection and depositing process inspect on a regular basis to ensure that all collections have been properly and timely deposited.
2. Perform timely Bank Reconciliations (monthly) to ensure;
 - a. Comparison of checks in appropriate detail with disbursement records.
 - b. Accounting for numerical sequence of cashed checks.
 - c. Examination of signatures and endorsements on a test basis.
 - d. Comparison of book balances used in reconciliations with the general ledger
 - e. Comparison of deposit amounts and dates with cash receipt entries
 - f. Investigation of outstanding items
 - g. Footing of cash books.
3. Physical inventories of blank check stock periodically conducted by persons independent of the cash disbursement function, and reconciled to department records.

Finding Number 3: Absence of Books of Accounts

Condition: Lelu Town Government only maintains cash disbursement journal to record payments made on various expenditures incurred and cash receipts journal to record collections arising from local revenues including funds received from revenue sharing. The Municipality does not maintain individual general ledgers to accommodate transactions involving its assets, liabilities, but only fund balances, revenues and different types of expenses are being maintained. We also noted that some expenses are not properly classified to its nature.

Interview with the treasurer confirms that the recording and maintenance of books of accounts was not done regularly because of unavailability of documents which was usually kept by the mayor.

Criteria: A government accounting system must make it possible to present the financial position and results of financial operations including funds and account groups of the governmental unit, in conformity with Generally Accepted Accounting Principles (GAAP). Therefore, a complete self-balancing group of accounts should be established, which should include but not limited to: general ledger, subsidiary ledgers, cash receipts journal, cash disbursements journal, payroll journal, encumbrance journal, and general journal.

Cause: The cause of the above condition is the failure of the Mayor and the Treasurer/or personnel responsible to set up and maintain individual ledgers to accommodate financial transactions of the municipality.

Effect: Arising from this condition, the auditors were unable to determine the completeness and accuracy of cash transactions. The municipality was not able to prepare accurate financial reports such as Statement of Assets and Fund Balance, and Statement of Operations. Some disbursements were made in excess of the budgeted amount.

Recommendation: We recommend Lelu Town Government to set up and maintain its books of accounts. Individual ledgers must be prepared to accommodate transactions on each type of assets, liabilities, revenues and expenditures especially with its classes to permit the preparation of its financial statements. Subsidiary ledgers must be maintained necessarily in keeping track of individual vendors/contractors. By doing so, relevant and reliable financial information can be easily obtained which is useful for management's decision making.

Management Letter Response: Annex I



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October 29, 2018

Hilton M. Phillip
Chairman

Yoshiro Abraham
Vice Chairman

Billy Palik
Floor Leader

MEMBERS

Osamu Nedlic
Chairman W&M

Presley Abraham
Chairman I&GO

Leonard Sijrah
Chairman R&D

Roland Isisaki
Chairman HESA

Mr. Stoney Taulung
Chief Auditor,
Kosrae State Public Auditor's Office

Re: Management Response to Audit Findings

Dear Mr. Taulung,

Greetings from the office of the Lelu Town Council. Hope this communication finds you in the best of health and in high spirit.

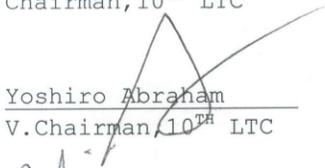
This communication is being presented to acknowledge the hard work and the tireless efforts that were put in place by your respective staffs in conducting the recent audit for the Lelu Town Government. The office of the Lelu Town Council is very pleased to have received your findings and we are somewhat disappointed that the Mayor of the Lelu Town Government has not cooperated with your staff in providing his response to your findings. Mayor Alokoa has verbally informed the council that he will not respond to your findings. With that the council is compelled to provide a response to your finding with additional recommendations. Kindly refer to the attached document stating the management response to the recent findings during your audit. This council is in accord with some of your finding which is indicated in the attached document and we also added some of our recommendations to your findings and hope that we can work together to solve some of the misunderstanding in the operation of the Lelu Town Government on how to manage our financial system most especially in the executive branch.

This office wishes to thank you and your respective staff for your work and hope that we can close out the audit at the earliest time possible so that we can move forward in managing the office of the Lelu Town Government in the most transparent and accountable fashion for a brighter future.

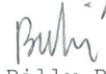
Regards,


Hilton Phillip
Chairman, 10TH LTC

Date : 10/29/18


Yoshiro Abraham
V. Chairman, 10TH LTC

Date : 10/29/18


Billy Palik
Floor Leader

Date : 10/29/18


Presley Abraham
Chairman, J&GO

Date : 10/29/18


Osamu Nedlic
Chairman, W&M

Date : 10.29.18


Leonard Sigrah
Chairman, R&D

Date : 10.29.18


Roland Isisaki
Chairman, Hesa

Date: 10/29/18

Finding Number 1: Lelu Town Government disbursement does not comply with the LTG financial management regulations and Manual of Administration resulting to questionable transaction.

Management Response and Recommendation:

The members of the 10th Lelu Town Council hereby concurred to your findings and recommendation. This Council also agree to provide a resolution for the purpose of enforcing its Financial Management Act. This Council also recommend that a full prosecution for criminal offense under any misuse of public funds under the Lelu Town Government shall be prosecuted under law.

Finding Number 2.1 No Segregation of Duties

Management Response and Recommendations:

The members of the 10th Lelu Town Council are in accord with your recommendations we also added our own response and recommendations as we see fit. Following are your findings with our own recommendations. 2.1a Collection, 2.2b Disbursement, 2.2 No procedural control on checks and cash items, 2.3 No procedural control on detail accounting of Cash and Cash Items.

2.1 (a) Collection:

Collection of all funds received by the Lelu Town Government whether it was received in the form of cash or check shall be deposited in the Lelu Town Treasury. The Lelu Town Government do have an internal control system over cash received which was being handled by the Treasurer until Mayor Floyd was elected as the Mayor of Lelu Town Government in Septemeber 2017. It is clearly indicated in Part 12.1 and Part 12.10 of the Lelu Town Government's Manual of Administration that the accounting of the all LTG fund is vested in the Treasurer. Collection of any cash receipt from any outside source of funds shall be the duty of the Treasurer and not the Mayor nor the Mayor's secretary or any person working for LTG except the Treasurer of the Lelu Town Government.

- We recommend that prosecution under the criminal offense for any misuse of public funds shall be prosecuted to the fullest effect of law.

2.1 (b) Disbursement:

Disbursements of any funds of the Lelu Town Government must first be authorized by the LTG Treasurer with the understanding that the Treasurer must first require supporting documents before releasing such fund. Lelu Town Government Manual of Administration clearly indicated that all disbursements of funds from the Lelu Town Government is vested in the Treasurer and not the Mayor. The Mayor/his staff and his wife or any other person are not authorized to prepare checks under the LTG. The only person authorized to prepare checks under the LTG is the Treasurer. There are numerous times that the Mayor or his wife had prepare checks for LTG which is against the law as the Mayor is

one of the signatories for LTG and for the Mayor to prepare checks it would lead to misuse of government funds.

- We recommend that prosecution under the criminal offense for any misuse of public funds shall be prosecuted to the fullest effect of law.

2.2 No procedural control on checks and cash items:

Possessions of LTG blank checks stocks and cash collection by the Mayor at his office drawer and at his residential home. This is subject to unauthorized use of public funds due to the Mayor being a signatory for LTG checks. Cash collection should be collected by the Treasurer and not the Mayor. Cash collected by the Mayor has not been accurately recorded and it could lead to unauthorized use of public funds. Any cash receive by the LTG shall be deposited and shall be appropriated for its purpose and use before any release of funds.

2.3. No procedural control on detail accounting of cash and cash items:

The Mayor of the LTG has removed and extracted the duties of the Treasurer of the LTG which has cost the absence of collection and disbursement records starting from September 2017 to October 2018. The LTG Mayor shall be held liable for all missing documents which has not been recorded prior to its collection and disbursement of funds.

- This council recommends that prosecution under the criminal offence for any misuse of public funds shall be prosecuted to the fullest effect of law.

Finding Number 3: Absence of Books of Account.

Management Response and Recommendations:

The 10th Lelu Town Council hereby review the findings and have confirmed that the absence of all books of accounts has been kept by the Mayor on his first day at office. The Lelu Town Treasurer could not provide accurate financial reports such as statement of assets, fund balance and statement of operation due the unavailability of these documents which is kept by the Mayor without transmitting such documents to the Treasurer for filing purposes. This body authorizes your institution to take every measure in retrieving such documents from the Mayor's office or at his residential home. We have repeatedly requesting his office to provide those documents to your office and he has not provided such information until today. This office recommends that you work with the office of the State Attorney General Office to assist your office in retrieving such documents to complete your audit. Mayor Floyd had continuously disbursed public funds in excess of budgeted accounts which is a clear indication that the funds obligated from other budget accounts were not hear marked for the purpose of the disbursement.

Your recommendations are well noted and the management hereby concurred to your recommendations and will work on your recommendations to better equip this office in the future to provide a systematic financial procedure for the office of the Lelu Town Government to set up a more transparent and accountable financial system to be used for years to come.

PUBLIC AUDITOR’S COMMENTS

We would like to extend our appreciation to the Lelu Town Government for their cooperation and assistance throughout the course of our audit.

In compliance with government auditing standards, a copy of this draft report was shared with the Mayor and Chairman of the LTG Council to provide response to the findings.

In addition to providing copies of this report to the Mayor, Chairman of the Council and Council Members, we also extend copies to the following officials:

1. Governor, Kosrae State
2. Speaker, 11th KSL
3. Members of the 11th KSL
4. Chief Clerk, Kosrae State Court
5. V6AJ Radio
6. Attorney General, Kosrae State

If there are any questions and concerns regarding this report, please contact the Office of the Public Auditor.


Stoney S. Taulung
Public Auditor

ACKNOWLEDGEMENT AND OPA CONTACT

Audit on Lelu Town Government

Report No. PA 01-2018

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ACKNOWLEDGEMENT Emma P. Balagot, Audit Manager
The audit staff that make key contributions to Alice S. George, Auditor III
the report Elizabeth Jonah, Auditor II
Reed J. Floyd, Auditor I

OPA Mission Conduct effective and efficient audits and
investigation to ensure that Government
resources are properly managed

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