

## U.S. Department of the Interior Office of Inspector General



*Photo Left: Kosrae  
Department of Education  
(Office of Inspector  
General Photo)*



*Photo Right: Desks  
and Chairs Stored at  
Kosrae High School  
(Office of Inspector  
General Photo)*

### **Kosrae State, Federated States of Micronesia:**

### **Property Accountability Process Needs To Be Improved**

**Report No. P-EV-FSM-0001-2007**

**October 2007**



# United States Department of the Interior

## Office of Inspector General

Washington, D.C. 20240

October 17, 2007

The Honorable Robert Weilbacher  
Governor of Kosrae State  
Federated States of Micronesia  
P.O. Box 187  
Tofol, Kosrae FM 96944

Re: Final Evaluation Report *Kosrae State, Federated States of Micronesia: Property Accountability Process Needs To Be Improved* (Report No. P-EV-FSM-0001-2007)

Dear Governor Weilbacher:

This report presents the results of our evaluation of Kosrae State Government's property accountability process (Report No. P-EV-FSM-0001-2007). The objective of our evaluation was to determine whether your Government's accountability process safeguarded supplies and equipment to minimize the risk of fraud, waste, and mismanagement. We evaluated property accountability for supplies and equipment purchased with grant funds for health and education, which totaled 65 percent of the \$6.5 million in financial assistance provided to Kosrae State by the Office of Insular Affairs<sup>1</sup> (OIA) in 2006. We also evaluated inventory practices for Kosrae State by testing equipment used by the Department of Education (DOE). The scope and methodology of our evaluation are detailed in Appendix 1.

## Results of Evaluation

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Kosrae State did not provide reasonable accountability over supplies and equipment purchased with health and education grant funds. Under the Fiscal Procedures Agreement (FPA) between the United States and the Federal States of Micronesia,<sup>2</sup> Kosrae, as one of the Federated States, agreed to "maintain effective controls and accountability for all Grant and Sub-Grant cash, Real Property, and personal property, and other assets to safeguard and ensure uses are solely for authorized purposes." The

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<sup>1</sup> The Department of the Interior's (DOI) OIA provides financial assistance to the Federated States of Micronesia through a Compact of Free Association. The financial assistance, usually in the form of grants, is targeted at high priority areas, such as health and education, to promote the financial and social well-being of the States.

<sup>2</sup> *Agreement Concerning Procedures for the Implementation of United States Economic Assistance Provided in the Compact of Free Association, as amended, Between the Government of the United States of America and the Government of the Federated States of Micronesia*

FPA establishes equipment management requirements, including the following two property accountability procedures.

1. Maintenance of an inventory of all property having a useful life of more than 1 year and an acquisition cost of \$5,000 or more. Information required for each piece of equipment included, but was not limited to, a description of the property, a serial number or other identifying number, the date and cost of acquisition, the percentage of U.S. funding used, and the property's location and condition.
2. Performance of a physical inventory of property and reconciliation of results with the property records at least once every 2 years.

Kosrae State's commitment to "maintain effective controls and accountability" requires that it design and implement, as necessary, additional procedures and controls to safeguard supplies and equipment from fraud, waste, and mismanagement. We found that Kosrae State had established supplemental procedures and controls in the areas of recordkeeping, property identification, and inventory policies. For example, its Financial Management Regulations (FMR) reduced the equipment accountability threshold to \$1,000 or more and added a requirement for property custodians to report all property in their control to the Department of Administration and Finance every 6 months. However, responsible personnel in Kosrae State's Departments of Administration and Finance, Health, and Education either did not perform property control duties required under the FPA and FMR or were ineffective in their efforts. In addition, policies and procedures were not sufficient to provide effective control. As a result, your Government has no assurance that supplies and equipment purchased for the Kosrae State Hospital (Hospital) and schools were used for authorized purposes or were protected from fraud, waste, and mismanagement. We made five recommendations to help improve property accountability. We believe that implementation of these recommendations will help Kosrae State develop an effective, accountable, and transparent local government.

## **Hospital Supplies**

Based on the results of our review, we concluded that Kosrae State cannot provide assurance that funds expended for medical supplies and pharmaceuticals were used for authorized purposes. The Hospital did not follow inventory policies established to account for, protect, and ensure the proper use of medical supplies and pharmaceuticals, including narcotics identified as controlled substances under the Controlled Substances Act because of their high potential for abuse.<sup>3</sup> Of the \$1.76 million in grant funds received for health in fiscal year 2006, we identified \$445,016 that was expended on consumable goods, including medical supplies and pharmaceuticals, purchased for the Hospital.

We tested the reliability of the Hospital pharmacy's inventory system by reviewing purchases and distributions of 12 controlled substances made between June 2006 and February 2007. We identified mathematical and recording errors in the records,

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<sup>3</sup> The Controlled Substances Act, Title II of the Comprehensive Drug Abuse Prevention and Control Act of 1970, 21 U.S.C. §§ 801-971, is the legal foundation for the U.S. Government's fight against drug abuse.

which, when adjusted and compared to actual counts, revealed significant variances in 3 of the 12 controlled substances, as shown in the following table.

Variances in Three Controlled Substances				
Drug	Amount on Inventory	Actual Count	Variance	
			Overage	Shortage
Tylenol with Codeine	179	349	170	
Valium	1,449	1,353		96
Phenobarbital	3,793	3,677		116

We were not able to determine the specific causes of the shortages because of deficiencies in the pharmacy's inventory practices. For example, pharmacy employees admitted that they sometimes distributed controlled substances to Hospital wards without written prescriptions. Further, they told us that they periodically adjusted the inventory balances of pharmaceuticals on hand to agree with their physical counts of pills, injectibles, and solutions without ascertaining the causes of the discrepancies. They also informed us that they had not been using an automated inventory system since December 2006 because of a lack of prescription labels.

## Education Supplies

Kosrae State received \$2.41 million for education in fiscal year 2006. With the assistance of Kosrae State officials, we identified a total of \$513,950 expended by DOE for fixed assets and consumable goods, which included supplies and equipment. We judgmentally selected and reviewed 10 large transactions totaling \$360,460 to determine whether supplies and equipment were received by intended recipients and used for authorized purposes. Based on logbook and other records, DOE was able to confirm that purchased textbooks were received and distributed to the schools. We found, however, that DOE did not maintain logbooks or other records to show how other supplies and equipment were distributed or used. As a result, there was no way to verify that these items, such as printers, printer supplies, typewriters, and even lumber and chain saws, were distributed to the schools or used for education purposes. In addition, we could not verify that two transactions for furniture, totaling \$95,202, were reasonable or appropriate and have referred these transactions to our Office of Investigations for review.

## Equipment

Based on the results of our review, we concluded that Kosrae State cannot ensure that equipment and personal property purchased with grant funds were adequately accounted for and protected from unauthorized use, theft, or loss. Kosrae State's FMR supplements FPA requirements by reducing the acquisition cost threshold to \$1,000 or more and by requiring that certain items, such as desks, chairs, printers, and computers, be included in the inventory regardless of acquisition cost. In addition, the FMR requires that property custodians provide a list of property under their control to the Director of

Kosrae State's Department of Administration and Finance or his designee every 6 months indicating any changes, such as acquisitions not previously reported, damaged property, or any disposition of property.

According to Kosrae State's Department of Administration and Finance, Division of Property and Supply officials, a physical inventory was last performed in 2003. However, they could not provide us with any supporting documentation showing that an inventory was performed during that period or how inventory discrepancies, if any, were resolved. Using an inventory listing dated September 2006, we sampled 223 out of a total of 283 items held by DOE. (See the Appendix for a discussion of our sample.) We found the following:

- None of the items had serial numbers shown on the inventory listing.
- 186 items did not have property tag numbers shown on the inventory listing.
- 125 items, valued at about \$470,000, could not be found.

During our testing, we found 60 items with property tags that were not included on the inventory listing. Further, we noted that items required by the FMR to be listed on the inventory regardless of cost did not include similar items like digital cameras, camcorders, battery backups, sewing machines, and televisions that were purchased with grant funds. During our visits to DOE offices and three schools, we observed 132 of these sensitive items, which we estimated to be valued at about \$25,000.

## **Recommendations**

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To ensure that there are effective controls over supplies and equipment purchased with Compact funds, we recommend that the Governor of Kosrae State:

1. Enforce established ordering and inventory control policies for pharmaceuticals dispensed by the pharmacy.
2. Enforce inventory control policies and a recordkeeping system to account for school supplies.
3. Enforce inventory requirements of the FPA and FMR and supplemental policies, which have been identified as critical for achieving accurate physical inventories.
4. Expand the list of items required by the FMR to be inventoried regardless of cost to include digital cameras, camcorders, cell phones, and other sensitive items.
5. Establish cyclical management reviews to assess compliance with established inventory and property accountability policies and hold appropriate officials accountable for compliance through their performance appraisals.

In your September 10, 2007 response to our draft report (Appendix 2), you concurred with our findings and recommendations. Based on your response, we consider Recommendations 4 and 5 to be resolved but not implemented. However, your response did not provide sufficient information for us to consider Recommendations 1, 2, and 3 resolved. Accordingly, we are requesting that you provide us with the information shown in Appendix 3 of this report.

The legislation, as amended, creating the Office of Inspector General requires that we report to the Congress semiannually on all reports issued, actions taken to implement our recommendations, and recommendations that have not been implemented.

Please provide a response by November 30, 2007. Your response should provide the information requested in Appendix 3. Please address your response to Mr. Kevin Graves, Acting Field Supervisor, Honolulu Field Office, 2800 Cottage Way, Suite E-2712, Sacramento, California 95825.

We appreciate the cooperation shown by Kosrae State during our evaluation. If you have any questions regarding this report, please call me at (202) 208-5745.

Sincerely,

A handwritten signature in black ink, appearing to read "Earl E. Devaney", written in a cursive style.

Earl E. Devaney  
Inspector General

cc: Honorable Miriam K. Hughes, Ambassador, Federated States of Micronesia  
Chairman, Joint Economic Management Committee  
David B. Cohen, Deputy Assistant Secretary for Insular Affairs  
Nikolao Pula, Director, Office of Insular Affairs  
Marina Tinitali, Audit Liaison Officer, Office of Insular Affairs  
Honolulu Field Office, Office of Insular Affairs

## Appendix 1

# Objective, Scope, and Methodology

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The objective of our evaluation was to determine whether the accountability process safeguarded supplies and equipment to minimize the risk of fraud, waste, and mismanagement. We reviewed accountability for supplies and equipment purchased with Health and Education sector grant funds as these two sectors received 65 percent of the total funding provided to Kosrae State in fiscal year 2006.

We conducted our evaluation from February to April 2007. Our evaluation was conducted in accordance with the January 2005 *Quality Standards for Inspections* issued by the President's Council on Integrity and Efficiency. To accomplish our objective, we:

- Reviewed the legal and regulatory framework for U.S. financial assistance to the Federated States of Micronesia, including the Compact of Free Association, subsidiary agreements, grant documents, and Kosrae State's financial management regulations. These documents establish numerous property accountability requirements and procedures.
- Reviewed reports by the Government Accountability Office that were applicable to our evaluation of property accountability.
- Reviewed and evaluated internal controls related to property accountability.
- Performed tests of property records to evaluate the adequacy of property controls and to verify the accuracy of property records. Kosrae State officials provided inventory listings showing a total of 867 property items. However, we limited our testing to the 283 property items controlled by DOE. Out of the 283 items, we judgmentally excluded 60 items identified as being vehicles and heavy equipment or located at four elementary schools that we did not plan to visit. Our judgmental sample therefore consisted of 223 property items.
- Performed tests of purchases made during fiscal year 2006 to determine if supplies and equipment were properly accounted for. We tested the reliability of the pharmacy's inventory system by reviewing purchases and distributions of



12 controlled substances made between June 2006 and February 2007. We also judgmentally selected and reviewed 10 large purchases totaling \$360,460 made by DOE in fiscal year 2006.

- Interviewed officials from OIA and Kosrae State.
- Reviewed DOI's *Fiscal Year 2005 Performance and Accountability Report*, including information required by the Federal Manager's Financial Integrity Act. DOI reported the need to increase the economic self-sufficiency of insular areas and address persistent program management problems.

The scope of our evaluation did not include a comprehensive review of Kosrae State's financial accounting and reporting controls. However, during our evaluation, we were advised by OIA officials that the Kosrae State Government diverted and misused at least \$1.025 million of Compact sector monies. Because OIA officials, who are responsible for Compact oversight, were taking action to determine how the diversion occurred and to recover the Compact sector funds, we did not consider it necessary to further evaluate the issue.



## Appendix 2

# Kosrae State Government Response

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## GOVERNMENT OF KOSRAE

Office of the Governor

Post Office Box 158

Kosrae, Federated States of Micronesia 96944

Telephone: 691-370-3002/3003..Facsimile: 691-370-3162

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September 10, 2007

Ms. Anne L. Richards  
Assistant Inspector General for Audits  
U.S. Department of the Interior  
Office of Inspector General  
1849 C Street, NW, MS 5341  
Washington, D.C. 20240

Re: Draft Report : *Kosrae State, Federated States of Micronesia: Property Accountability Process Needs to be Improved*  
(Assignment No. P-EV-FSM-0001-2007)

Dear Ms. Richards:

We sincerely appreciate the opportunity given to us to review and comment on the subject draft report on Kosrae State Government's Property Accountability Process. In our examination of the report, we reached the same conclusions on areas cited that need immediate attention for improvement and compliance. The report provides a useful tool upon which to formulate measures to improve our internal procurement process.

### Findings/Results of Evaluations

We concur to the results and findings of the report that Kosrae did not provide reasonable accountability over supplies and equipment purchased with health and education grant funds.

#### Hospital Supplies

We concur to the findings on Hospital Supplies accountability. The overage of 170 tablets of Tylenol with Codeine could have resulted from donations made by Canvasback Mission as these wouldn't have shown up on purchase records. The shortages of Valium and Phenobarbital were most likely due to pharmacy filling prescriptions using patients discharge notes without actual doctors' prescriptions. The Department of Health Services has required the pharmacy to issue controlled drugs per discharge notes only upon valid and signed doctors' prescriptions.

#### Education Supplies/Equipment

We concur to the findings on Education Supplies and Equipment accountability. The Director of

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Letter to Ms. Anne L. Richards

Page 1

"SHAPING TOMORROW TODAY"




Department of Education is in the process of hiring a Property Custodian on a contractual basis to be responsible for the overall supplies and equipment procurement and inventory processes for the whole Department of Education. This person should be onboard no later than the end of October 2007. The Director of the Department of Education will work closely with the Director of the Department of Administration & Finance to complete a physical inventory that would, among other things, ensure that property and sensitive items are recorded with serial numbers and official tag numbers and properly accounted for by January 2008.

#### Recommendations

We also concur to the five recommendations identified in the report. Recommendations 1 - 3 are being implemented within the Department of Health Services, Department of Education, and the Department of Administration & Finance under the supervision of the Department Directors. Recommendations 4 and 5 will be implemented through Executive Order by the Governor by October 1, 2007.

Once again, we thank you for the opportunity given to us to review and comment on the draft report. If you have any questions, please contact Mr. Tiser H. Reynold, Director, Department of Administration & Finance @ (691)370-3400 or email: treynold\_kos@mail.fm.

Sincerely,

  
Robert J. Weilbacher  
Governor

cc : Kosrae Public Auditor  
Honolulu Field Office, OIA  
Directors, DAF/DHS/DOE

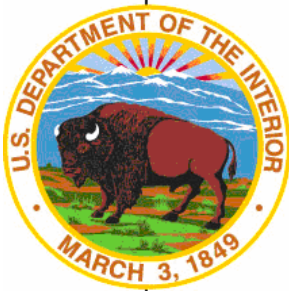
### Appendix 3

## Status of Recommendations

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Recommendations	Status	Action Required
1	Management concurs, but additional information needed.	Provide a plan of action that identifies the specific corrective actions being taken by the Director, Department of Health Services, and a target date for implementing the plan of action.
2	Management concurs, but additional information needed.	Provide a plan of action that identifies the specific corrective actions being taken by the Director, Department of Education, and a target date for implementing the plan of action.
3	Management concurs, but additional information needed.	Provide a plan of action that identifies the specific corrective actions being taken by the Director, Department of Administration and Finance, and a target date for implementing the plan of action.
4 and 5	Resolved, not implemented.	Provide a copy of the Governor's Executive Order.

## **Report Fraud, Waste, Abuse and Mismanagement**



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U.S. Department of the Interior  
Office of Inspector General  
Mail Stop 5341 MIB  
1849 C Street, NW  
Washington, D.C. 20240

***By Phone:***

24-Hour Toll Free      800-424-5081  
Washington Metro Area      703-487-5435

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703-487-5402

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