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 **ERNST & YOUNG**

Quality In Everything We Do

Democratic Republic of Timor-Leste Management Report

30 June 2004



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INTRODUCTION

We have completed our audit of The Consolidated Fund for East Timor (CFET) for the financial year ended 30 June 2004 and have issued an unqualified audit report.

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 Ministry of Planning and Finance, Office of the Treasury, and have met the independence requirements of the International Federation of Accountants ("IFAC") Code of Ethics for Professional Accountants.



EXECUTIVE SUMMARY

Key Financials

The consolidated entity achieved revenues of US \$107.66 million for 2004, an increase of 29.5% over the 2003 revenues of US \$83.16 million. The majority of this increase relates to Timor Gap tax revenues (up by US \$11.62 million in the 2004 year) and tax revenues (which have risen by US \$7.76 million in the 2004 year). Total expenditure incurred during the year amounted to US \$73.05 million, a decrease of nearly 1% over 2003. As indicated in the table below, the majority of this increase relates to expenditure on Capital, which decreased by US \$4.24 million in the 2004 year.

In total, the Government of the Democratic Republic of Timor-Leste recorded an excess of revenue over expenditure of US \$34.61 million in 2004, in comparison to a surplus of US \$9.34 million in 2003.

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

Item	2004	2003	Change
Revenue	107.66	83.16	29.5%
Less expenditure:			
Salaries	24.21	22.07	9.8%
Goods and Services	38.96	37.63	-3.5%
Capital	<u>9.88</u>	<u>14.12</u>	<u>-30.02%</u>
Total expenditure	73.05	73.82	1.0%
Surplus (deficit)	34.61	9.34	

As at 30 June 2004 the Government held cash and cash equivalents totalling US \$80.9 million (30 June 2003 US \$40.39 million). Outstanding commitments recognized by the government at 30 June 2004 totalled US \$16.47 million (30 June 2003 US \$14.87 million).



EXECUTIVE SUMMARY (CONT'D)

Audit report modifications

As noted, our audit report is not qualified, however we have clarified the scope section of the report to reflect that our audit was directed at verifying the amounts deposited to and paid from the relevant bank accounts. In additions, additional explanation was included regarding our audit not covering off on completeness of electricity charges revenue.

Key audit findings

Our examination for the year ended 30 June 2004 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 Service.
- There are a number of security concerns within the Payroll system, especially the level of security to prevent system abuse, and the reconciliation procedures between Payroll Department and agencies.
- There has been a misappropriation of funds in Districts Manatuto and Aileu by the District Finance Offices under the Treasury of Timor-Leste, amounting to US \$46,405 and US \$72,781 respectively.
- A fraudulent transaction was found which involved expenditure relating to vehicle Government vehicle repairs and maintenance.
- There is an amount of US \$515,174 that is uncollectible by the Government as there are no final assessment forms to support the action.
- Monies collected and recorded as revenue by Treasury are not reconciled by the revenue collecting agencies, (such as Land and Property, and Customs), to the invoices owed by customers.



EXECUTIVE SUMMARY (CONT'D)

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.

We acknowledge that the Democratic Republic of Timor-Leste is only in its fourth year of operation 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 2003 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 Payroll section has continued to improve their system of internal controls with respect to ensuring that payroll transactions are appropriately authorised;
- Revenue from hospitals and State University has been transferred to Government bank account;
- Internal audit performed several significant audits, such as, misappropriation of funds in District Manatuto, Alieu and Liquisa. There are several regular audits in agencies had been completed and the relevant audit suggestions have been delivered to Treasury;
- The Procurement Unit has increased the number of signatures required for the approval of single source procurement justifications; and
- A Contract Assessment Committee (CAC) is in the process of being set up to review single source procurements over US \$200,000. The CAC replaces the former Transitional Contract Committee (TCC) which consisted of UNTAET employees, and has as its objective to ensure that the stipulations of the ETPA Procurement Manual are adhered to.



MATTERS ARISING

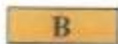
The following schedules set out further details of issues arising from our audit. A number of the issues identified were also raised in the prior year. We have colour coded our priority ratings to enable major weaknesses to be easily identifiable. The key to the colour ratings is listed below the matters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

Schedule	Audit Issue	Rating	Issue Raised in Prior Year
1	1.1 Integrity of PIMS and Debt Collection	A	✓
	1.2 Prepaid Meters	B	
2	2.1 Revenue not banked by agency	B	✓
	2.2 Tax Revenue	B	
	2.3 Timor GAP	B	
	2.4 Border Services Revenue	B	
3	Reconciliation	A	
4	4.1 Single Source Procurements Discussion	B	
	4.2 Review by the TCC	B	
	4.3 Receiving Reports	B	
5	Fraudulent Transaction	A	
6	Reconciliation of Inventory	B	
7	7.1 Payroll Security	B	
	7.2 Confirmation of Payroll Details	B	
8	Multiple Agency Expenditure vs. CPV	B	
9	Asset Register	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.



A minor weakness that you should nevertheless address to 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 work in this regard 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 identify.

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



DETAIL SCHEDULES

1. POWER AUTHORITY

1.1 INTEGRITY OF POWER INVOICING MANAGEMENT SYSTEM ("PIMS") AND DEBT COLLECTION

Audit issue

The total billings figure for power charges amounting to US \$12,226,889 calculated by PIMS cannot be relied upon. Also, 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 and for removal of tenants on non-payment of rent.

Observation and Effect

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

- 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.
- the amount of billing calculated per PIMS to 30 June 2004 was US \$12,226,889 whilst the payments collected and banked for power services amounted to US \$3,431,119. This suggests that there is approximately US \$9 million of uncollected power revenue.
- Similarly, the amount of billing calculated by the Department of Land and Property differed to the amount of revenue recorded by the Treasury. This is a result of a lack of credit control in the rental revenue collection system.

Due to apparent inaccuracies in the PIMS system, however, the level of accounts receivable cannot be estimated with any confidence, nor are we able to quantify the errors. We were unable to verify the balance of outstanding power invoices. Also, it is not possible to determine whether the government is collecting all the power revenue that it is entitled to.

Both the PIMS system and the Department of Land and Property do 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.



1.1 INTEGRITY OF POWER INVOICING MANAGEMENT SYSTEM ("PIMS") AND DEBT COLLECTION (CONT'D)

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 formalised debt collection policy be put in place to ensure that payments are received on a regular basis, also to identify and limit potential bad debts. Invoices should be amended so customers are aware that any breaches may result in disconnection of the power supply.

In addition, we would also recommend that a review of the staffing structure be undertaken to determine the positions required and the training needs for the Department of Land and Property to operate effectively and efficiently.

(Rating **A**)

Management Response

As mentioned in the last year's management response, the government has taken steps to address this issue of PIMS. The installation of prepaid meters, which is the long-term solution, has already started. To show its seriousness the management has ordered an additional 17,000 prepaid meters over and above the initial figure of 10,000. The management contract has already been awarded to a competent firm. With this the situation will improve considerably in the near future.

Compared to the previous years, debt collection has improved. This trend will continue as more prepaid meters are installed. The assessment of the current management contract is pegged to increase in receipts.

In view of the efforts made by the power authority, the rating may now be replaced with 'B'.



1.1 INTEGRITY OF POWER INVOICING MANAGEMENT SYSTEM ("PIMS") AND DEBT COLLECTION (CONT'D)

Conclusion

It is good to see the government has taken steps to address the issue of PIMS. However, work is required to verify what steps have been taken by the government to reconcile the debtors to determine the validity and collectibles of the outstanding amounts. Until an effective PIMS system is functioning and tested by us and proper reconciliation of outstanding amounts has been performed, our recommended rating "A" remains.



1.2 Prepaid Meters

Audit Issue

No reconciliation has been performed between the money collected and banked and the prepaid power revenue recorded in the Actaris system.

Observation and Effect

It was noted during our visit to Power Service that there are no reconciliations between the prepaid meter revenue recorded in the Actaris system and the amount of money that is actually collected and banked. This has several effects:

1. The revenue recorded by the Treasury for power can not be relied on as the completeness of the revenue is an issue; and
2. It leaves room for misappropriation of funds.

Recommendation

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

(Rating **B**)

Management Response

The prepaid meter system has just been in operation in this year of audit. The revenue reconciliation with the EDTL is carried out on a regular basis. However, the management will also look into the aspects of revenue collection under the prepaid meter system and if necessary, the existing reconciliation procedure will be reviewed.

Conclusion

To follow up at next year's audit.



2. REVENUE

2.1 REVENUES NOT BANKED BY AGENCY

Audit Issue

Ministry of Justice has breached revenue collection policies by not banking all revenue receipts.

Observation and Effect

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

District courts and the Dili and Baucau court, under Ministry of Justice, collect court fees, which are retained by each court and not banked to the Treasury account. We understand that the Ministry of Justice is awaiting a new regulation related to court fees which will authorise them to retain a certain percentage of court fees to meet operational expenses.

The instance described above appears 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).

This breach is 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. This has two critical consequences:

1. The risk that funds may be stolen or used for inappropriate purposes is 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.



2.1 REVENUES NOT BANKED BY AGENCY (CONT'D)

Observation and Effect (contd)

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.

Recommendation

In addition to carrying out monthly revenue reconciliations as recommended, 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 **B**)

Management Response

Compared to the last year a considerable improvement has taken place during the year of report in all the areas except in case of court fees. The aspect of the 'court fees' will be pursued further with the concerned authorities.

Conclusion

To follow up at next year's audit.



2.2 TAX REVENUE

Audit Issue

No wage income tax withholding forms are filled out by the Government when withholding tax from salaries and wages paid to civil servants.

Observation and Effect

As requested by *UNTAET Regulation 2000-18* under *Chapter VII section 31.1*:

- A *person* withholding wage income tax under *Section 30* shall deliver to the Central Payments Office or its nominated agent by the fifteenth day after the end of a calendar month:
 - (a) a completed wage income tax withholding form as prescribed by the Commissioner; and
 - (b) any wage income tax withheld in that month.

A *person* is set out in UNTAET Directive No. 2001-1 to include the East Timor Transitional Administration (ETTA) or its successor as may be provided in UNTAET regulations.

Since the East Timor Government is the successor of ETTA, therefore in pursuant to UNTAET Regulation 2000-18 Section 31.1, the Government is required to provide wage income tax withholding forms. However, this is not the case at present. The effect of Government not filling out and returning wage income tax withholding forms is that the tax revenue collected from wages of civil servants is not captured by the tax revenue system (SIGTAX). This also causes concern when trying to reconcile the total revenue calculated by SIGTAX and the revenue recorded by Treasury.

In reality, there is no inflow or outflow of cash in the Government. The amount of tax withheld from civil servants' wages did not leave Banking and Payments Authority of East Timor (BPA) and was not received by the Taxation Office. Therefore this causes an overstatement of both expenditure and revenue by US \$574,299.



2.2 TAX REVENUE (CONT'D)

Recommendation

We strongly recommend that the Government comply with the UNTAET Regulations and Directives by filling out wage income tax withholding forms when deducting tax from salaries of civil servants. This will enhance the ability of management to reconcile the tax revenue collected by agencies and recorded by Treasury, and decrease the possibility of discrepancies occurring between the revenue recorded by the Treasury and the agency.

(Rating **B**)

Management Response

The various Agencies were fully debited by the Gross salaries and wages of the Civil Servants. In the annual accounts these were shown as expenses to the Agencies. On the other hand the net salaries & wages, which are reflected in the banks' statement are duly reconciled with the payment instruments in this regard. Further, the payroll figures are also reconciled with the Free Balance figures on regular basis. Accordingly the treasury's records are well in order.

However, in order to keep the SIGTAX system in order, the Treasury has now been filing the tax return forms during the current financial year, i.e. 2004-05 in respect of the taxes deducted from Civil Servants to the Tax department.

Conclusion

Satisfactory subject to review in the next audit.



2.3 TIMOR GAP

Audit Issue

Timor GAP Revenue

No tax audits are conducted on the tax received from taxpayers operating in the Timor Sea.

Observation and Effect

Currently the Timor GAP taxes paid by taxpayers are collected under a self assessment system. Whilst the existence of a self assessment tax system is not a problem in itself, the absence of tax audit on a regular basis raises concerns about the integrity of the information provided by taxpayers. At the moment, the only control in the Timor Sea GAP revenue collection process is the checking of the calculations made by taxpayer in their tax assessment form by the recording officer.

The effect is that due to the lack of controls in place the revenue collected by agency can not be easily verified. Hence the completeness of the Timor Sea GAP recorded can not be verified.

Recommendation

We recommend that tax audits are conducted on a regular basis, preferably on a continuous basis. This will ensure the integrity of the information provided by taxpayers. It will also act as a deterrent to taxpayers who might consider providing false information in their tax assessment forms.

(Rating **B**)

Management Response

This Timor GAP Revenue issue is in the nature of recommendation by the audit. The Tax department (ETRS) will be advised with the audit recommendations on tax audit.

Since the audit has not specified any case of short-remittance or non-compliance of any provision of the Tax Regulation, this audit issue need not be pursued further and may be dropped.



Conclusion

We note management's comment and will follow up these matters in our next audit.

Additional Management Response

The Commissioner of Tax (ETRS) has reported that the tax audit for Timor Gap revenue is conducted on quarterly basis and in addition, if necessary, special audit is also conducted by his department.

In view of this, this issue need not be pursued further and may be dropped.

Conclusion Following Additional Management Response

As we have not seen any evidence of the audits, we intend to follow this up in the next audit.



2.4 BORDER SERVICES REVENUE

Audit Issue

There is an amount of US \$515,174.25 that is uncollectible by the Government as there are no final assessment forms to support the action.

Observation and Effect

During our visit to the Department of Customs, it has discovered that an amount of US \$515,174.25 is still in the Escrow bank account as at the end of the financial year. However, this amount can not be collected by the Government as there are no final assessment forms available to enforce the Escrow service to transfer the money. The usual situation under which this could occur is that the assessment process is not complete and the imported goods are still being held at Port Authority. However, during our discussion with the revenue advisor of Customs it was found that the concerned goods have already been released without the issuance of a final assessment.

Recommendation

We recommend the Department of Customs to reconcile and complete the paper work for the import settlement and clear the unsettled funds which are still sitting in the importer bank account in escrow.

(Rating **B**)

Management Response

Earlier the customs clearance procedure was not aligned with the automated system. Since September 2004 the new customs clearance process has been implemented and that will facilitate the reconciliation procedures also.

This is a single case that is being looked into by the customs authorities.

Conclusion

Management's comment noted. We will follow up this matter in our next audit.



3. RECONCILIATION

Audit Issue

No reconciliation existed between revenue recorded by agencies and the Treasury.

Observation and Effect

During our visit to 8 agencies, no reconciliation between the agencies and the Treasury. This is a major weakness in the control system and has the following effects:

1. Treasury does not know the exact amount of revenue collect and recorded by the agencies;
2. It gives rise to difficulties in ensuring that all money collected have been proper recorded and banked;
3. It gives rise to difficulties in maintaining adequate debtor control.

Recommendation

We recommend that 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. It will also ensure that all money collected by agencies is banked.

(Rating A)

Management Response

Treasury, on a monthly basis, produces details of each category of revenue and the ensuing reports are sent to the relevant agencies for them to check against their records. They are supposed to report back in case of discrepancies. Due to lack of manpower, it may not be always possible to go to all the places or to the districts for reconciliation of small amount of revenue collected there from. From the materiality point of view also it does not warrant such physical visits to all the departments. In case of major revenue collecting departments, the treasury officials go physically to these departments for reconciliations. Accordingly it may be observed that the reconciliation is not only conducted but that is done on regular and monthly basis.

In view of the fact as explained above and also from materiality point of view, this issue need not be pursued further and may be dropped.

Conclusion

Reconciliation is an important control issue therefore audit comment is valid.



4.1 SINGLE SOURCE PROCUREMENTS

Audit Issue

We tested a sample of single source procurement items for adherence to the procedures for single source procurement as set out in the Public Procurement Manual for Civil Administration in Timor Leste. We noted that there were a small number of single source procurements for which justifications, though outside those specifically cited in the Manual, appeared reasonable.

Observation and effect

Section 10.10 of the Procurement Manual allows procurement from a single source when:-

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

Single source procurement may also be justified under emergency conditions (10.14) or for certain specific categories of goods and services (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 (from PU-5), which must be approved by the Chief of the Procurement Unit (section 10.11 of the Procurement Manual).

During our review of Procurements, nine single source procurements (SSP) were found, in the sample selection of 30 procurements in the 2004 financial year. Two of these related to an in-house bridge construction project, hence the tender process was not followed. We were informed that it is Government policy that for in-house projects, the tender process is not followed. Another two related to the rehabilitation of a military camp which related to a prior contract, for which the tendering process was indeed followed.

The procurement concerning the supply of fuel related to a contract with a company which had restructured and changed its name since the original fuel contract under the UN Administration and the Procurement Unit is now in the process of preparing a new international tender.



4.1 SINGLE SOURCE PROCUREMENTS (CONT'D)

Observation and effect (contd)

Those SSP's which included urgency in their respective justifications were tested for validity of the grounds of urgency (in strict accordance with the Procurement Manual). The Procurement Manual (10.14) stipulates that single source procurements are only permissible if:-

- a) an emergency exists which is a threat to public health or safety, which creates an immediate need for supplies, equipment and services which cannot be met through normal procurement methods and the lack of which would seriously threaten:
 - 1. the function of the Administration;
 - 2. the preservation or protection of property; and
 - 3. the health and safety of any person; and
- b) emergency cases which would seriously jeopardize or have potential to jeopardize, the operational capability of the Administration if immediate procurement action not taken.

Most reasons (for urgency) given in the procurements tested appeared to be subjective in nature and not strictly valid in terms of the Manual stipulations (above). The respective procurements related to: uniforms, weapons, bridge construction and the installation of a database. Although the reasons for urgency did not always exactly match those cited in the Manual, other reasonable justifications as mentioned above were given.

For this reason we have included a management point, with effects and recommendations below.

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

In addition, the absence of effective controls in this area could encourage agreements which violate sections 7 and 8 of the Public Procurement Manual for Civil Administration in East Timor:-

'7.1 The acceptance of any gratuity in the form of cash, merchandise or any other thing by an official or employee of the Administration from any vendor, shall be deemed to be a violation of this article and shall be subject to disciplinary action.';
and

'8.1 Conflict of Interest: Employees of East Timor Administration are not permitted to participate as bidders in the procurement process.'



4.1 SINGLE SOURCE PROCUREMENTS (CONT'D)

Recommendation

We recommend that for all procurements, strict adherence to the stipulations of the ETTA Procurement Manual be enforced.

(Rating B)

Management Response

Single source procurement in respect of procurement of Uniforms, Weapons, installation of a database etc. were carried out in accordance with Section 10.10 of the Procurement Manual, due to lack of competition, ensuring quality standards for the uniforms and sensitive nature of the products like security equipments, weapons and ammunition.

The procurement Department is working on an awareness campaign within the ranks of department heads, to ensure the importance of adhering to the procurement procedures in order to minimize the single source procurements.

Conclusion

Noted.



4.2 REQUIREMENT OF REVIEW BY THE TCC

Audit Issue

The ETTA Procurement Manual requirements concerning review by the Transitional Contract Committee for procurements of US \$200,000 or more, is not being adhered to.

Observation and effect

Clause 10.11 of the Procurement Manual stipulates that: *'...single source procurements of US \$200,000 or more shall be subject to review by the TCC (Transitional Contract Committee).'*

Three of the single source procurements found constituted an amount which exceeded US \$200,000. When tested, no evidence of review by the TCC was found. However, after discussion with the Director, we understand that the TCC was formed by the UNTAET and constituted UN employees only. The Government is now in the process of creating a new CAC (Contract Assessment Committee), which is a long process owing to the fact that only employees of the Procurement Unit are familiar with Procurement procedures. A procedure has been introduced whereby all single source procurements are signed by the Director and Minister of the division requesting the procurement, then by the Director of Procurement and finally approved by the Minister of Procurement.

Recommendation

We recommend that strict adherence to the ETTA Procurement Manual is enforced and that the CAC be set up as soon as is possible.

(Rating **B**)

Management Response

As mentioned in the report, with the approval of Minister of Planning & Finance, the CAC is in the process of being constituted with the members from across the key ministries.

This has been delayed since the Decree Law on procurement, which is supposed to serve as the basis for the appointment of the members, is yet to be finalized for enactment.

Conclusion

Noted.



4.3 RECEIVING REPORTS

Audit issue

It was noted that not all closed procurement files contained Receiving Reports (for goods procurement) or Completion Reports (for services rendered).

Observation and effect

Only 6 of the 25 procurements tested had a receiving report or project completion report on file. This was partly owing to the fact that much procurement selected was still 'open', i.e. the goods had not yet been received or the construction work was not yet complete. We understand that, in some cases, there may be another form of 'receiving report', some document which proves delivery of the goods or services.

Recommendation

We recommend that the above control be enforced.

(Rating **B**)

Management Response

Audit observations are self-explanatory. The R&I and other related reports are issued once the vendor fulfils the contractual obligation by delivering the goods, services or works. Therefore files, which are open, are still active until the procurement process is finalized.

However the department has also recently introduced measures that would improve the records management by assigning specific staff members to deal with the filing issue to ensure file history of all procurements, from the time of initiation to its completion.

Conclusion

For follow-up at next audit.



5. FRAUDULENT TRANSACTION

Audit Issue

A fraudulent transaction was found which involved expenditure relating to Government vehicle repairs and maintenance.

Observation and Effect

After research and investigations into possible cannibalisation of vehicle parts, it was found that vehicle maintenance / spare parts expenditure involved fraudulent activity. Excessive payments were made in terms of an unapproved price list, the prices differing substantially from those on an approved price listing and in accordance with market research. The possibility of collusion was also noted.

Recommendation

We recommend that controls be introduced and enforced to prevent or detect fraudulent activity of this nature in the future. One such control measure could be the appointment of an independent RDTL Officer / Workshop Manager with knowledge of mechanical engineering, who is responsible to the Government of East Timor for the prevention of irregularities and the quality of contract work performed.

(Rating **A**)

Management Response

The audit recommendation is noted. The Procurement division is working towards enhancing cooperation with the department of Transport for all procurements related vehicle maintenance and repair. It would involve issue of works order with the details of services required and estimated cost of works, in order to facilitate issuing of a CPV prior to commencement of any such works. This will make the Transport department and the end-users directly responsible and accountable for any fraudulent practice of this nature, since they have to certify the works and issue a satisfactory report to facilitate the payment process. This directive is already under implementation.

Conclusion

Satisfactory.



6. RECONCILIATION OF INVENTORY

Audit Issue

Inventory (unallocated stores) per the stock count sheets does not agree or reconcile to inventory per the general ledger.

Observation and Effect

During our review of inventory, we noted that the balance of unallocated stores per the stock count sheets exceeded the balance per the general ledger by US \$11k. This was explained by staff as the 5% freight included in the stock sheet inventory items. However no accurate reconciliation was provided.

The absence of a periodic reconciliation between accounting records and physical inventory records enhances the risk of misstatement of inventory in the Financial Statements and could present a platform for potential stock theft.

Recommendation

We recommend that physical inventory be periodically reconciled to inventory as recorded in the accounting records and that detailed reconciliation reports are retained on file.

(Rating **B**)

Management Response

Physical inventory is already being taken and reconciled periodically in every three months. As explained to the audit by staff in Supply and Inventory Management unit, the difference highlighted by the audit, is due to the inventory carrying costs, which also include element of freight. This is going to be a recurring feature and it is also not material.

As explained above, this issue need not be pursued further and may be dropped.

Conclusion

We still recommend that a proper reconciliation be carried and variances adequately explained and retained in the file.



7. PAYROLL

7.1 PAYROLL SECURITY

Audit Issue

General access to the payroll system allows the creation of new staff records.

Observation and Effect

During our discussion with head of payroll, it was discovered that all payroll staff have access to create new employee records within the CHRIS system. It was noted that usually the creation of new employee records must be supported by relevant documentations and proper authorisation. However, due to the fact that the payroll system itself does not have the necessary security features to prevent abuse, there is a risk that new staff records can be created without proper authorisation by anyone who has general access to the system.

Recommendation

We strongly recommend a complete review of the security features of the CHRIS system be undertaken to ensure that the security level is adequate to prevent abuse of the system and data corruption. Specifically, we would recommend additional security features to be implemented in regards to the creation and editing of staff records. By ensure adequate security controls are in place, the possibility of system abuse and data corruption will be greatly reduced.

(Rating **B**)

Management Response

This is not factually correct. The payroll system CHRIS has an in-built security control feature. The authorized person can only log into the system. The head of payroll unit is responsible in providing access to the authorized staff in the payroll unit. The creation and editing of civil servant's record are carried out in the system only by the authorized staff in the payroll unit on the basis of approved documents received from concerned department and endorsed by the department of Human Resources and Public Employment.

In view of this fact, this issue need not be pursued further and may be dropped.



7.1 PAYROLL SECURITY (contd)

Conclusion

The issue here is regarding the proper authorisation procedures within the Payroll department regarding the creation of new employee records, whilst it is fine for payroll officers to be able to create new staff records, this should be authorised only by head of Payroll and / or reviewed by head of Payroll to ensure that all records created are valid and correct.

Additional Management Response

The Payroll officers are authorised and responsible for creation of new staff records. With the Payroll Officers having their respective individual responsibility, the security of payroll system is maintained.

In view of this, this issue need not be pursued further and may be dropped.

Conclusion Following Additional Management Response

Notwithstanding the additional management response, our conclusion remains per above.



7.2 CONFIRMATION OF PAYROLL DETAILS

Audit Issue

There is no confirmation of payroll details conducted by the Payroll Department.

Observation and Effect

Currently all payroll data such as employee details and levels are provided to the Payroll Department by the relevant head of departments and district finance officers. The department then processes the payroll information and sends them to Treasury for payment. There are no confirmations done on payroll details by the Payroll Department. If the payroll details provided are wrong, it will not be noticed in the payroll process. Hence it increases the risk of misappropriation of funds and fraud.

Recommendation

We strongly recommend confirmations be done on payroll data on a regular basis. This will increase the accuracy of the payroll data and ensure that salaries are not paid to employees who have ceased employment with the Government. Also by conducting regular reviews and confirmations of payroll data, management will be in a better position to pick up any irregularities in the payroll process.

(Rating **B**)

Management Response

Again this is also not factually correct. First of all the concerned department stands responsible for the payroll data provided by them. Secondly these are also endorsed by the department of Human Resources and Public Employment under the existing regulation and procedure.

In view of this fact, this issue need not be pursued further and may be dropped.

Conclusion

The issue here is that we did not discover any form of confirmations is done by the Payroll department. This increases the likelihood of false / invalid information being submitted by departments. It would be an improvement in the control environment to put in place a confirmation process on a periodical basis for payroll information.



Additional Management Response

The Head of Payroll further clarified that every year in the beginning the list of employees is sent to the Agencies for confirmation and every month the list is also given to the finance officer of the agency.

In view of this issue need not be pursued further and may be dropped.

Conclusion Following Additional Management Response

As we have not seen any evidence, we intend to follow this up in the next audit.



8. MULTIPLE AGENCY EXPENDITURE VS. CPV

Audit Issue

Commitment and Payment Vouchers (CPV'S) have not been issued for payments relating to multiple agency expenditure for fuel, Government vehicle maintenance and communication.

Observation and effect

During our review of expenditure, we noted that for fuel expenditure, car maintenance and communication expenditure, Commitment and Payment Vouchers (CPV'S) had not been raised.

The ETTA Manual stipulates that for all expenditure items, the following procedure applies:-

1. a CPV is opened;
2. the Procurement Unit issues a purchase order;
3. a Sales Order is received from the supplier;
4. goods/services and an invoice are received from the supplier.

We found that for fuel, car maintenance and communication expenditure, the goods/services and invoices had been received from respective suppliers, but no CPV had been opened.

The absence of strict adherence to ETTA Manual procedures on Expenditure will give rise to a risk of unauthorised expenditure and loss to the Government.

Recommendation

We recommend that strict adherence to the ETTA Manual with regard to Expenditure be enforced and controls be introduced to this effect.

(Rating **B**)

Management Response

This issue was not raised by the audit last year. The multiple agency expenditure system was inherited from the UNTAET. However from October 2004 all procurement needs for fuel and vehicle maintenance etc. are being processed following regular CPV system and not as multiple agency expenditure.

Conclusion

Agree with the management's response and will follow this matter in our next audit.



9. ASSET REGISTER

Audit Issue

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.

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.

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.



9. ASSET REGISTER (CONT'D)

We further recommend that additions to the asset register be reconciled to the capital expense on a quarterly basis, 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 National Asset Management Unit has been making all efforts in order to introduce every data from the Assets in the Excel Data Base. The items not yet introduced are those that were reported by R&I after the issue of Consolidated List to the Audit. Meanwhile, and until now, the said items are being introduced stage by stage according to the programme (including donated assets).
- Regarding the Land and Property Data Base, it falls under the competence of the Land and Property Division, but nevertheless the National Asset Management Unit is carrying out efforts to inventory lands and buildings in a proper Data Base.
- The physical identification of all Government's assets has not been concluded within 2003-04 Fiscal Year since there were many donated assets (by Ausbatt, Porbatt, Fiji, UNMISSET & others) and consequently much time was needed for identification, codification, transfer and storing activities.
- It is true that until now the National Asset Management Unit still uses the Manual Excel Program to update the assets database. After finalisation and verification of each item, the data will be uploaded in the Free Balance system.

The policy issues relating to the assets valuation, depreciation etc. will be addressed by the Government in due course.

9. ASSET REGISTER (CONT'D)

Conclusion

Noted.