REPORT OF THE AUDITOR-GENERAL

ON THE RESULTS OF FINANCIAL STATEMENT AUDITS

OF PUBLIC ENTERPRISES

AND OTHER STATUTORY BODIES

for the years ended 31 December 2008,
31 December 2009 and 31 December 2010

Parliamentary Paper
Number:.....2011

TUVALU GOVERNMENT

Office of the Auditor-General

Private Mail Bag
Vaiaku, Funafuti
TUVALU

Phone No: +(688) 20131, +(688) 20132 Fax No: +(688) 20133

Our Reference: 05/05/10 Date: 7th November 2011

Honorable Speaker of Parliament
Office of the Speaker of Parliament
Parliament of Tuvalu
Vaiaku

Dear Sir,

TUVALU AUDITOR GENERAL'S REPORT:
RESULTS OF FINANICIAL STATEMENT AUDITS OF PUBLIC ENTERPISES AND OTHER STATUTORY BODIES

I am pleased to present to you my report on the results of financial statement audits of public enterprises and other statutory bodies. I report to you Honorable Speaker since the House of Parliament is not sitting to present the report as required under section 42 and section 45 of the Audit Act 2008. Nineteen (19) bound copies of the report are provided herewith for distribution to all Honorable Members of Parliament.

Appreciate proper arrangement for all purposes, taken to be a document published by order or under the authority of Parliament and proper scrutiny by the Public Accounts Committee.

Sincerely,

Isaako K. Kine
Auditor- General for Tuvalu

Cc: All Honorable Members of Parliament
Secretary to Government
All heads of Public Enterprises
All heads of Statutory Bodies
Director of PERMU

Table of Contents

Introduction

The format of this report

This report is tabled under section 42 of the *Audit* Act 2008. Individual audit reports have been issued to each of the entities audited for inclusion in their annual reports to be tabled in Parliament, along with management letters recommending improvements. This report is a summary of the financial statements which have been audited, the results of the audit, analysis of the movements in the financial statements, and commentary on the major issues experienced in each entity. Additionally common issues which have been identified by the Tuvalu Audit Office (TAO) in the audits of the entities are also detailed.

The report contains recommendations for the Public Accounts Committee and Parliament to consider and act upon.

Auditor General's Mandate

The Auditor General of Tuvalu had the mandate to perform the 2008 and 2009 audits of the public enterprises under the *Audit* Act 2008 and the *Public Finance* Act 2008. From 1 December 2010 the mandate shifted to the *Public Enterprises (Accountability and Performance)* Act 2009 (PE Act) for the Public Enterprises. There is no change to the mandate with the change in legislation. The mandate for statutory bodies remains unchanged under the *Public Finance* Act 2008.

Accounting Framework Used (including guide to preparation of financial statements)

The accounting standards used for the preparation of all of the Public Enterprises and Statutory Bodies financial statements was the International Financial Reporting Standards (IFRS). IFRS is required under section 6.2.1(a) of the PE Act. The TAO considers the usage of IFRS to be appropriate for entities audited.

As part of the PE Act (Schedule 6) the Ministry of Finance is responsible for the development of the reporting format required for annual and quarterly reports.

Auditing Standards Used

The Auditing standards used in the performance of the financial statement audits were the International Standards for Supreme Audit Institutions (ISSAI). The audit approach is a risk based approach and is considered to be compliant with the ISSAIs.

Types of Audit Opinions Issued

The objective of the financial statement audit is to present an opinion on whether the financial statements present a true and fair view: The Tuvalu Audit Office (TAO) in compliance with the International Standards for Supreme Audit Institutions (ISSAI) issues audit opinions on the financial statements presented for audit. The types of audit opinions which can be issued are:

- Unqualified: In our opinion the financial statements do present a true and fair view.
- Qualified except for: In our opinion except for the matters noted in the qualification paragraph the financial statements present a true and fair view.
- Qualified adverse: In our opinion the financial statements do not present a true and fair view.
- Qualified disclaimer: We are unable to form an opinion whether the financial statements present a true and fair view.
- Unqualified with an emphasis of matter paragraph: In our opinion the financial statements do present a true and fair view, however, emphasis which we consider important to the user is drawn to a certain disclosure within the financial statements.

- Unqualified with an other matter paragraph: In our opinion the financial statements do present a true and fair view, however, users' attention is drawn to a matter relevant to their understanding of the audit of the financial statements or the audit report.

Significant changes to the environment of the Public Enterprises

The Public Enterprise (Performance and Accountability) Act 2009

The Public Enterprise (Performance and Accountability) Act 2009 (PE Act), which was enacted by Tuvaluan Parliament on 28 May 2010 and entered into force on 1 December 2010, specifies both requirements and Tuvaluan Government responsibilities in relation to the Public Enterprises. Prior to enactment of the PE Act, each public enterprise was governed by its own individual Act of incorporation. The individual Acts of incorporation are still in force; however, in the event of inconsistencies between the individual Act of incorporation and the PE Act, the PE Act is considered the dominant Act. The entities now considered Public Enterprises which fall under the PE Act are:

- National Bank of Tuvalu (NBT);
- Development Bank of Tuvalu (DBT);
- Telecommunications Corporation (TTC);
- Vaiaku Lagi Hotel (VLH);
- Electricity Corporation (TEC);
- Fishing Corporation (NAFICOT);
- Philatelic Bureau (TPB); and
- Maritime Training Institute (TMTI).

The overall aim of the PE Act is to ensure that all public enterprises conduct their operations in as close to a commercial manner as possible, thereby reducing the Tuvaluan Government's ability to influence business decisions. The PE Act removes Government representatives from boards (except under limited circumstances) and seeks to reduce expectations of Government financial support.

Under the PE Act, the Auditor General, at the request of the shareholding Minister or the Secretary of Finance, can carry out a performance audit on any public enterprise. In carrying out this task, the Auditor General has been empowered to enter the premises and take copies of required documents. For transparency purposes, the PE Act also requires public enterprises to submit annual corporate plans, and financial statements and accounts to Ministry of Finance.

The Public Enterprise Reform and Monitoring Unit

The PE Act requires that a Public Enterprise Reform and Monitoring Unit (PERMU) be created to monitor the performance of all public enterprises on behalf of the shareholding ministers, and advise these ministers with respect to the government's investment in public enterprises. This provides for a coordinated approach to monitoring public enterprise performance.

The introduction of MYOB (Mind Your Own Business) Accounting Software into all Public Enterprises

Except for the Tuvalu Electricity Corporation who already had a computerised accounting system in place, the Public Enterprises have been provided with Mind Your Own Business Accounting software. The Public Enterprises are using the software to varying degrees.

Stipulation of Community Service Obligations and process to be followed
With the introduction of the Public Enterprises Act, Community Service Obligations of the Public Enterprises are now required to follow a stringent process stipulated in part III and IV of the Public Enterprises Act. This is attempting to distance the Public Enterprises from the Government to ensure that they are acting in the interest of making a profit, rather than providing services to the Government.

Independence of Board of Directors
The Board of directors are now required to be more independent of the Tuvaluan Government, with no Member of Parliament, Public Servant or Constitutional Officer permitted to be appointed unless certified by Cabinet, is in the national interest and the appointee has skills and experience which cannot be found elsewhere.

Common Issues with the Public Enterprises and Statutory Bodies

ANNUAL REPORTS NOT TABLED IN PARLIAMENT

Under both the Public Finance Act and the PE Act, Annual reports of the Public Enterprises and Statutory Bodies, including financial statements, Audit reports, report on operations and by the board of directors are to be tabled in Parliament. At the writing of this report the following entities have tabled annual reports in Parliament.

Annual reports (including Financial Statements) for Statutory Bodies and Corporations tabled in Parliament

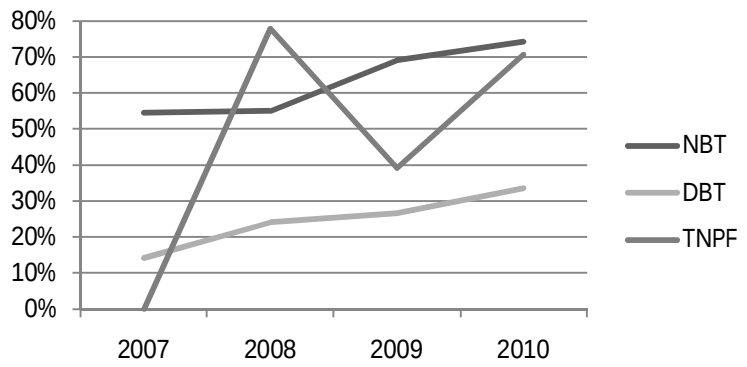
Name	2006	2007	2008	2009	2010
NBT	✓	✓	✓		
DBT		✓			
TTC	✓				
TEC					
TNPF		✓	✓	✓	
VLH					
TCS					
TMTI	✓	✓			
NAFICOT					
TPB	✓	✓	✓	✓	✓

Annual Reports are necessary to highlight the operations of the organization during the year. They should include achievements and progress against milestones in each entity's Corporate Plan. The PEs should be reporting against Key Performance Indicators and be justifying their performance. Without a reporting mechanism in place, underperformance goes unpunished, and good performance goes unnoticed.
Part of the changes to the PE Act is that the PERMU are performing monitoring functions of the Public Enterprises. The guidelines for the annual reports and the requirements are stipulated in the reporting guidelines for Public Enterprises, issued by the Ministry of Finance.

***Recommendation 1**: Apart from tabling annual reports in Parliament, there is no accountability of the Public Enterprises and Statutory Entities to the public of Tuvalu. If the annual reports are not tabled in a timely manner or at all, the public have no way to assess the performance and financial situation of these entities. The TAO recommends that the entities compile and table all outstanding annual reports and submit these reports for tabling in Parliament. Additionally we recommend that the PERMU takes an active role in monitoring and follow up of the Public Enterprises who have not submitted annual reports in a timely manner.*

DEBTORS MANAGEMENT

Allowance for credit impairment as a percentage of total loans for the three financial institutions of Tuvalu



The graph above shows an increasing trend in the allowance for credit impairment for the three financial institutions from 2007. This increase decreases liquidity and profitability for the financial institutions of Tuvalu. The average allowance for credit impairment throughout the small island states in the Pacific is 1.2%[1]. By comparison the average in Tuvalu over the past 4 years is 45%.

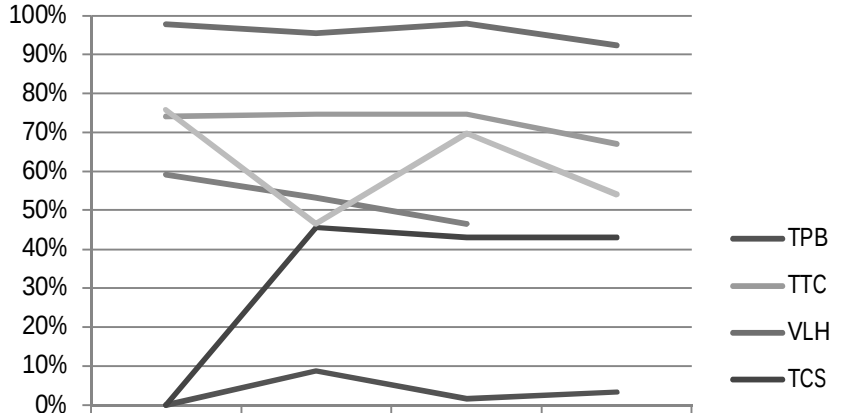
Allowance for credit impairment as a percentage of total loans

	2007	2008	2009	2010	Average
NBT	55%	55%	69%	74%	63%
DBT	14%	24%	27%	34%	25%
TNPF	0%	78%	39%	71%	47%
Average	23%	52%	45%	60%	45%

***Recommendation 2:** The three lending institutions should impose a more strict loan assessment process, ensure that collateral is provided as well as make a concerted effort to follow up on loans in arrears*

[1] INTEREST RATES AND BANK PROFITABILITY IN THE SOUTH PACIFIC – PFTAC study. Average rate of Solomon Islands, Vanuatu, Samoa and Tonga from 2000 to 2009.

Allowance for credit impairment as a percentage of total loans for the non financial institutions of Tuvalu



	2007	2008	2009	2010
TPB	0%	9%	2%	3%
TTC	74%	75%	75%	67%
VLH	98%	95%	98%	92%
TCS	0%	46%	43%	43%
TMTI	59%	53%	47%	
TEC	76%	47%	70%	54%

Apart from the Tuvalu Philatelic Bureau, the provision for doubtful debts as percentage of total receivables for the non financial entities is above 40%. In other words, for every $1 owed to the entities, they can expect to recover less than 60 cents. This has a great impact on cash flow and also going concern. Note the TCTC and NAFICOT have been excluded as they have not submitted financial statements for audit 2002 and 1999 respectively.

Recommendation 3: *That the entities should monitor their receivables, send reminder notices, make follow up phone calls to their debtors and commence legal action against long terms debtors using either the Attorney-General's Office or the People's lawyer*

CASH MANAGEMENT

The cash on hand (less bank overdraft) at balance date is shown in the table below. All figures are in thousands.

	TTC	TEC	TPB	VLH	DBT	TNPF	NBT	TCS	TMTI
2007	-478	-294	-48	72	196	1,167	11,258	707	-3
2008	-2,397	-920	-49	53	248	1,703	15,510	359	132
2009	-964	-479	-42	118	978	1,739	14,302	460	38
2010	-930	-385	-49	103	800	859	15,229	*	*

*Financial statements yet to be presented for audit. Note that TCTC and NAFICOT have not presented financial statements for audit since 2002 and 1999 respectively.

Having limited working capital (i.e. cash) restricts the entities' ability to grow, provide quality services and make provident fund contributions on behalf of their employees. Of particular

concern are the TEC, TPB and TTC which have had a negative cash position for the past four years. High amounts of interest are paid on the overdrafts which could be used to provide better services to the people of Tuvalu. Additionally the interest expense restricts the ability for the entities to earn a profit.
The issues raised with the amount of cash on hand are closely related to uncertainty surrounding an entities ability to continue as a going concern.

Recommendation 4: *Measures are taken to ensure that adequate working capital is present in each of the entities and that management take an active role in the management of working capital. Review of the pricing of goods and services, collection of debts owed, proper recording of receivables as well as management and forecasting for future outflows should be performed by the entities in an attempt to improve their cash position.*

GOING CONCERN

Being able to continue as a going concern refers to an entity that will continue in operations for the foreseeable future and will be able to realise assets and discharge liabilities in the normal course of operations.
The following table shows the entities audited who have uncertainty surrounding their ability to continue as a going concern and may require assistance to continue trading. The following entities had either emphasises of matter or qualifications surrounding their ability to continue as a going concern during 2008, 2009 and 2010. The entities not mentioned here did not have significant risk surrounding their ability to continue as a going concern for 2008, 2009 and 2010.

Entity	DBT	TEC	TPB	TTC	VLH	TCS
2008						
Uncertainty surrounding being able to continue as a Going Concern	yes	yes	yes	yes	yes	no
Net Assets '000	898	-922	-127	422	106	2,562
Net profit/loss'000	-153	-41	-57	-945	-10	31
2009						
Uncertainty surrounding being able to continue as a Going Concern	no	yes	yes	yes	no	yes
Net Assets '000	2,264	-1,064	-137	-544	136	1,124
Net profit/loss'000	1,349	-140	-60	-964	-22	-1,442
2010						
Uncertainty surrounding being able to continue as a Going Concern	no	yes	yes	yes	no	*
Net Assets '000	2,489	-7,211	-188	-694	91	*
Net profit/loss'000	-199	25	-101	-150	-45	*

* Financial statements yet to be presented for audit.

The cause of the uncertainty surrounding these abilities to continue as a going concern is varied. See the individual analysis of each entity for more details. Some common causes noted by audit are the pricing of goods and services, the lack of robust collection of debts owed and proper recording of revenues and amounts owed.

Recommendation 5: *That management of each of the entities with going concern issues in their last audit report is implementing change to ensure that they are able to be able to continue as a going concern. This includes increasing the prices of their goods and services, discontinuing unprofitable goods and services, requesting formal Community Service Obligation payments from the Tuvalu Government for unprofitable segments which are required to be delivered and being more stringent with debtors (both collection and approval).*

INTERNAL CONTROL ENVIRONMENT WEAKNESSES

The definition of internal control environment is contained in the appendices.

Overall, the strength of the internal control environment of the entities audited was considered weak. The number and seriousness of the management letter points in each entity demonstrates a weak control environment. These issues have been raised in individual management letters which have been sent to each entity. The following issues were experienced over a majority of the entities:

- Reconciliations: Reconciliations between the general ledger and subsidiary systems in use (i.e. bank statements, subsidiary ledgers) were performed poorly, if it all. Reconciliations are key in ensuring that all data in the general ledger and through it the financial statements are complete, no unauthorised payments are being made out of the bank accounts, subsidiary ledgers agree to the general ledger and all transactions are able to be explained. If there are major errors in reconciliations, these should be brought to the attention of the board, and appropriate action taken to settle the differences. Reconciliations are vital if ledgers and account information are to be relied on by users.
- Asset management including inventory: Asset management is not being performed to an acceptable standard throughout the entities audited. Asset and Inventory registers were either not present or out of date. Stock counts which are a major component of the internal control environment were not performed. Completed and properly investigated stock counts give information regarding pilfered and stolen stock, stock obsolescence, slow moving stock as well as ensuring that all stock is recorded.
- Collection of and accounting for receivables: In most of the entities the assessment of the collectability of receivables was only performed at year end when requested by the auditors. Controls should be in place ensuring that credit is not provided to customers without appropriate assessment of likelihood of recovery. Additionally there should be controls surrounding the follow up of outstanding receivables as mentioned in recommendation three.

ASSISTANCE IN PREPARATION OF FINANCIAL STATEMENTS FROM AUDITORS TO PRODUCE IFRS COMPLIANT ACCOUNTS

Most of the entities were reliant on the auditors to assist in the production of IFRS compliant accounts to a certain extent. The entities have been provided with a template and guidance over the past audits which are being used to a limited extent, however, significant re-work was required to ensure compliance. The Ministry of Finance under the PE Act has issued a required reporting format on financial statements of the Public Enterprises as well as model accounts. On audit review it was found the model accounts needed to be updated before they were compliant with IFRS.

Recommendation 6: *The TAO recommends that the entities work towards ensuring that their 2011 accounts are IFRS compliant and compliant with the required reporting format. Additionally we recommend that the required reporting format is updated and re-issued to ensure the model accounts contained are in compliance with IFRS. When the reporting requirements are updated, training to communicate the new requirements should be run with the Public Enterprise accountants.*

MYOB USAGE

Audit observed the under usage of the MYOB accounting package within the Public Enterprises. Accounting packages are considered to be more efficient and effective compared with excel or manual accounting, with less manual errors being made due to system controls.

Recommendation 7: *We recommend that the Public Enterprises continue to expand their usage to use MYOB while phasing out their paper based or excel based ledgers. Additionally we recommend that the most knowledgeable users of MYOB in each entity meet with each other regularly to discuss efficiencies, any new techniques or issues so that knowledge and identified efficiencies are shared.*

RECURRING MANAGEMENT LETTER POINTS

Management letters from the audit summarise our findings and recommendations for change in areas where we have identified weaknesses. The findings and recommendations of the audit are discussed with the auditee at the end of the audit, and the auditee is encouraged to respond to the recommendations with their planned strategy to rectify the issues.

If management letter findings are not adequately addressed, they are reported in the next year's management letter. Recurring findings are an indication that the entity is not implementing our recommendations for change.

The number of findings in an entity should decrease as the entity implements changes and improves. This rate of improvement has been slow in Tuvalu as shown by the following tables.

Number of management letter points

	NBT	DBT	TEC	TPB	TTC	VLH	TCS	TNPF	TMTI	NAFICOT	TCTC
2007	19	16	20	6	30	18	24	11	15	n/a	n/a
2008	21	21	34	6	24	15	32	14	10	n/a	n/a
2009	25	17	28	9	25	19	40	12	13	n/a	n/a
2010	26	21	16	9	25	19	n/a	14	n/a	n/a	n/a

Number of recurring management letter points

	NBT	DBT	TEC	TPB	TTC	VLH	TCS	TNPF	TMTI	NAFICOT	TCTC
2007	19	5	16	6	23	11	11	8	12	n/a	n/a
2008	11	11	18	6	7	7	16	1	4	n/a	n/a
2009	13	14	16	3	16	13	26	4	6	n/a	n/a
2010	19	13	9	3	18	6	n/a	9	n/a	n/a	n/a

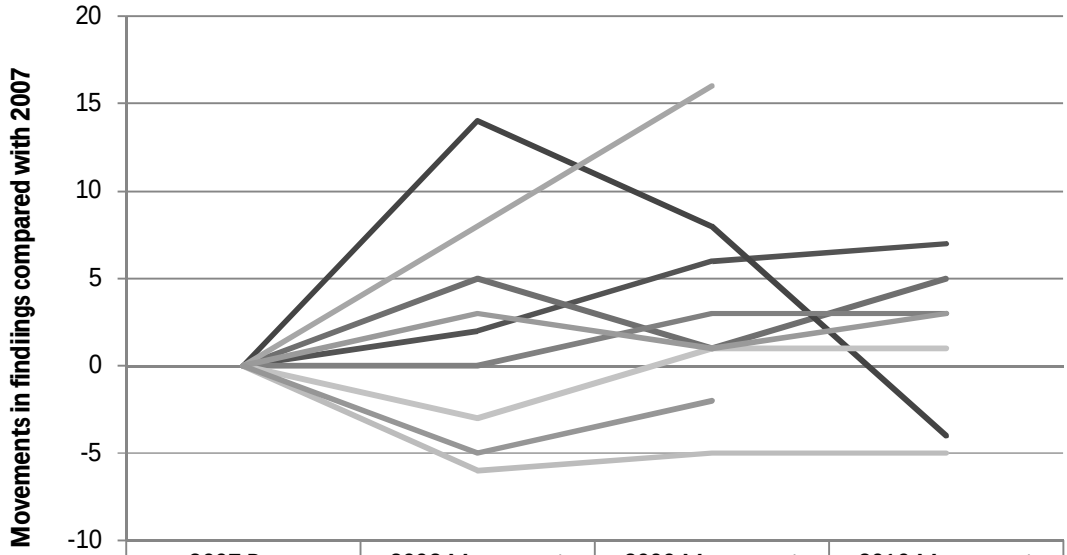
n/a: financial statements have not been presented for audit at time of publication, hence no management letter issued.

This is a poor reflection on the operations of the Enterprises as a whole. Management letters should get smaller over time, it is a sign of improvement in the organizations. No significant effective remediation is being undertaken to resolve these issues

Recommendation 8: *That the entities take a more active interest in the resolving of the issues raised in the management letters. Measures could include having to report to the board of directors every meeting on the progress of resolving the findings, making plans to prioritise and the findings and requesting for assistance/ advice from the Tuvalu Audit Office on how to proceed.*

The graph below shows the movement in the number of management letter points (findings) for each year for each entity compared with the number in 2007. What is expected when continual improvement is being made is a consistent reduction in the number of management letter points (i.e. a downward trend). As shown on the graph, the number of management letter points has remained quite consistent with neither signicant increases nor decreases.

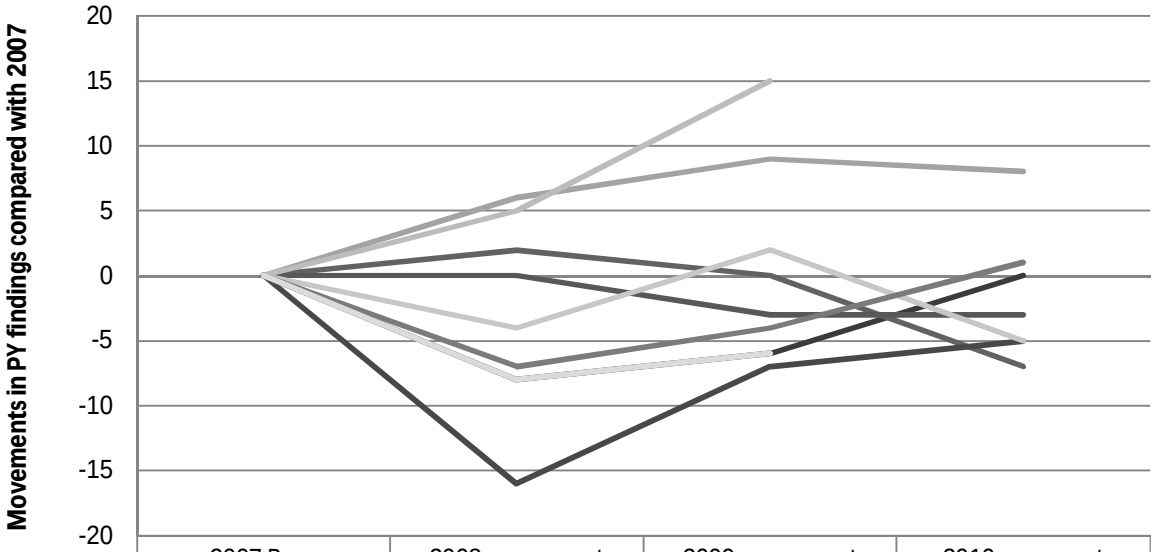
Movements in Findings since 2007



	2007 Base	2008 Movement	2009 Movement	2010 Movement
NBT	0	2	6	7
DBT	0	5	1	5
TEC	0	14	8	-4
TPB	0	0	3	3
TTC	0	-6	-5	-5
VLH	0	-3	1	1
TCS	0	8	16	
TNPF	0	3	1	3
TMTI	0	-5	-2	

The graph below shows movements in recurring management letter points for all the entities audited. Recurring management letter points are management letter points which have been raised in the prior year which have not yet been resolved. Note that there is a limited decrease in the number of recurring findings. If consistent improvements are made the number of recurring findings would be on a downward trend.

Movement in Prior Year (PY) findings using 2007 as a base



	2007 Base	2008 movement	2009 movement	2010 movment
NBT	0	-8	-6	0
DBT	0	6	9	8
TEC	0	2	0	-7
TPB	0	0	-3	-3
TTC	0	-16	-7	-5
VLH	0	-4	2	-5
TCS	0	5	15	
TNPF	0	-7	-4	1
TMTI	0	-8	-6	

AMOUNTS OWING BETWEEN ENTITIES AND THE TUVALUAN GOVERNMENT

According to the PE Act, the Public Enterprises are to be become more and more independent of the Tuvaluan Government with a formal community service obligation agreement being the only time there is not to be a profit making motive. During the audits we identified a lot of offsetting of receivables from the Tuvaluan Government with payables to the Tuvaluan government. This compromises independence and creates a precedent so that when further revenue/ expenses are incurred, they are offset rather than a cash settlement occurring. This does not encourage independence or stringent cash flow monitoring.

Recommendation 9: *The amounts owing and owed between the Tuvaluan Government and entities should be settled as soon as possible. Formal agreements should be arranged and signed, agreeing on forgiveness of loans and future payments are made in a timely manner. Interest charges should be levied on the Tuvaluan Government by the entities on outstanding payables.*

IN KIND DONATIONS

In Kind donations are provided by donors either for free or with a nominal charge. These donations are not made in cash but in the provision of goods and services. These donations normally meet the definition of an asset and should be included in the financial statements of the particular entity.

Recommendation 10: *Entities should ensure that when receiving an in kind donation that it is accounted for correctly. The pricing of the good or services provided by the entities should take into account the depreciation charge against the asset to ensure that going concern issues do not occur in the future in the event that the donations cease. Additionally, even though the assets were provided free of charge, the asset should still be maintained and kept in a usable state.*

FRAUD POLICIES

There were limited fraud policies in place or in use in each of the Public Enterprises. A Fraud Policy is a key document in the prevention and detection of fraud. It sets the entities stance that there is zero tolerance for fraud and ensures that a proper procedure is followed in the reporting of fraud. Without a fraud policy if an employee does encounter fraud, they will not know the proper policies and procedures to follow.

Recommendation 11: *That each entity creates a Fraud Policy which is explained and is accessible to each employee of the entity. The Tuvalu Audit Office can and has provided model fraud policies on request.*

Common issues with Financial Institutions

Below are some issues common to the Financial Institutions Sector (NBT, DBT and TNPF)

POLICIES AND PROCEDURES

There are a lack of documented policies and procedures relating to the primary and day to day functions of these institutions. This needs to be addressed in a timely manner to allow smooth transition as workers retire or leave and are replaced by new inexperienced workers.

Recommendation 12: *The financial institutions should document detailed policies and procedures for day to day functions. This will assist in ensuring that a higher level of consistent service is delivered.*

GRADING OF LOANS

There is a weakness across the financial institutions sector with regard to the grading of loan quality. Loan grading refers to assessing the quality of each individual loan (i.e. the likelihood the loan will be repaid on time). As grading is one of the primary functions of the financial institutions it is important that loans are graded correctly, to minimise exposure to unknown credit risks. Loans graded appropriately are able to be valued more accurately, and provisioned as required.

Recommendation 13: *The financial institutions should continue to perform their loan grading activities regularly and accurately. This will minimise exposure to unknown credit risks and will assist in assessing creditworthiness of established customers.*

CREDIT WORTHINESS AND VALUATION OF LOAN SECURITY

There are continuing problems across the sector in determining whether borrowers are credit-worthy. This may lead to the financial institutions unknowingly increasing their credit risk. When coupled with issues surrounding the valuation of loan security, the problem is compounded. If borrowers are less than credit worthy, and the value of assets offered as security are over-valued, then the institutions are increasing their risk, and exposing themselves to irrecoverable financial losses.

Recommendation 14: *The financial institutions should become more stringent and consistent when performing creditworthiness assessments and have an independent valuer assess the value of loan security being offered.*

National Bank of Tuvalu

Activities

The National Bank of Tuvalu is constituted under the *National Bank of Tuvalu Act 2008*.
It is charged with carrying on general banking business in Tuvalu. The borrowing, lending and investment powers of the bank are outlined in the Act.

The NBT is now required to comply with the *Public Enterprises (Accountability and Performance)* Act 2009. The main requirement is that the NBT's principal objective is to be a successful beneficial enterprise, with requests from the Tuvaluan Government for services on other than commercial terms formalized and compensated in a formal process called a community service obligation.

Audit opinion

The audits of the National Bank of Tuvalu's (NBT) financial reports for the year ended 31 December 2008, 31 December 2009 and 31 December 2010 all resulted in Unqualified Independent Audit Reports.

Key issues

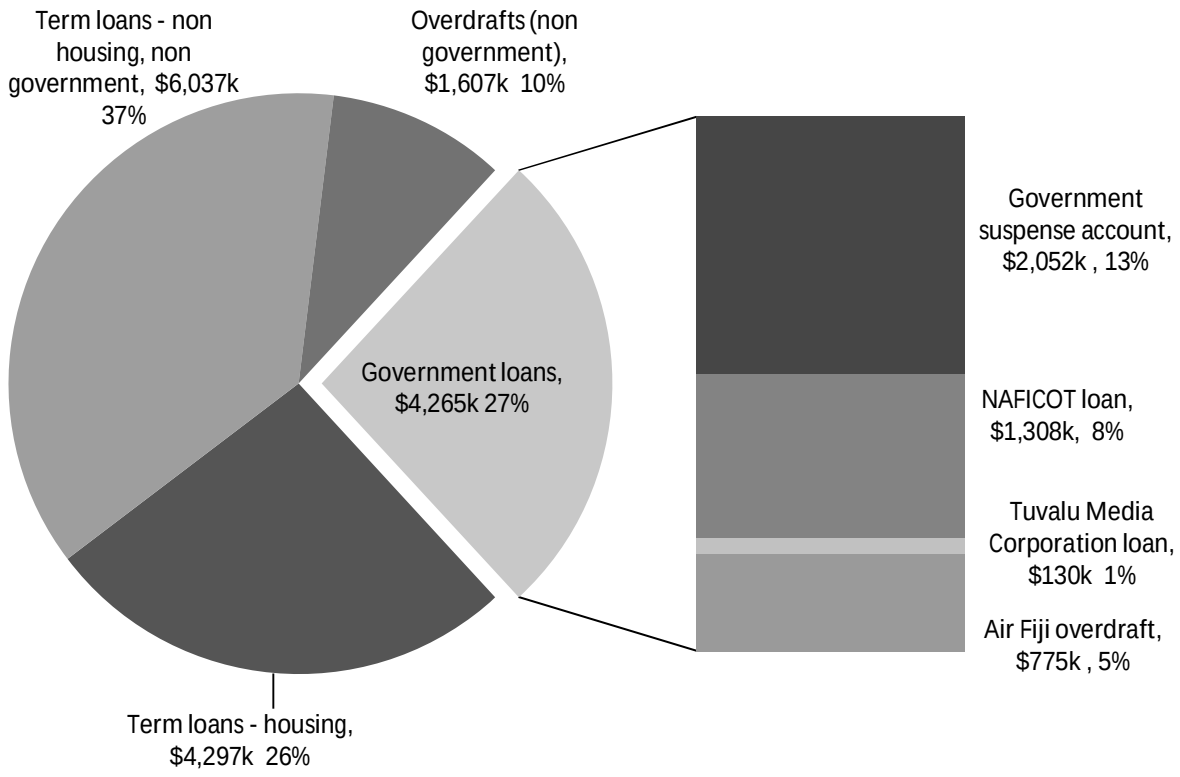
OPERATIONAL ISSUES

Significant issues and recommendations that have been indentified in past audits are not being adequately addressed by the NBT. The issues identified are surrounding the NBT's control systems, procedures and processes in the lending and operational practices. Poor management of the banking system resulted in weak performance - particularly the lending department.

LIQUIDITY ISSUES

A strong liquidity position should be priority for the NBT. The deposit to gross loan ratio in the NBT is very high and as a result the quality of the NBT's loan portfolio continues to decrease. As the majority of customer deposits are "at call" the bank needs to keep a high-level of liquidity to meet these potential withdrawals.
A large proportion of the Bank's loan portfolio relates to Tuvalu Government debt or Tuvalu Government guaranteed debt. It was also noted that the Government of Tuvalu has used the NBT as a financer of its budget resulting in the severe depletion of the NBT's liquidity level.

NBT loan portfolio breakdown, including loans to the Tuvaluan Government



Specifically the factors that have contributed to the liquidity problem are the non payment of loans by the Tuvaluan Government, long outstanding personal and housing loans and the unsatisfactory level which collection of overdue loans is being performed.

If nothing is done to address the diminishing liquidity level, recapitalisation may be required in the near future. The NBT should focus on training staff to improve banking discipline and overall management in order to maintain capital adequacy and prudential limits. In addition, the Tuvaluan Government needs to seek a strategic banking partner to assist in the overall management and operation of the bank.

LENDING ISSUES

Poor lending and credit assessment practices have contributed to the poor quality of the Bank's loan portfolio. These have resulted from a lack of technical expertise, no formal or appropriate lending policy and the over-riding of existing policies. Unnecessary credit risks should not be taken with lending.

Control issues

We identified opportunities for improvement in the following areas:

- strategic management process of the NBT;
- appropriate training of lending staff and use of internal audit function;
- development of proper policies on credit reviews;
- accurate performance of Loan grading;

- restructuring of the “hardcore” loan accounts;
- proper security documentation to be obtained for loans;
- generation of daily arrears reports;
- strengthening of treasury and liquidity management function;
- timely clearance of reconciling items from due to/due from other banks;
- proper policies on credit reviews;
- timely processing to prevent unauthorised withdrawals; and
- development and formalization of policies and procedures for outer island banks.

These and other matters have been formally raised in a management letter to the Board.
We acknowledge that the Board has developed a draft lending policy, which is an issue that was raised during the audits over a number of years.

Financial Information - National Bank of Tuvalu

Year ended 31 December	2010 $'000	Change $'000	Change %	Notes	2009 $'000	Change $'000	Change %	Notes	2008 $'000	Change $'000	Change %	Notes	2007 $'000
Operations													
Net Interest Income	**1,347**	72	6%		**1,275**	211	20%	6	**1,064**	216	25%		**848**
Operating Income	**1,657**	-368	-18%	4	**2,025**	-25	-1%		**2,050**	525	34%		**1,525**
Operating Expense	**-1,419**	17	-1%		**-1,436**	-93	7%		**-1,343**	-121	10%	5	**-1,222**
Bad Debts write off	**0**	14	-100%		**-14**	-14	-100%		**0**	118	-100%		**-118**
Allowance for Credit Impairment	**107**	465	-130%	2&7	**-358**	61	-15%		**-419**	-257	159%	2	**-162**
Income Tax Expense	**-507**	-58	13%		**-449**	-43	11%		**-406**	-248	157%	3	**-158**
Comprehensive income (loss)	**1,185**	142	14%		**1,043**	97	10%		**946**	233	33%		**713**
Assets	**28,154**	-69	0%		**28,223**	-1,288	-4%		**29,511**	3,714	14%		**25,797**
Liabilities	**20,362**	-1,253	-6%		**21,615**	-2,332	-10%		**23,947**	2,972	14%		**20,975**
Net assets (at 31 December)	**7,792**	1,184	18%	1	**6,608**	1,044	19%	**1**	**5,564**	742	**15%**	**1**	**4,822**

NOTES:

1. The NBT's net asset amount has been increasing from 2007 to 2010. This change was mainly due to increases in '*cash and cash equivalent*' and '*loans and advances*' of the bank during the periods. This is due to increased business activity within the bank.
2. Allowance for credit impairments expenses increases by 159% in 2008 which was caused by a more robust evaluation performed in 2008 of Loans and Advances assessed to be uncollectable in 2008. The expense each year has been decreasing indicating less allowances are being made each year. In 2010 there was a reversal which resulted in a gain due to loans previously assessed as impaired being re-assessed as collectable.
3. The increase in income tax expense is as a result of increases in salary increment and recruitment in 2008.
4. Other operating income decreased in 2010 due to decreases in foreign exchange income and fees and charges collected.
5. Increase in operating expense is due to unauthorised debt provision expense of $83k, increase in electricity expenses by $14k, increase in telecommunication expenses of $15k and increase in travelling expenses of $15k.
6. Interest income (Loans and Advances) increased by $169k accompanied by a fall in interest expenses (term deposits, saving accounts and call accounts) by $167k for the period ending 31st December 2009.
7. $465k of the amount assessed to be uncollected in prior years was assessed at collectable in 2010.

Development Bank of Tuvalu

Activities

The Development Bank of Tuvalu (DBT) is constituted under the provisions of the *Development Bank of Tuvalu* Act 2008. It is charged with carrying out general banking business in accordance with generally accepted international banking principles and practices. Specifically this includes providing finance by making loans for the long-term development of Tuvalu and providing relevant related advice and support services.

The DBT is now required to comply with the *Public Enterprises (Accountability and Performance)* Act 2009. The main requirement is that the DBT's principal objective is to be a successful beneficial enterprise, with requests from the Tuvaluan Government for services on other than commercial terms formalized and compensated in a formal process called a community service obligation.

Audit opinion

The audit of the Development Bank of Tuvalu's (the DBT) financial reports for the year ended 31 December 2008, 31 December 2009 and 31 December 2010 resulted in unqualified Independent Audit Reports.

Key issues

ADOPTION OF MANAGEMENT LETTERS (REPEATED ISSUE)

Management letter points in the prior year, although acknowledged positively, have not been implemented. Many issues in the current management letter have been outstanding for more than two years.

Significant management letter points have been raised for the past two years surrounding:

- systems, processes and procedures around loan assessment, loan approvals, credit management and collections;
- provisioning for loan losses;
- valuation of security during assessment of loan losses; and
- the approval of loans with sub standard security presented as collateral.

The improvements recommended are considered important for the Bank to minimise their risk of losses and to continue to operate as a going concern. The DBT made a loss in 2010 of $199k with credit impairment expense contributing $431k to this loss. The slower the implementation the more the DBT exposes itself to financial and operational inefficiencies.

LENDING POLICY

A more aggressive collection and recovery action on loans in arrears needs to be undertaken to improve the quality of the DBT's loan portfolio. Where customers make reduced repayments, consideration should be given to charging penalties.

The DBT's credit lending policy is outdated and needs to be revised. Interest rates and charges in the lending policy inadequately cover the bank's operational costs and working capital requirements. These have resulted from the current economic and political condition of the

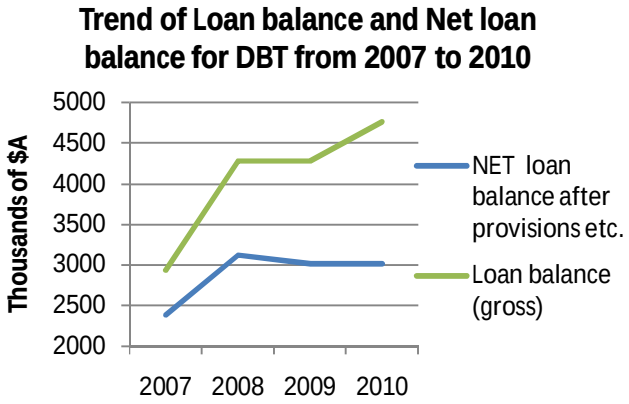
Tuvaluan economy, as well as inflation. The lending policy manual needs to be reviewed and updated to take in account the current situation in Tuvalu.

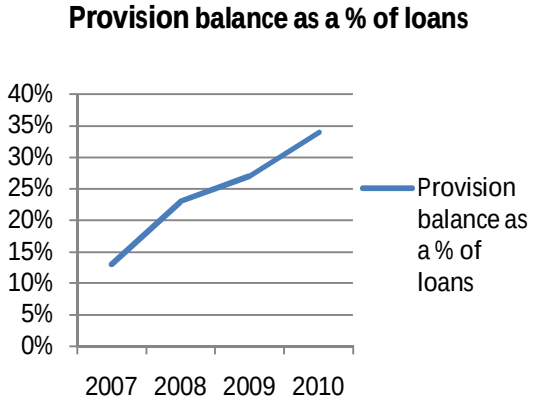
FOLLOW UP ON OVERDUE LOANS

The quality of the bank's loan portfolio has deteriorated considerably. The DBT is unable to adequately recover the balances of loans given out in prior years. The increase non performing loans have resulted in the DBT making significant losses in 2010. A detailed analysis of the loan book is shown below.

Year	**2007 '000s**	**2008 '000s**	**2009 '000s**	**2010 '000s**
Loan balance (gross)	$2,938	$4,280	$4,282	4,761
Interest in suspense (suspended interest)	-157	-167	-178	-227
Provision for doubtful debts	393	991	1,092	1,523
Accounts overdue > 5 months	*	*	341	647
NET loan balance after provisions etc.	2,388	3,122	3,012	3,011
Provision balance as a % of loans	13%	23%	27%	34%

* Data not available.





From the graphs and data above the deterioration of the quality of the loan portfolio is evident. An improvement in the quality of loan assessment prior to approving customers' loans will ensure that customers are more likely to meet the full payment amount. The bank needs to develop a more robust and thorough loan assessment procedure to avoid the risk of approving unsustainable loans over a short to medium term. Consideration should be given to factors such as the borrowers' credit history and income generation capability. Moreover, in the approval process security taken for loan should be used as a secondary source of repayment.

The bank's cash flow could be severely affected and could lead to further deterioration of loans accounts if the recommendations are not implemented.

Control Issues identified during the audit:

We identified opportunities for improvement in the following areas:

- establishment of Internal audit function;
- segregation of duties in the finance division;
- authorization of significant journals;
- anomalies in the bank reconciliation;
- asset count to be performed;
- arrears report to be updated; and
- improvement in the monitoring process.

These and other matters have been formally raised in a management letter to the Board.

Financial Information - Development Bank of Tuvalu

Year ended 31 December	2010 $'000	Change $'000	Change %	Notes	2009 $'000	Change $'000	Change %	Notes	2008 $'000	Change $'000	Change %	Notes	2007 $'000
Operations													
Net Interest Income	**276**	73	36%		**203**	-111	-35%		**314**	108	52%		**206**
Operating Income	**331**	-1,104	-77%	7	**1,435**	1,242	644%	7	**193**	-15	-7%		**208**
Operating Expense	**-375**	-10	3%		**-365**	322	-47%	6	**-687**	-364	113%	6	**-323**
Allowance for Credit Impairment	**-431**	-330	327%	5	**-101**	699	-117%	5	**-598**	-327	121%	5	**-271**
Operating surplus/(deficit)	**-199**	-1,371	-117%	4	**1,172**	1,950	-251%	**3**	**-778**	-598	332%	**3**	**-180**
Assets	**3,856**	-184	-5%		**4,040**	197	5%		**3,843**	601	19%		**3,242**
Liabilities	**-1,367**	587	-30%		**-1,954**	1,296	-40%		**-3,250**	-1,060	48%		**-2,190**
Net assets (at 31 December)	**2,489**	403	19%	2	**2,086**	1,493	252%	**1**	**593**	-459	**-44%**	**1**	**1,052**

NOTES:

1. Net Assets significantly decreased from 2007 to 2008 due to fluctuations in cash and cash equivalents and loans and advances
2. Cash and cash equivalents increased in 2009 and decreased in 2010 while loans and advances slightly decreased from 2009 to 2010.
3. DBT continued to report operating loss since 2007. This was mainly due to the increase in operating and personal expense. The profit in 2009 is due to the forgiving of a European Investment Bank loan of $971k and increases in operating income.
4. Operating surplus decrease due to one off effect of loan forgiven in 2009 and decreases in unrealized exchange income.
5. Allowance for credit impairment expense increased from 2007 to 2008 by 121% and 327% from 2009 and 2010. This is due to the lack of robust credit assessment procedures and collection procedures.
6. Decrease in operating expense is due to an unrealised exchange gain being made in 2009.
7. Increase of operating income in 2009 is due to the forgiveness of a loan to the DBT by the European Investment Bank of $970k. Decrease in 2010 is due to the forgiveness of the loan being a one off factor in 2009, not a recurring payment.

Tuvalu Telecommunications Corporation

Activities

The Tuvalu Telecommunications Corporation (TTC) is constituted under the provisions of the *Tuvalu Telecommunications* Act 2008. It is charged with carrying on the business of supplying telecommunications services and is able to establish, conduct, work, operate, and maintain telecommunications services and systems within and outside Tuvalu. Under *The Tuvalu Telecommunication* Act 2008, the Telecommunications is given an exclusive right to operate these services and system.

The TTC is now required to comply with the *Public Enterprises (Accountability and Performance)* Act 2009. The main requirement is that the TTC's principal objective is to be a successful beneficial enterprise, with requests from the Tuvaluan Government for services on other than commercial terms formalized and compensated in a formal process called a community service obligation.

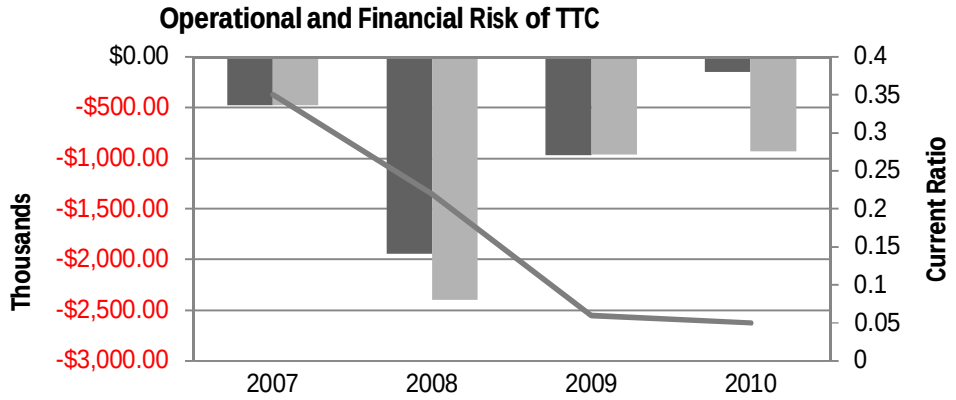
Audit opinion

The audit of the Tuvalu Telecommunication Corporation (TTC) for the period ending 31 December 2008 resulted in an Unqualified Audit Report. For the periods ending 31 December 2009 and 31 December 2010, an Unqualified Audit Report with an emphasis of matter surrounding the deficiency of working capital and shareholder equity was issued.

Key issues

HIGH OPERATIONAL AND FINANCIAL RISK

The TTC's financial position and operating performance over the years has been deteriorating significantly, which has resulted in cash flow issues, a working capital deficiency, negative shareholders equity and losses over the past four years.



	2007	2008	2009	2010
Net Loss	-$478,100.00	-$1,945,945.00	-$964,896.00	-$150,616.00
Balance of Cash and Cash equivalents (less overdraft)	-$478,000.00	-$2,397,000.00	-$964,000.00	-$930,000.00
Current assets/ Current Liabilities (Current ratio)	0.35	0.22	0.06	0.05

Some of the major factors contributing to the losses, deficiency working capital and cash flow position are:

- lack of formal product/pricing analysis;
- declining trend in overall revenues of the Corporation;
- poor cash flow monitoring mechanisms in place;
- poor debtors' collection process and procedures; and
- lack of control over costs.

A comprehensive review of the TTC's strategy, financial and operational aspects should be carried out to ascertain the cause of the poor operational and financial performance. In addition, Community Service Obligations need to be quantified and possible compensation obtained from government should they require these services to be provided.

RECOVERY OF OUTSTANDING DEBTORS

Procedures and processes surrounding the collection of debtors are very weak. The TTC has over $1.2 million of trade debtors that have been outstanding for at least four years and little has been done to recover this debt. Furthermore, it was also noted that at balance date uncollected phone bills due from staff members amounted to $19k. Attempts were made to recover these sums; however, no significant progress was made. These noteworthy amounts have impacted the cash flow and the ability of the corporation to meet its immediate liabilities.

Unless there is a major review of controls surrounding the operation, pricing structure, revenue assurance and generation, the TTC will continue to require financial support either from NBT or the Tuvaluan Government.

CASH POSITION

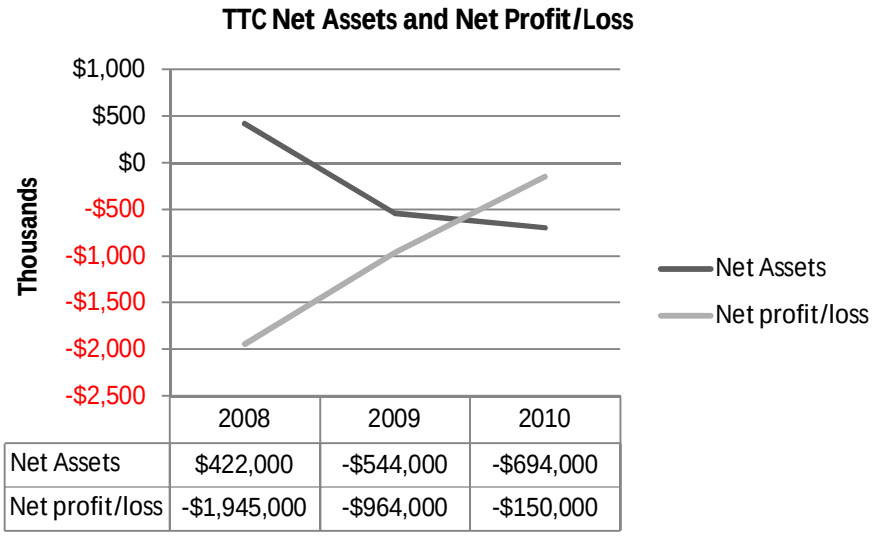
The TTC's cash position has deteriorated during the year. The TTC's operating cash balance shows an overdraft of $986k in 2010, which is similar to a balance of $994k in 2009 and $550k in 2008. The cost of operation exceeds total revenue and this trend has been in existence since 31st December 2007. It was also noted that the cash position has been severely deteriorated to an extent that the TTC was facing difficulties in making provident fund and salary tax payments for staff members. The following factors are considered to have contributed significantly to this state:

- poor debt collection and recovery in the past;
- high operations costs and small growth in revenue;
- delays in the implementation of the new network system; and
- variations in costs of new equipments purchased for the new network.

The TTC should ensure appropriate strategies are in place to address its cash position. Moreover, further funding from stakeholders should be sourced to improve liquidity of the Corporation.

GOING CONCERN

The TTC's liquidity position has been the main concern resulting in the emphasis of matter issued. The impact of the deficiency of working capital, net loss and deteriorating cash flow will further give rise to liquidity and solvency risk. The corporation's Net Asset and Net Loss trend for the period 31 December 2008 to 31 December 2010 are as follows:



	2008	2009	2010
Net Assets	$422,000	-$544,000	-$694,000
Net profit/loss	-$1,945,000	-$964,000	-$150,000

Liquidity and solvency risk will be an issue for the corporation if nothing is done to mitigate the issues.

Control issues

We identified opportunities for improvement in the following areas:

- absence of proper license agreement;
- unauthorized usage of pin codes;
- completion of outer island's bank reconciliations;
- inadequate fixed assets policies and procedures;
- inadequate debtors management, aging and billing software;
- clarification of tax liability;
- recovery of staff's phone bills;
- development of Fixed Asset policies, and
- lack of proper accounting and control system.

These and other matters have been formally raised in a management letter to the Board.

Financial Information - Tuvalu Telecommunications Corporation

Year ended 31 December	2010 $'000	Change $'000	Change %	Notes	2009 $'000	Change $'000	Change %	Notes	2008 $'000	Change $'000	Change %	Notes	2007 $'000
Operations													
Revenue	**1,612**	508	46%	5	**1,104**	228	26%	1	**876**	-280	-24%	2	**1,156**
Expenses	**-1,632**	297	-15%	6	**-1,929**	689	-26%	3	**-2,618**	-900	52%	4	**-1,718**
Financing cost	**-124**	-9	8%		**-115**	-66	135%		**-49**	-65	-406%		**16**
Tax Expense	**-6**	18	-75%		**-24**	130	-84%		**-154**	-223	-323%		**69**
Operating surplus/(deficit)	**-150**	814	-84%	7	**-964**	981	50%	3	**-1,945**	-1,468	308%		**-477**
Current Assets	**115**	-43	-27%	8	**158**	-346	-69%	9	**504**	23	5%		**481**
Non-current assets	**2,390**	-204	-8%		**2,594**	-295	-10%	10	**2,889**	-434	-13%		**3,323**
Current Liabilities	**-2,545**	76	-3%		**-2,621**	-310	13%		**-2,311**	-921	66%	11	**-1,390**
Non-current liabilities	**-654**	20	-3%		**-674**	-14	2%		**-660**	-613	1304%	12	**-47**
Net assets (at 31 December)	**-694**	-151	28%		**-543**	-965	-229%		**422**	-1,945	-82%		**2,367**

NOTES:

1. The increase in revenue was due to an increase in internet link income of $138k and increase in sales of prepaid cards and sales of Sky Pacific connections.
2. Decrease in revenue due to a $135k in telephone revenue and a one of debt recovery of 235k in 2007 which did not affect the 2008 accounts.
3. Decrease in expenses due to decrease in impairment loss expense of $510k and decrease in depreciation expense of $134k
4. Increase due to increase in doubtful debts expense of $122k, an impairment loss of $597k booked and a $300k increase in operating expenses, mainly attributed to satellite charges and exchange losses.
5. Increase in revenue due to increase in telephone revenue of $105k, increase in Government Grant revenue of $264k, Licence fee revenue $75k and Other income increasing by $134k.
6. Decrease in expenses due to decrease in doubtful debt expense of $113k, a decrease in personnel expenses of $41k and decreases in other operating expenses mainly surrounding rent subsidies ($100k) and satellite charges ($52k)
7. Decrease in deficit due to the increase in revenue from debt recovery and phone rental, as well as decrease in expenditure from doubtful debts and other operating expenditure.
8. Decrease in current assets due to reduction in trade and other receivables of $53k partially offset by an increase in cash and cash equivalents of $14k.
9. Decrease due to decrease in trade and other receivables $351k, due to collection and due to increase in allowance for doubtful debts.
10. Decrease in non-current assets due to depreciation charge of property plant and equipment of $223k.

11 Increase in current liabilities dues to creditors and accruals increasing by $889k due to trade creditor increase of $467k, Traffic creditors increasing by $256k and the bank overdraft increasing by $166k.

12 Increase in non-current liabilities due to deferred tax liability increase of $154k and increase in deferred revenue of $459k.

Tuvalu Electricity Corporation

Activities

The Tuvalu Electricity Corporation (TEC) operates under the provisions of the *Tuvalu Electricity Corporation Act 2008.* It is charged with carriage of the general business of the supply of electricity either for sale or otherwise within Tuvalu. The TEC carries out all local functions related to electricity. These include generation and distribution of electricity, maintenance the supply network, managing the required load and the maintenance of customer accounts.

The TEC is now required to comply with the *Public Enterprises (Accountability and Performance)* Act 2009. The main requirement is that the TEC's principal objective is to be a successful beneficial enterprise, with requests from the Tuvaluan Government for services on other than commercial terms formalized and compensated in a formal process called a community service obligation.

Audit opinion

The audit of Tuvalu Electricity Corporation's (TEC) financial report for the year ended 31 December 2008, 31 December 2009 and 31 December 2010 resulted in a qualified Independent Audit Report. The report was qualified on the basis of going concern, deficiency of working capital and shareholder's equity, un-reconciled debtors and inventory valuation.

Key issues

ADOPTION OF THE MANAGEMENT LETTER

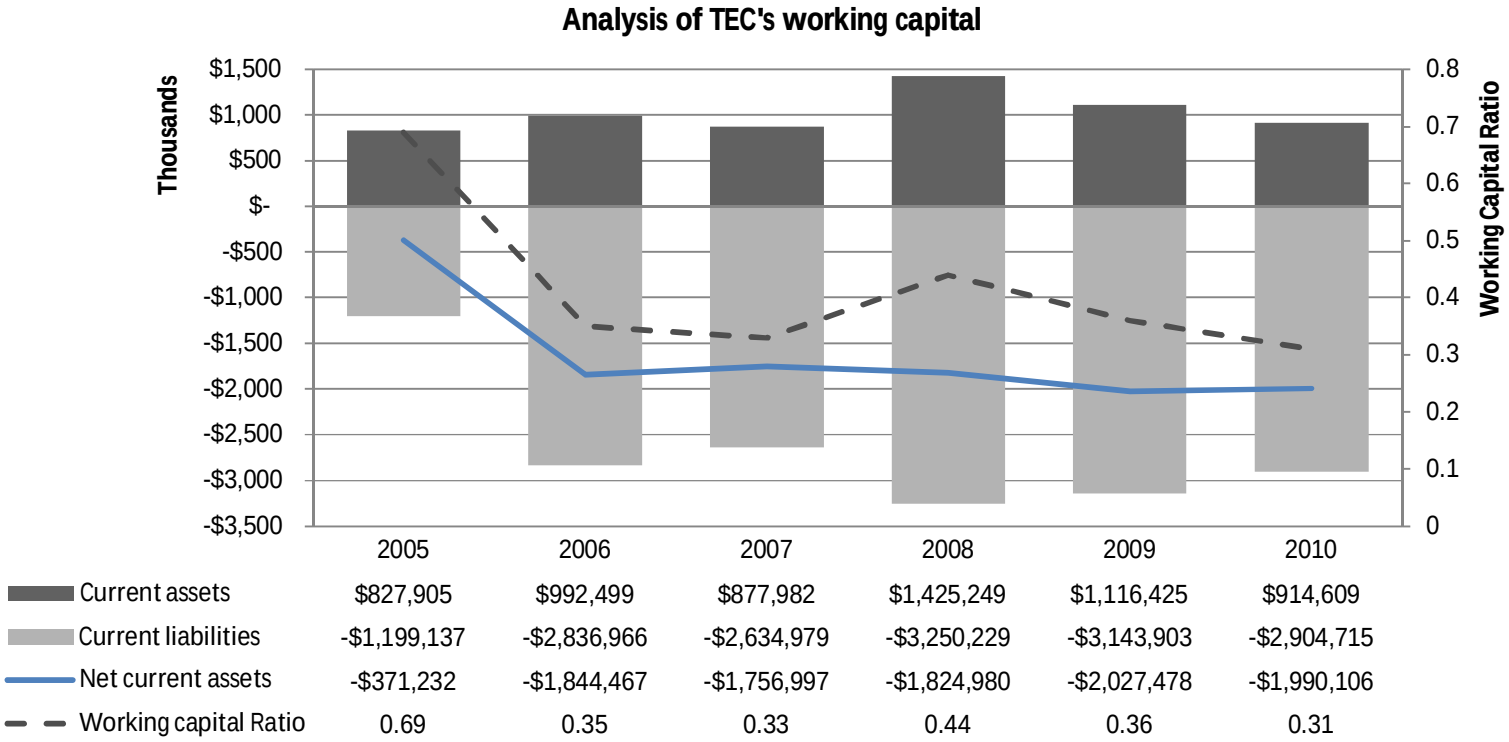
Management letter points in prior years, although accepted by management have not been adequately addressed and implemented. It is understandable that financial matters will take time to address; however, consideration should be given to immediately address system, processes and procedural issues.

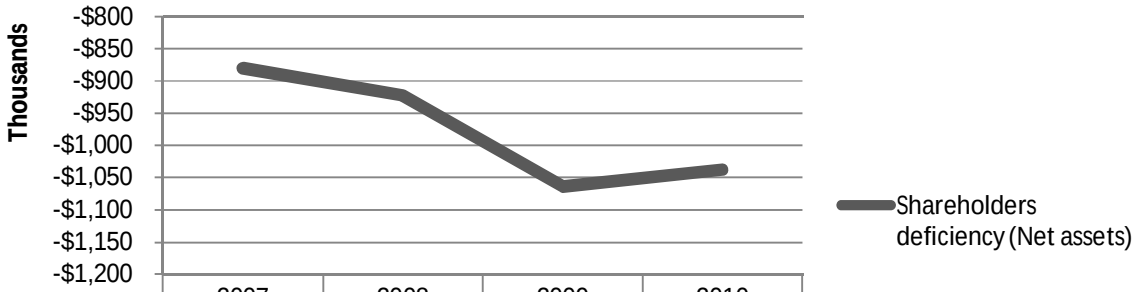
Management and the Board should agree on setting a formal timeline to address issues raised and assign a senior staff member to regularly follow up on the progress made against the timeline set to address them. This should not be performed to appease the auditors, but to ensure that improvement is continued to be made, in an attempt to reduce the severity of the qualification.

HIGH OPERATIONAL AND FINANCIAL RISK

The TEC's working capital position continues to deteriorate since its inception in 1996. As at 31 December 2010, the TEC's shareholder's equity had a deficiency of $1,038k (2009 - $1,063k). The balance of the bank overdraft of $406k in 2010 (2009 - $503k) reflects the TEC's cash flow difficulties over the past three years. With continuous working capital and cash flow difficulties, the TEC has a high level of operational and financial risk. The major factors contributing to cash flow difficulties need to be addressed in a timely manner to ensure that TEC can operate more effectively.

The table below shows the capital position and shareholder's deficiency of the TEC's working capital:





	2007	2008	2009	2010
Total assets	$10,580,474	$10,613,038	$8,953,165	$7,094,331
Total liabilities	-$11,460,957	-$11,085,988	-$10,016,564	-$8,132,092
Shareholders deficiency (Net assets)	-$880,483	-$922,950	-$1,063,399	-$1,037,761

Major factors contributing to the negative working capital and cash flow position are:

- high cost of fuel to generate electricity and high maintenance cost of the generators due to wear and tear. Continuous increase in cost of fuel due to increase in unit prices;
- high level of debtors due to poor management of customers' debt. A significant part of this debt balance is outstanding from the Tuvaluan Government; and

- the fixed tariff rate, which is strictly controlled by the Government and the decline in Government assistance over the years in relation to fuel subsidy and operational grants.

The qualified opinion in regards to the risk of the TEC no longer being able to continue as a going concern is based on the factors above.

Continuous support from Government in the form of agreed Community Service Obligations are needed to alleviate the high cost of operations. Furthermore, consideration should be given to carrying out a thorough financial and operational review to determine causes of the poor financial performance.

INFORMATION NOT PROVIDED ON A TIMELY BASIS

The TEC's major finance reconciliations were not prepared and compiled on a timely basis while other reports were not received from management. This resulted in the delay in finalising the audit for the year ended 31 December 2010.

It is important that finance reconciliations are prepared, reviewed and approved on a timely basis to detect and address errors and omissions in a timely manner. Additional training on finance reconciliations are needed to enhance staff's skills and knowledge and to enhance the quality of the finance reconciliation and reports.

The non preparation of management monthly accounts will affect the quality and reliability of financial reconciliations and reports.

OUTSTATIONS FINANCIAL PERFORMANCE NOT MONITORED REGULARLY

The financial performance of the outstations (outer island branches) is not being monitored on a regular basis. To effectively monitor and control operations at the outer islands, proper reports including a profit and loss statement should be compiled and reviewed by management regularly.

The introduction of the new Quantum General Ledger system in 2010 should enable the Corporation to compile outstation reports as the system has the tools to extract data based on location.

The TEC should consider preparing monthly financial reports that shows total revenue, total costs and surplus/loss in order to ascertain that each outstation is performing in line with its budget.

Control issues

We identified opportunities for improvement in the following areas:

- development and implementation of proper journal forms;
- proper management of inventory;
- improvement of trade debtors turnover;
- review of bank reconciliation;
- treatment of donated assets;
- strengthening of IT management; and
- maintenance of annual leave records.

Without proper management of all these issues, Tuvalu will not effectively be able to control and monitor its energy needs and usage. These and other issues have been formally raised in the management letter to the board.

Financial Information - Tuvalu Electricity Corporation

Year ended 31 December	2010 $'000	Change $'000	Change %	Notes	2009 $'000	Change $'000	Change %	Notes	2008 $'000	Change $'000	Change %	Notes	2007 $'000
Operations													
Revenue	**6,236**	1,927	45%	1	**4,309**	-473	-10%		**4,782**	286	6%		**4,496**
Expenses	**-6,176**	-1,831	42%	2	**-4,345**	399	-8%		**-4,744**	88	-2%		**-4,832**
Financing cost	**-35**	69	-66%		**-104**	-25	32%		**-79**	-41	108%		**-38**
Operating surplus/(deficit)	**25**	165	-118%	3	**-140**	-99	241%		**-41**	333	-89%		**-374**
Current Assets	**915**	-201	-18%	8	**1,116**	-310	-22%	4	**1,426**	549	63%	5	**877**
Non-current assets	**6,180**	-1,657	-21%	7	**7,837**	-901	-10%		**8,738**	-964	-10%		**9,702**
Current Liabilities	**-2,905**	239	-8%		**-3,144**	106	-3%		**-3,250**	-614	23%	6	**-2,636**
Non-current liabilities	**-5,227**	1,646	-24%	9	**-6,873**	963	-12%		**-7,836**	990	-11%		**-8,826**
Net assets (at 31 December)	**-1,037**	27	-3%		**-1,064**	-142	15%		**-922**	-39	4%		**-883**

NOTES:

1. Increase in revenue due to increase electricity revenue of 484k and increase in amortisation of grant income of $869k and increase in grants paid of $922k.
2. Increase in expenditure due to increases in fuel costs ($238k), increase in doubtful debts expense ($395k), impairment expense increase of (727k) and increase in obsolescence expenses ($223k).
3. Decrease in surplus due to the increase in expenditure only being partly offset by the increases in revenue for 2010.
4. Decrease due to the decrease in Receivables balance of $380k due to provision for doubtful debts increase of $265k and increased collections of receivables of the balance.
5. Increase mainly attributed to increase unpaid receivable from the Tuvaluan Government of ($595k).
6. Increase in current liabilities predominantly due to increase in bank overdraft of $581k
7. Decrease due to depreciation of $964k and impairment of $726k.
8. Decrease in current assets due to decrease in inventories on hand ($342k) due to an increase in allowance for stock obsolescence which was partly offset by an increase in receivables ($53k).
9. Decrease is due to deferred grant income being amortised into revenue as the benefits of the grant are used ($1,645k).

Vaiaku Lagi Hotel

Activities

The Vaiaku Lagi Hotel (VLH) is constituted under the provisions of the *Vaiaku Lagi Hotel Corporation Act 2008*. It is charged with carrying on the business of operating a hotel, including the running and management of restaurants, refreshment rooms, tearooms, coffee shops, Accommodation Facilities, Bars and entertainment. Its functions include dealing in foods, drinks, and other products in the course of the business, fitting out and furnishing rooms, providing laundry services.
The VLH is now required to comply with the *Public Enterprises (Accountability and Performance)* Act 2009. The main requirement is that the VLH's principal objective is to be a successful beneficial enterprise, with requests from the Tuvaluan Government for services on other than commercial terms formalized and compensated in a formal process called a community service obligation.

Audit opinion

The audit of the Vaiaku Lagi Hotel's (VLH) financial report for the year ended 31 December 2008, 31 December 2009 and 31 December 2010 resulted in an unqualified Audit Report.

Key issues

PROFITABILITY OF THE VLH

The VLH continues to operate unprofitably. The overall net assets of the VLH continue to decline with no significant strategy in place to change this trend. No assessments have been conducted by the VLH to ascertain the reason for this continued loss.
The loss/profit after tax and net assets over the last five years are highlighted below:

	2010 $	2009 $	2008 $	2007 $	2006 $
Net (loss) / profit / (loss) after tax	(46,550)	(22,472)	53,129	(10,427)	(88,850)
Net assets	90,311	136,861	159,333	172,085	185,203

The hotel building has been fully depreciated so even though no depreciation expense has been booked, the VLH continues to incur losses. These have resulted from the lack of compliance with process, procedures and the lack of good internal controls. The capturing of all revenue and follow up of debts owed to the VLH is one area of internal control which directly affects the VLH's financial position.

In order for the VLH to trade profitably, a clear disciplined strategy needs to be undertaken and implemented. A review of the VLH's operations needs to be undertaken to ascertain areas of operational weakness, internal control weakness and unprofitable segments.
Following this review a strategy needs to be implemented to improve on the areas identified.

IMPLEMENTATION OF ISSUES TO BE IMPROVED

The implementation of issues raised by audit in the past years is very poor. Significant numbers of issues are raised every year and there is lack of action taken by the VLH to resolve them.

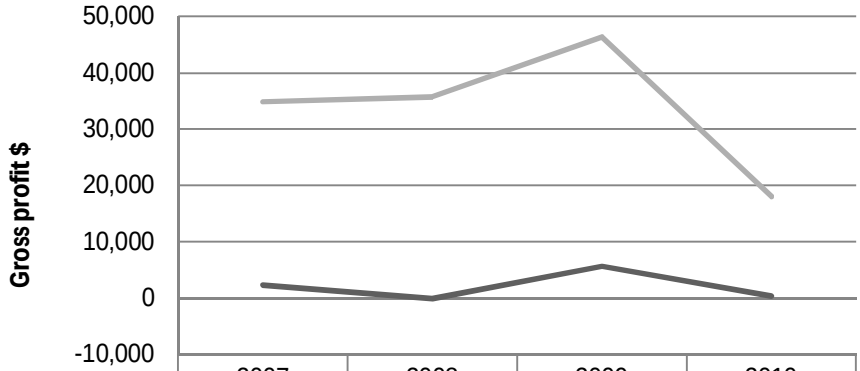
The continuous delay in implementing issues raised resulted in the audit reporting the same issues as in the past, with the Hotel facing greater difficulties in resolving them.

The Board and management needs to develop appropriate strategies to address and resolve these recurring issues and set appropriate timelines to implement them.

PROFITABILITY OF BAR AND KITCHEN TO BE IMPROVED

The bar and food departments have incurred low and declining gross profits in the 2010 financial year. The analyses of the gross profits of the two departments for the last four years are:

Trend in Gross profit from food and beverage sales



	2007	2008	2009	2010
Gross Profit / (loss) from Food	2,263	-142	5,592	278
Gross profit from Beverage	34,849	35,777	46,407	18,066

Key attributing factors include:

- High level cost of operations and declining trends in sales. For example in the beverage area, sales declined from $146k in 2009 to $113k in 2010 while payroll cost for the department increased from $21k to $34k in 2010. This adverse trend indicates that the VLH is not effectively managing its operating costs.
- The lack of costing and meal planning review by the VLH's food department. A proper menu costing needs to be carried out in order to have a correct picture of costs incurred for meals provided.
- Weak internal controls and procedures over stock items in the food and beverage department led to pilferages and stock losses.
- The decline in demand of beverages offered due to high pricing and guests preferring to purchase beverages from other competitors. The hotel needs a strategic review in the price and quality of its service and compare to competitors in the market.

A comprehensive objective, strategies and business plan need to be established to address the ongoing ineffectiveness and decline in profits in these two departments. In addition, management need to review the price of meals, bar inventory selling prices and salaries and wages of employees in the bar and

beverage area. Furthermore, the control over stock in these two areas needs to be reviewed and strengthened.

COMPUTERISED ACCOUNTING ENVIRONMENT

Currently no computerised accounting information system is used by the VLH. The size and nature of operations warrants the purchase of a computerised accounting system as the manual general ledger is considered prone to errors.

Having to perform all accounting tasks manually consumes a significant amount of time when attempting to prepare management reports. This may in turn hinder management final decisions through lack of timely information.

A thorough review of the VLH's information and business process needs to be undertaken with consideration to acquiring an integrated accounting system. This will assist the Hotel in producing a more timely and efficient reporting information.

NO DEBTOR RECOVERABILITY ASSESSMENT CONDUCTED

It is crucial that debtors provisioning is conducted on a monthly basis to ensure that non performing debts are identified and provided for. It was noted that no debtors provisioning was conducted before audit of 2010 financial year. This practice is unacceptable as there are non performing debtors against which provisioning needs to be raised. The lack of provisioning assessment will result in the hotel inadequately providing for non performance debts and misstated profit and loss thus not reflecting the true financial performance of the hotel.

The assessment of debt recoverability will assist in identifying problem debtors and ensure credit facilities for these debtors are ceased.

Control issues

We identified opportunities for improvement in the following areas:

- weak financial and internal controls;
- review of journal entries;
- verification of fixed assets register;
- maintenance of Fixed Assets Register;
- valuation of building and improvement;
- strengthening of quotation process;
- improvement of revenue and receivable process;
- improvement of debtors collection;
- write off of long outstanding debtors;
- revision of basis of costing;
- strengthening of procurement planning; and
- proper reconciliation of cash.

These and other matters have been formally raised in a management letter to the Board.

Financial Information - Vaiaku Lagi Hotel

Year ended 31 December	2010	Change	Change	Notes	2009	Change	Change	Notes	2008	Change	Change	Notes	2007
	$'000	$'000	%		$'000	$'000	%		$'000	$'000	%		$'000
Operations													
Revenue	**575**	2	0%		**573**	-71	-11%		**644**	9	1%		**635**
Cost of sales	**-319**	-1	0%		**-318**	70	-18%	4	**-388**	25	-6%		**-413**
Other Operating Income	**49**	15	44%	15	**34**	-67	-66%	5	**101**	62	159%	11	**39**
Expenses	**-351**	-40	13%	1	**-311**	-7	2%		**-304**	-33	12%		**-271**
Operating surplus/(deficit)	**-46**	-24	109%	2	**-22**	-75	-142%		**53**	63	-630%		**-10**
Current Assets	**135**	-18	-12%		**153**	20	15%	8	**133**	25	23%	12	**108**
Non-current assets	**81**	19	31%	6	**62**	-17	-22%	9	**79**	16	25%	13	**63**
Current Liabilities	**-126**	-47	59%	7	**-79**	-26	49%	10	**-53**	12	-18%	14	**-65**
Net assets (at 31 December)	**90**	-46	-34%	3	**136**	-23	-14%		**159**	53	**50%**		**106**

NOTES:

1 Expenses continue to increase due to increase in hotel operating cost every year and also an increase in doubtful debts expense in 2010 of $24k
2 The hotel continue to run on a loss due to high operation costs and decline in gross profit in the bar and food department.
3 Decline in net asset trend every year indicates that overall, total assets continue to decrease while total liabilities increases yearly.
4 Decrease in Cost of sales due to decrease in cost of food of$51k and beverage costs of $24k.
5 Decrease in Other Operating Income due to reversal of over accruals of $51k and room tax expense of $29k in the prior year
6 Increase in Non-current assets due to additions made for Plants and Equipment of $17k, Furniture and fittings of $16k and Motor vehicles of $15k offset by depreciation.
7 Increase in Current Liabilities due to the increase in Other Payables of $65K, $5k increase in provision for annual leave and a $23k decrease in Trade Payables.
8 Increase in cash at bank of$38k partially offset by a decrease in receivables of $15k.
9 Decrease in non-current assets is due to increase in depreciation charge of $24k offset partially by acquisitions.
10 Increases in Current Liabilities causes from the increase in Creditors and Payables of $26k
11 Increase in other income due to the reversal of over accruals in the prior year of $51k and increase in internet charges, hotel hiring fee, guest laundry and other income.
12 Increase in current assets due to the increase in the hotel inventories (Beverage $19k & food $18k), cash at bank ($5k) and the decrease in allowance for doubtful debts from the prior year.
13 Increase in non-current assets due to decrease in the amount of depreciation charge of $21k during the year.
14 Decrease in current liabilities due to the decrease in trade payables during the year $12k.
15 Increase in Other operating income due to the increase of $7k in the hotel hiring fee plus other increases in guest laundry ($1k), internet charges ($2k) and other income ($4k).

Tuvalu Philatelic Bureau

Activities

The Tuvalu Philatelic Bureau (TPB) is constituted under the provisions of the Tuvalu Philatelic Bureau Act 2008. It is charged with carrying on general philatelic business to include the sale, promotion and production of stamps. Its functions include selling stamps locally to tourists, taking mail orders for stamps abroad, and approving designs for new stamp issues.

The TPB is now required to comply with the *Public Enterprises (Accountability and Performance)* Act 2009. The main requirement is that the TPB's principal objective is to be a successful beneficial enterprise, with requests from the Tuvaluan Government for services on other than commercial terms formalized and compensated in a formal process called a community service obligation.

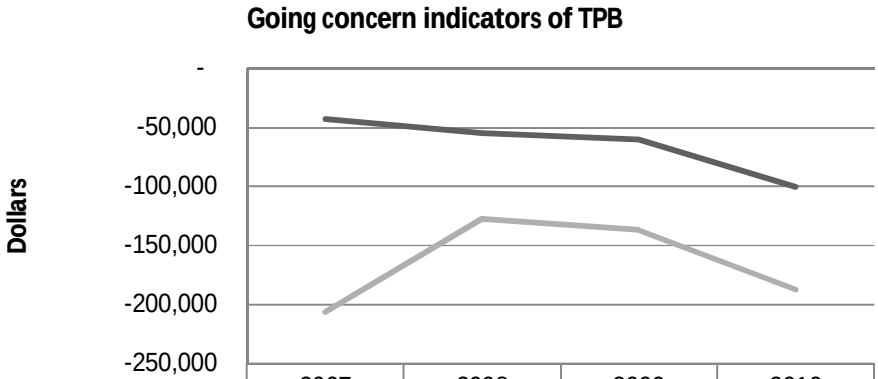
Audit Opinion

The audit opinion for the year ended 31 December 2008 was unqualified. For the years ended 31 December 2009 and 31 December 2010 the audit opinion was qualified surrounding the valuation of the stamp inventory with an emphasis of matter surrounding the TPB's ability to continue as a going concern.

Key Issues

GOING CONCERN

The TPB has made significant losses in 2008, 2009 and 2010 and has a negative net asset position. The viability of the Bureau will continue to be under severe strain if no injection of capital is provided by the Government of Tuvalu. Measures should be taken to increase profitability by decreasing expenditures and creation of a strategies to make the TPB profitable once again. The graph below shows the increase in losses made since 2007 as well as the declining negative net asset position.



	2007	2008	2009	2010
Comprehensive income	-42,818	-55,094	-59,966	-100,472
Net assets	-206,651	-126,978	-136,944	-187,416

LACK OF INVENTORY PRICING AND QUANITY DATA

There is lack of inventory pricing and quantity data, surrounding both stamps and stationary. This is due to stock takes not being performed. As such the Tuvalu Audit Office was unable to gain assurance surrounding the balances of inventory and cost of goods sold. Inventory management controls assist in the management of stock, assessing if there has been any theft/ pilfering of the stock and assessing which types of stamps were popular with customers.

USAGE OF THE FINANCIAL MANAGEMENT AND INFORMATION SYSTEM

The TPB currently uses a paper based system to perform their accounts recording. Although acceptable, this method is considered to be more inefficient than the usage of a computer based accounting system including it being unable to be backed up properly and is susceptible to human error. The accounting package MYOB (Mind Your Own Business) is owned by the Tuvalu Philatelic Bureau, however, is not in use. We recommend that MYOB is used as the primary financial management and information system as opposed to the paper based ledger system currently in use.

Control Issues

We identified opportunities for improvement in the following areas:

- maintenance of a daily back up of work not performed;
- management of accounts receivable ledger (including documentation);
- pricing of inventories correctly;
- management and reporting on the Inter-Governmental Philatelic Corporation;
- performance of stock takes at year end
- maintenance of inventory listings;
- preparation process of financial statements; and
- lack of electronic financial management and information system

These and other matters have been formally raised in a management letter to the Board.

Financial Information- Tuvalu Philatelic Bureau

Year ended 31 December	2010	Change	Change	Notes	2009	Change	Change	Notes	2008	Change	Change	Notes	2007
	$'000	$'000	%		$'000	$'000	%		$'000	$'000	%		$'000
Operations													
Gross profit	**55**	-4	-7%		**59**	3	5%		**56**	6	12%		**50**
Other Income	**35**	-1	-3%		**36**	-1	-3%		**38**	5	15%		**33**
Total Expenses	**-190**	36	-23%	5	**-154**	5	3%		**-149**	-23	18%	2	**-126**
Operating surplus/(deficit)	**-100**	-41	69%		**-59**	-3	5%		**-55**	-12	28%		**-43**
Current Asset	**88**	6	7%		**82**	0	0%		**82**	63	332%	4	**19**
Non-current Asset	**9**	-1	-10%		**10**	1	11%		**9**	5	125%		**4**
Current Liabilities	**-284**	56	-24%	3	**-229**	11	5%	1	**-218**	5	-2%		**-223**
Net Assets surplus/(deficit)	**-187**	-51	37%		**-137**	-10	8%		**-127**	73	-37%		**-200**

NOTES:

1. Increase due to non-payment of creditors at the end of 2009 given the bank overdraft was at its limit.
2. Increase due to staffing cost increase of $19k
3. Increase in current liabilities due to unpaid TNPF surcharges as well as other amounts owed to creditors.
4. Increase due to a $63k receivable booked for outstanding monies from the previous stamp printer.
5. Increase in expense due to interest surcharge on unpaid TNPF contributions ($23k) and employee expenses ($9k) due to long service leave payouts.

National Fishing Corporation of Tuvalu

Activities

The National Fishing Corporation of Tuvalu (NAFICOT) is governed under the National Fishing Corporation of Tuvalu Act of 2008. The NAFICOT's business is in the exploitation,
processing and marketing of marine resources including, engage in fishing, culturing and harvesting of all forms of aquatic life, process, buy, sell and market all forms of aquatic life, encourage and assist in the development of locally owned fishing enterprises and encourage the people of Tuvalu to exploit marine resources of all kinds.

The NAFICOT is now required to comply with the *Public Enterprises (Accountability and Performance)* Act 2009. The main requirement is that the NAFICOT's principal objective is to be a successful beneficial enterprise, with requests from the Tuvaluan Government for services on other than commercial terms formalized and compensated in a formal process called a community service obligation.

Audit Opinion

No set of financial statements were presented for audit for 2008, 2009 or 2010. The last set of financial statements prepared by the National Fishing Corporation of Tuvalu was in 1999. They were qualified on the issues of incorrect comparative information, lack of proper accounting records and no effective system of internal controls. This is considered to be unacceptable.

Recommendation 15: *That PERMU and the Tuvaluan Government continue to request and follow up with NAFICOT financial statements for the past 11 years. In the event that the NAFICOT refuse to submit financial statements, take action against them in accordance with the Public Enterprises (Accountability and Performance) Act 2009.*

Tuvalu Maritime Training Institute

Activities

The TMTI is constituted under the provisions of the Tuvalu Maritime Training Institute Act 2008. It is charged with carrying on maritime training including the assessment of competence of seafarers and the issuance of assessment certificates attesting that competence.

The primary functions of TMTI are to operate training vessels, to buy, sell or import food and drinks for training use, to operate workshop facilities, and to charge for its services and training as the board determines.

The TMTI is now required to comply with the *Public Enterprises (Accountability and Performance)* Act 2009 as it is considered a public beneficial enterprise. The TMTI is required to operate in as efficient and effective manner as comparable organisations that are not owned by the State and it to provide an excellent service to its users.

Audit opinion

The audit of the Tuvalu Maritime Training Institute (TMTI) for the periods ending 31 December 2008 and 31 December 2009 both resulted in a Qualified Independent Audit Report. The qualification for 2008 and 2009 accounts was based on the uncertainties over the collectability of Revalidation Fees. Financial statements for 2010 are yet to be presented for audit.

Key issues

MANAGEMENT OF DEBTORS

The TMTI's account receivables net of provision for doubtful debts are carried in the statement of financial position at $690,533. Records for the debtors to the TMTI pre 2008 are not present, and there is significant uncertainty surrounding the collectability of these debts. There has already been provisioning of the debt, however, given the lack of records pre 2008, the audit considered this to be insufficient. If all of the provision for doubtful debts of $601,963 was applied to the pre 2008 balance, a net receivable of $535,607 of the pre 2008 balance would still remain.

Management has not adequately provided for these debts as they are unable to assess the collectability given the lack of information surrounding the debtors. The maximum amount of misstatement is estimated at $535,607, in understatement of provision for doubtful debts and understatement of doubtful debts expense.

PAY AS YOU EARNED (PAYE) TAX OWED TO TUVALU GOVERNMENT.

The TMTI owes a substantial amount of money for PAYE taxes to the Tuvaluan Government. This has not been paid due to a disagreement with the Tuvaluan Government surrounding the TMTI receiving full payment of scholarship monies due to TMTI. This issue was also being discussed in previous years and also raised in previous management letter and yet there has not been any arrangement made to address the issue. The balance is not considered to be misstated in the financial statements.

In order to solve this repeated issue, the TMTI should formally correspond with the Tuvaluan government to mutually arrange to forgive these debts and agree on a payable amount, and to eliminate these assets and liabilities off each other's accounts.

FINANCIAL STATEMENT PREPARATION

The financial statements for 2009 required a significant amount of re-work to be compliant with International Financial Reporting Standards (IFRS). This included re-working the Financial Statements and notes to the Financial Statements.

To ensure that the financial statements are compliant with IFRS, there should be a review of the TMTI's financial statements by the accountant and responsible staff to ensure that the Financial Statements are free from misstatements and calculation errors before being presented to audit. A template of the Financial Statements has been be provided to the TMTI by the Tuvalu Audit Office.

Control issues

We identified opportunities for improvement in the following areas:

- lack of budget analysis;
- segregation of duties;
- preparation and review of bank reconciliations;
- maintenance of Annual leave records;
- management of inventory;
- backups of computer systems; and
- review and approval of recharges.

These and other matters have been formally raised in a management letter to the Board.

Financial Information - Tuvalu Maritime Training Institute

Year ended 31 December	2009	Change	Change	Notes	2008	Change	Change	Notes	2007
	$'000	$'000	%		$'000	$'000	%		$'000
Operations									
Revenue	**510**	-15	-3%		**525**	-170	-24%	2	**695**
Other Income	**133**	-61	-31%	1	**194**	194	0%		**0**
Total Expenses	**-682**	35	-5%		**-717**	-23	3%		**-694**
Tax Expense	**0**	0			**0**	0			**0**
Operating surplus/(deficit)	**-39**	-41	-2050%		**2**	1	100%		**1**
Current Asset	**1,151**	68	6%		**1,083**	214	25%	3	**869**
Non-Current Asset	**6,052**	391	7%		**5,661**	5,082	878%	4	**579**
Current Liabilities	**-5,641**	-498	10%		**-5,143**	-4,337	538%	5	**-806**
Net Assets surplus/(deficit)	**1,562**	-39	-2%		**1,601**	959	149%		**642**

2010 Accounts have not been submitted for audit at time of publication.

NOTES:

1 Decrease in Other Income due to decrease of Special Development Assistance of $157k and Republic of China Grant of $16k partly offset by an increase in Subsidies from Government of $90k and Supplement from APNL of $13k.

2 Decrease in Revenue due to decrease in Revalidation Fees of $83k and subsidies from the Government of $39k.

3 Increase in Current Assets due to increase in Cash and Cash Equivalent of $103k and inventory of $18k.

4 Increase in Non-Current Asset due to additions of $5,033k in Property, Plant and Equipment in the form of Work in Progress (TMTI project funded by ADB).

5 Increase in current liabilities due to increase in deferred revenue of $4,307k (Due to TMTI project grant Work in Progress) and increase in accounts payable of $33k.

Tuvalu National Provident Fund

Fund activities

The Provident Fund is constituted under the *National Provident Fund* Act 2008.The Provident Fund is responsible for collecting of contributions, payments of benefits and administration expenses, investing and accounting for all money collected, paid or invested under the *National Provident Fund* Act 2008. The Board, on behalf of the members, subject to ministerial oversight is responsible for setting levels of contributions, appointing investment managers and the general administration of the Fund.

Audit opinion

The audit of the Tuvalu National Provident Fund's (TNPF) financial report financial reports for the year ended 31 December 2008, 31 December 2009 and 31 December 2010 resulted in unqualified Independent Audit Reports.

Key issues

SUSTAINABILITY OF MEMBERS' CONTRIBUTION

Concerning trends were noted in the sustainability and management of members' contributions managed by the TNPF including:

- Members' small loans totalled $6.8m, 20% of the total investment funds. While interest is earned on this loan, the level of arrears is 10% of the loan balance, with numerous instances of members not making repayments. The non-payment of these loans has resulted in lower cash flow and cash returns in the form of interest from members' small loans.
- Withdrawals on members' funds amounted to $3.5m as at 31 December 2010 ($3.1m as at 31 December 2009). The trend continues to increase over the years which negatively affect the TNPF's cash flow.
- The TNPF is in the process of building a market on the main island of Funafuti and has spent $34k during 2010 on the two storey market project. The target completion date was exceeded due to issues with the previous contractors which have been terminated. The investment property is still work in progress project (WIP as at 31 December 2010: $352,628) and is experiencing significant delays. Given the market project is yet to open, no cash flows are being generated for the fund.

The above factors significantly affect the cash flow of the Fund and the sustainability and security of member's fund.

The Fund needs to devise appropriate strategies to address and minimize factors contributing to financial impacts on the decrease in cash flow and reduced security of member's fund.

INABILITY TO GENERATE LOAN REPORTS AT BALANCE DATE

The TNPF is unable to generate effective loan reports from their loans management system. The following reports were not able to be produced:

- daily arrears report to assist in identifying customers who fail to make repayments by due date;

- loan arrears by members account for the year ended 31 December 2010; and
- back dated reports for audit.

To mitigate the lack of available reports from the loans management system, hard copies of members' small loans are required to be maintained. This is considered inefficient and requires a significant double up of work performed.

The lack of awareness and understanding of staff surrounding the full capabilities of the loans management systems has compounded the issue of not being able to generate reports from the loans management system.

These reporting limitations have made it difficult for the TNPF to effectively manage and monitor loans falling into arrears. This has attributed to the high level of arrears on members' loans.

The TNPF needs to consider upgrading the loans management system to generate the reports highlighted above. This will allow the TNPF to effectively monitor arrears, effectively manage the loans portfolio and to minimise the level of accounts falling into arrears. In addition, training should be provided to staff to enhance their understanding and to increase their usage of the loans system.

LIMITED FOLLOW UP ON OUTSTANDING CONTRIBUTIONS AND SURCHARGES

As at 31 December 2010 approximately $169k is owed to the Fund for surcharges of 5% levied to employers who fail to make contribution on their employees' behalf. Surcharges to individual employers valued greater than $10k and over 90 days old have been provided for in full due to the likelihood of the TNPF not recovering this amount.

Employees whose accounts are not being credited due to employers not making contributions on their behalf are disadvantaged. In addition, the increase in doubtful debts by $35k (an increase of 167%) at 31 December 2010 was mainly due to the difficulty in recovering surcharges.

In order to reduce these arrears, the enforcement section of the TNPF needs to be strengthened in terms of increasing skills and expertise; improvement of policies and procedures; and regular and accurate reporting.

IT SKILLS AND EXPERTISE OF STAFF

The TNPF continues to face numerous system issues since the installation of its core system the LMS (Loans Management System) in 2008. The major issue noted during audit relates to unidentified variances between members' loan balances and contributions in the LMS compared with the general ledger.
The TNPF's IT support revealed that the LMS is capable of extracting reports, however, due to the lack of skills and expertise of staff in using the LMS, they are unable to extract management reports.
The TNPF needs to resolve all system related issues on a timely basis and provide staff with proper effective training on the use of the Loans Management Systems and members contribution module.

Control issues

We identified opportunities for improvement in the following areas:

- clearance of long outstanding reconciling items;
- calculation of employees benefits according to IFRS;
- review of loans repayments;

- review of policy surrounding recognition and accounting of interest; and
- establishment of a cash flow planning function.

These and other matters have been formally raised in a management letter to the Board.

Financial Information Tuvalu National Provident Fund

Year ended 31 December	2010 $'000	Change $'000	Change %	Notes	2009 $'000	Change $'000	Change %	Notes	2008 $'000	Change $'000	Change %	Notes	2007 $'000
Operations													
Revenue	**2,939**	-571	-16%	5	**3,510**	7,303	-193%	5	**-3,793**	-5,683	-301%	4	**1,890**
Expense	**-595**	-87	17%	3	**-508**	14	-3%	3	**-522**	-38	8%		**-484**
Operating surplus/(deficit)	**2,344**	-658	-22%	6	**3,002**	7,317	-170%		**-4,315**	-5,721	-407%	2	**1,406**
Total Asset	**36,290**	3,107	9%	8	**33,183**	3,719	13%	8	**29,464**	-3,035	-9%	7	**32,499**
Total Liabilities	**-31**	7	-18%		**-38**	37	-49%		**-75**	-41	121%		**-34**
Net Assets surplus/(deficit)	**36,259**	3,114	9%	1	**33,145**	3,756	13%	**1**	**29,389**	-3,076	-9%		**32,465**

NOTES:

1. Movement in net asset due to the asset balance of member's contributions and the market fluctuations that these assets are subject to.
2. The year 2007 revealed an operating surplus of $1.4m to an operating loss of $4.3m. This was due to the unrealised loss on investment of $4.5m in 2008.
3. Increase due to increase in employee expenses, doubtful debts expense due as well as training and travel costs.
4. Substantial decrease in Revenue is due to the impact of the Global financial crisis on the TNPF's investment portfolio via investment gains.
5. Increase due to the recovery of the global investment markets. Investment gains recovered to above levels at the end of 2006.
6. Decrease due to falls in gains on investments as well as expenses increasing, due to staff and doubtful debts expenses.
7. Decrease due to the losses on investments made
8. Increase is due to the investment gains made, offset by a decrease in cash and cash equivalents.

Tuvalu Cooperative Society

Activities

The Tuvalu Cooperative Society (TCS) constituted under the *Tuvalu Cooperative Society Act 2008*. The principal activities of the cooperative were the wholesaling and retailing of groceries, frozen and consumer goods, hardware and sporting goods and equipments.

The Board, on behalf of the members, subject to ministerial oversight is responsible for managing of shareholder's contributions, appointing managers and the general administration of the TCS.

Audit opinion

The audit of the Tuvalu Cooperative Society (TCS) for the year ended 31st March 2008 resulted in an Unqualified Independent audit report. For the year ended 31st March 2009 an Unqualified Audit Opinion with an emphasis of matter surrounding the risk of no longer continuing as a going concern was issued. The financial statements for 2010 are yet to be presented to the Tuvalu Audit Office for audit.

Key issues

THE TCS'S ABILITY TO CONTINUE AS A GOING CONCERN

The Cooperative's financial state of affairs has deteriorated to a precarious position as at 31st March 2009. The audit reveals that the significant loss incurred and the decline in liquidity position for the period ending 31st March 2009 raises the risk of the TCS no longer being able to continue as a going concern. The gross profit of $1.2 million cannot meet personnel cost of $1.6 million let alone other operational costs.

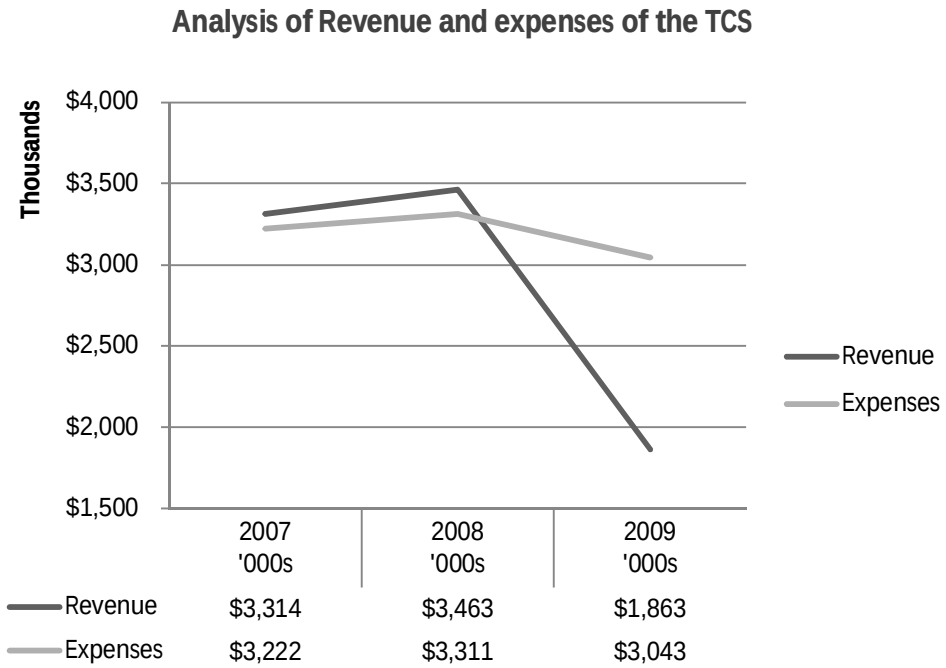
The impact of price control policy implemented by the Tuvaluan Government resulted in the significant decline in sales and gross margin, making it difficult for the TCS to pay suppliers and meet personal and operational costs.

If nothing is done to improve strategic planning, financial planning and the overall management of the TCS, the liquidity and solvency risk will continue to increase.

PERSONNEL AND OPERATING COST TO BE MORE EFFECTIVELY MONITORED

The independent audit review of the TCS's financial statements revealed that personnel, administrative and operating costs still remain at significantly high levels despite a decline in sales and gross margin. This has largely attributed to the loss incurred for the 2009 financial year. Below is the trend analysis on the respective costs.

	2009 $'000s	2008 $'000s	2007 $'000s
Personnel expenses	1,627	1,859	1,787
Other operating expenses	1,012	1,016	981
Administrative expenses	270	305	331
Total expenses	**2,910**	**3,181**	**3,099**
Total operating costs as a %age of total revenue	**23%**	**21%**	**20%**
Total operating costs as a %age of gross profit	**227%**	**96%**	**110%**
Gross profit	1,279	3,307	2,831



From the graph above, it can be seen that there has been a large decrease in revenue without a corresponding decrease in expenditure.

Management should consider implementing a cost management strategy that involves management, department heads and supervisors closely monitoring personnel and operating costs. The strategy should include stringent cost cutting measures.

RESPONSES TO MANAGEMENT LETTER

Poor responses have been received from TCS management toward management letters issued during our audits. These management letters serve the purpose of highlighting matters identified during the audit which we believe should be brought to the attention of management and be tabled at the Directors meeting so they can monitor the improvement process. The lack of a response to our management letters may be an indication that the issues we have highlighted in the past are not being adequately discussed with the board and are not being addressed in a timely manner.

OVERALL INTERNAL CONTROL

The overall internal control framework of the TCS in monitoring head office and branch operations is considered weak and requires strengthening. The issues identified during the audit were:

1. inadequate preparation, review and reconciliation of cash on hand and cash in transit transactions to bank statements;
2. weak controls surrounding the accuracy and completeness of stock ordering, receiving, recording and management process;
3. inadequate controls surrounding the completeness of creditors account, audit noted some instances of invoices paid twice;
4. weakness surrounding the accuracy and completeness of the management reports and weekly cash returns prepared by the branches;
5. variances when reconciling members deposit accounts to general ledger accounts; and
6. weakness in controls surrounding member's account balances.

With the TCS's weak internal control framework in place the risk of errors, omissions, irregularities and potential misstatements in the daily operation of the cooperative not being detected by management is greatly increased.

INVENTORY

The TCS lacks a proper inventory management system to monitor inventory balances. Without a proper inventory system in place, it is difficult to make sound purchasing decisions and there is an increase in the amount of resources required during stock takes. Having a proper inventory system in place will facilitate in-depth analysis and monitoring of the TCS's stock movements on a day to day basis.

CASH

Issues were identified surrounding the performance of reconciliations of cash in transit, daily cash taking and weekly cash returns. There was insufficient supporting documentation provided to support the balances of these accounts and some of the accounts have not been reviewed by an authorized officer. Reconciliations are only prepared at year end for audit purposes. The lack of reconciliation and independent review by an authorized officer may pose the risk of errors, irregularities, and omissions in the cash balances.

DELAY IN PAYMENTS TO SUPPLIERS

Late payment to suppliers resulted in interest charges being incurred by the TCS. The delay in payments to suppliers caused from the unavailability of funds has potential to significantly affect the credibility and reputation of the TCS. Due to the TCS's history of late payments, the National Bank of Tuvalu (NBT) created a call account and $600k loan facility for the TCS in order to meet their payment obligations. In order to mitigate this problem, having regular and accurate cash flow projections should be done on a monthly basis based on realistic and proper assumptions. The sales figure and payment to its suppliers should be properly measured and taken into account.

Control issues

We identified opportunities for improvement in the following areas:

- improvement of internal control framework;
- implementation of strategic plan;
- strengthening of Internal audit function;

- generation of appropriate responses to Management Letter;
- performance of Cash in transit reconciliations on a timely basis;
- variances in Member deposits to be resolved;
- effective monitoring of Personnel and operating costs; and
- strengthening of finance and accounting function.

These and other matters have been formally raised in a management letter to the Board.

Financial Information - Tuvalu Co-operative Society

Year ended 31 March	2009	Change	Change	Notes	2008	Change	Change	Notes	2007
	$'000	$'000	%		$'000	$'000	%		$'000
Operations									
Revenue	**12,247**	-2,600	-18%	1	**14,847**	8	0%		**14,839**
Cost of goods sold	**-10,968**	572	-5%		**-11,540**	469	-4%		**-12,009**
Other Income	**583**	427	274%	10	**156**	-330	-68%	11	**486**
Expenses	**-3,042**	268	-8%		**-3,310**	-88	3%		**-3,222**
Financing cost	**-206**	-116	129%	2	**-90**	-65	260%	6	**-25**
Tax Expense	**-58**	-26	81%	3	**-32**	-9	39%	7	**-23**
Operating surplus/(deficit)	**-1,444**	-1,475	-4758%		**31**	-13	-30%		**44**
Current Assets	**4,636**	-1,764	-28%	4	**6,400**	712	13%		**5,688**
Non-current assets	**1,249**	-114	-8%		**1,363**	151	12%		**1,212**
Current Liabilities	**-4,334**	611	-12%		**-4,945**	-704	17%	8	**-4,241**
Non-current liabilities	**-427**	-171	67%	**5**	**-256**	-145	131%	**9**	**-111**
Net assets (at 31 March)	**1,124**	-1,438	-56%		**2,562**	14	1%		**2,548**

2010 financial statements audit has not been completed, nor have the financial statements been signed by the directors of the TCS. The 2009 amounts are the amounts from the draft financial statements.

NOTES:

1 Decrease in revenue due to decrease in demand for goods during the year, and pricing control placed on the TCS by the Government of Tuvalu.

2 Increase in financing cost due to increase in bank charges and interest of $107k and a decrease in interest income of $9k.

3 Increase in Tax Expense due to Tax Loss in the prior year of $469k and a decrease in Prima facie income tax expense calculated at 30% on the operating profit of $397k.

4 Decrease in Current assets due to decrease in finished goods of $1,809k, $181k in the Inerest bearing deposit and also the increase of $18k in allowance for doubtful debts.

5 Increase in non-current liabilities due to increase in DBT Loan (Borrowing) of $171k.

6 Increase in Financing cost due to increase in bank charges and interest of $75k.

7 Increase in tax expense due to non-deductible items of $8k and also under provision in prior years of $2k.

8 Increase in current liabilities due to increase in Creditors & Accruals of $473k, Members deposits of $120k, Borrowings of $79k (Bank overdraft $75k, DBT Loan $4k) and income tax payable of $35k.

9 Increase in non-current liabilities due to increase in DBT Loan (Borrowing) of $145k.

10 Increase in Other income due to the $210k reversal of allowance for stock obsolescence in the prior year and also increase of $165k in other income, $46k in Agency fee and commission of $8k.

11 Decrease in Other income due to variance in member's deposit brought to account ($56k) and surplus in cash on hand brought to account ($59k) from the prior year. Also decrease of $107k in others, $56k in Commission and hire of video of $2.8k.

Tuvalu Coconut Trading Co-operative

Activities

The Tuvalu Coconut Trading Co-operative (TCTC) is governed under the Copra Act of 2008 and the Co-operative societies Act of 2008. The TCTC's main purpose is to purchase copra produced in Tuvalu by local farmers and to export it overseas for sale. The TCTC is not a public enterprise.

Audit Results

No set of financial statements were presented for audit for 2008, 2009 or 2010. The last set of financial statements presented by the Tuvalu Coconut Trading Co-operative for auditing was in 1992. They were unqualified but showed an emphasis of matter regarding a lack of supporting documentation. The (TCTC) is still operating its main business of buying and selling local products.

Recommendation 16: *That the Tuvaluan Government continue to request and follow up with TCTC financial statements for the past 19 years.*

Acknowledgements

The Auditor-General, and the staff of the Audit Office, wish to acknowledge the support and assistance of the staff of all the Public Enterprises and Statutory entities and we look forward to continued cooperation and improvements in the future.

Appendix 1 – Listing of all audit recommendations from report and their page number

Appendix 2 Types of audit opinions

The following are the types of audit opinions issued by the Tuvalu Audit Office:

- Unqualified: In our opinion the financial statements present a true and fair view.
- Qualified except for: In our opinion except for the matters noted in the qualification paragraph the financial statements present a true and fair view.
- Qualified adverse: In our opinion the financial statements do not present a true and fair view.
- Qualified disclaimer: We are unable to form an opinion whether the financial statements present a true and fair view.
- Unqualified with an emphasis of matter paragraph: In our opinion the financial statements do present a true and fair view, however, emphasis which we consider important to the user is drawn to a certain disclosure within the financial statements.
- Unqualified with an other matter paragraph: In our opinion the financial statements do present a true and fair view, however, users' attention is drawn to a matter relevant to their understanding of the audit of the financial statements or the audit report.

Appendix 3 Definitions

CONTROL ENVIRONMENT

The control environment of an entity co-ordinates all systems used in order to safeguard the entity's assets, check the accuracy of the accounting information, promote efficiency, encourage staff to be productive and assist management to adhere to the policies of the entity.

The purpose of the control environment is to monitor how the entity is performing and to implement a plan that will help the entity performing. Controls also deter and prevent people from doing things their own way, and from committing fraud.

With controls in place, employees' duties can be arranged and the records and systems designed to make it possible to carry out effective accounting control over the assets, liabilities, income and expenses of the entity. Under this system the work of the employees is broken up wherever possible, so no single employee will perform a complete cycle of a particular operation.

GOING CONCERN

Under the going concern assumption, an entity is viewed as continuing in business for the foreseeable future. General purpose financial statements are prepared on a going concern basis, unless management either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so. When the use of the going concern assumption is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business.

PUBLIC ENTERPRISE

An organization included in Schedule 1 of the Public Enterprises (Accountability and Performance) Act of 2009and any subsidiary of a Public enterprise. See Public Beneficial Enterprise and Public Trading Enterprise below.

PUBLIC BENEFICIAL ENTERPRISE

An organisation listed in Part B of Schedule 1 of the Public Enterprises (Accountability and Performance) Act of 2009 and any subsidiary of a Public Beneficial Enterprise. Organisations listed in Part B of Schedule 1 are:

- Maritime Training Institute (TMTI)

PUBLIC TRADING ENTERPRISE

An organisation listed in Part A of Schedule 1 of the Public Enterprises (Accountability and Performance) Act of 2009 and any subsidiary of a Public Trading Enterprise. Organisations listed in Part A of Schedule 1 are:

- National Bank of Tuvalu (NBT)
- Development Bank of Tuvalu (DBT)
- Telecommunications Corporation (TTC)
- Vaiaku Lagi Hotel (VLH)
- Electricity Corporation (TEC)
- Fishing Corporation (NAFICOT)
- Philatelic Bureau (TPB)

List of Abbreviations

ADB: Asian Development Bank
AusAID Australian Agency for International Development
COFOG: Classification of Functions of Government
DCC: Development Coordinating Committee
EU: European Union
FIC: Forum Island Countries
FTF: Falekaupule Trust Fund
GDP: Gross domestic product
GFS: Government Finance Statistics
GOT: Government of Tuvalu
IFRS: International Financial Reporting Standards
IMF: International Monetary Fund
INCOSAI: International Conference of Supreme Audit Institutions
INTOSAI: International Organisation of Supreme Audit Institutions
IRD: Internal Revenue Department
ISSAI: International Standards of Supreme Audit Institutions
k: Thousands
MoFEPI: Ministry of Finance, Economic Planning and Industries
NAFICOT: National Fishing Corporation of Tuvalu
PAC: Public Accounts Committee
PASAI: Pacific Association of Supreme Audit Institutions
PE Act: The Public Enterprises and Accountability Act of 2009.
PE: Public Enterprise
PEFA: Public Expenditure and Financial Accountability
PEFA: Public Expenditure and Financial Accountability
PFM: Public Financial Management
PFM: Public Financial Management
PFM-PR: Public Financial Management Performance Report
PFTAC: Pacific Financial Technical Advisory Centre
RISC: Regional Institutional Strengthening Committee
TAO: Tuvalu Audit Office
TCS: Tuvalu Co-operative Society
TDF: Tuvalu Development Fund
TMC: Tuvalu Media Corporation
TMTI: Tuvalu Maritime Training Institute
TNPF: Tuvalu National Provident Fund
TTFAC: Tuvalu Trust Fund Advisory Committee
VLH: Vaiaku Lagi Hotel