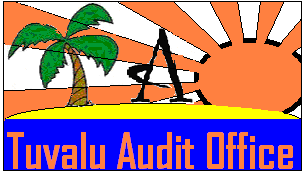
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**AUDITOR GENERAL’S REPORT:**

**STATES OWNED ENTERPRISES**

**Year Ending 31 December 2007**



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**TUVALU KAUPULES**

##### **AUDITOR GENERAL’S REPORT**

**FOR THE YEAR ENDING 31 DECEMBER 2007**

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# **GENERAL OVERVIEW**

# **2. COMMON ISSUES**

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# **3. Bank Institutions**

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| |  | | --- | | **3.1 National Bank of Tuvalu** |  AUDIT OPINION The audit of the Bank’s financial report for the year ended 30 June 2007 resulted in an unqualified Independent Audit Report.  **KEY ISSUES**  **Liquidity**  The Bank’s liquidity is still a high priority. The deposit to gross loan ratio is very high and the quality of the loan portfolio continues to decrease. As all customer deposits are mostly “at call” the bank needs to keep a level of liquidity to meet these potential withdrawals.  A large proportion of the Bank’s loan portfolio relates to government direct or guaranteed debt. The suspense account represents $5 million and the NAFICOT loan represents $1.3 million.  If nothing is done to address this issue future recapitalisation may be required. The Government needs to move to have these accounts and an overdraft facility (if used) approved as loans by Parliament and have formal agreements signed regarding their use and terms.  **Lending**  Poor lending and credit assessment practices have contributed to the poor quality of the Bank’s loan portfolio. These have resulted from a lack of technical expertise, no formal or appropriate lending policy, and over-riding of existing policies. Unnecessary credit risks should not be taken with lending.  **Credit Worthiness**  Tuvalu has three financial institutions apparently capable of lending to the public. However, there is not necessarily any checks between the institutions when clients approach to borrow money. This has led to a situation where clients are able to run up debts with one bank, and then when they get unmanageable, turn to another lender to issue more debt. It is necessary to investigate the lending powers of these institutions and determine whether or not they are supposed to overlap.  **CONTROL ISSUES**  We identified opportunities for improvement in the following areas:   * Timely identification of impaired accounts * Action needed in the arrears recovery process * Appropriate training of lending staff and use of internal audit function * Closer monitoring of construction loans * More accurate loan grading to be performed * Proper security documentation to be obtained for loans * Proper policies on credit reviews * Timely processing to prevent unauthorized withdrawals * Policies and procedures need to be developed and formalized for outer island banks   These and other matters were formally raised in a management letter to the Board.  We acknowledge that the Board has developed a draft lending policy, an issue that we have  raised over a number of years.  **FINANCIAL INFORMATION**  **Year ended 30 June 2007 2006**  **$’000 $’000**  **Operating income**  Interest Income 1,388  Non-Interest Income 1,562  Interest Expense  (435)  **Total operating income  *2515***  **Total operating expenses**  1,250  **Gross profit 1,265**  Allowances for credit impairment (589)  Income tax expense 267  **Net Profit 410**  **Net assets (at 31 December)**  ***4210***  Proposed Dividend 307  **Amount Owed by Government at 31 December 2007\* 6573**  *\*Government Suspense Account $4,924*  *NAFICOT Loan $1,308*  *Air Fiji Loan $ 341*  $6,573  \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ *Auditor-General’s Report to Parliament 2007*  Non-Interest income has increased to $1.562 m (2005 $1.246m) This increase was due entirely to foreign exchange income.  Further allowances for credit impairment of $.589m (2005 $.910m) have been booked, indicating further write-downs in the Bank’s Debt Portfolio.  **BOARD ACTIVITIES**  The National Bank of Tuvalu is constituted under the *National Bank of Tuvalu Act 1982*.  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 National Bank of Tuvalu is directed under the Act to conduct its business in the national interest subject to Ministerial policy directive. A board of directors, chaired by the Secretary for Finance, is charged with ensuring that the policy of the Bank is directed towards the national interest, stability and balanced development of the economy of Tuvalu.   |  | | --- | | Development Bank of Tuvalu |   **AUDIT OPINION**  The audit of the Bank’s financial report for the year ended 30 June 2007 resulted in an unqualified Independent Audit Report.  **KEY ISSUES**  **Going Concern**  The Bank’s viability is being diminished by continual losses. As at 31 December 2007 the accumulated losses were $1,658m. In 2006 there was a further capital injection of $635,000 from the Republic of China. Without the continued support of Government and the Bank’s financiers, the effects of operating losses will keep eroding the working capital of the bank.  **Lease Financing Commencement**  In 2006, the Bank commenced issuing personal loans, which it has termed as “Lease Financing”. This allows customers to take out loans for the purchase of personal assets. This is a high-risk type of finance, as it is hard to guarantee the value or adequacy of the security held against the loans. Although these loans are not outside the powers of the bank, they seem inconsistent with the spirit of the legislation “making loans for the long term development of Tuvalu”. Attention needs to be paid to the legislation to determine the intended scope of operations. Currently, staff and expertise restrictions are impacting this banks performance, and detrimentally affecting the operations of other financial institutions as they are attempting to gain market-share in a closed market.  **Credit Worthiness**  Tuvalu has three financial institutions apparently capable of lending to the public. However, there is not necessarily any checks between the institutions when clients approach to borrow money. This has led to a situation where clients are able to run up debts with one bank, and then when they get unmanageable, turn to another lender to issue more debt. It is necessary to investigate the lending powers of these institutions and determine whether or not they are supposed to overlap.  **Preparation of Financial Statements**  The Corporation again did not prepare their own financial statements and relied on auditors to assist in preparing them. This is unacceptable practice and has resulted in KPMG charging fees for preparation assistance, on top of fees for audits. It also creates an unfavorable auditing situation. Costs can be saved in this area.  **CONTROL ISSUES**  We identified opportunities for improvement in the following areas:   * Lack of action on previous management letter areas. * the financial report submitted by the Board for audit was incomplete and of poor quality,   requiring numerous amendments and significant reworking by the Board’s officers   * Lack of reconciliation of savings accounts and suspense accounts and reporting of variances in other accounts. * Loan assessment, approval and follow-up of overdue loans are sub-standard. * No provisioning exercise has been performed on loans in arrears. * Controls over journal entries need improvement.   These and other matters will be formally raised in a management letter to the Board.  **FINANCIAL INFORMATION**  **Year ended 30 June 2007 2006**  **$’ $’000**  **Operations**  Income  182  Expenditure  (335)  **Operating surplus/(deficit)  *(***153)  **Net assets (at 31 December**   ***898\****  ***\*Includes a new capital injection of $650,000 from Republic of China***  \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ *Auditor-General’s Report to Parliament 2007*  Expenditure increased due to the recognition of the unrealized exchange loss on the European Investment Bank borrowings of $40,375 (2004 $30,190 gain).  Wages and Salaries increased to $160,957 (2004 $124,098).  **BOARD ACTIVITIES**  The Bank is constituted under the provisions of the *Development Bank of Tuvalu Act 1990*. Its wide-ranging lending and investment powers are subject to ministerial direction. 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.   |  | | --- | | **Tuvalu National Provident Fund** |   **AUDIT OPINION**  The audit of the Fund’s financial report for the year ended 30 June 2007 resulted in an unqualified Independent Audit Report.  **KEY ISSUES**  **Small Members Loans**  Small loans to members have increased significantly over the years from 2004 to 2006 in line with an increase to the lending limits. These loans are secured against members contributions.   |  |  |  |  | | --- | --- | --- | --- | |  | **2004** | **2005** | **2006** | | **Balance** | $1,481,638 | $3,423,081 | $5,187,368 | | **% Total Funds** | 6.75% | 13.55% | 17.58% | | **Loan Limit** | 15% | 24% | 30% |   These loans have been approved on the basis that they are within the loan limits, not necessarily whether the borrower can repay them or their level of existing commitments with other Tuvaluan lending establishments i.e. NBT and DBT. They have a growing level of arrears. The non-performance of parts of this asset class has the ability to impact the overall earnings of the Fund.  **MEDU Scheme**  The Fund is proposing to introduce a medical scheme to assist members of the Fund. This scheme allows members to utilize their contribution to finance the educational and medical costs of the beneficiaries to the scheme. The scheme works as a compulsory savings for all TNPF members in which an extra 6% (3% employer, 3% employee) is added to retirement savings. Members who need to access this money early to cover authorized expenses are able to access it, and those who don’t can access it together with their other TNPF funds on normal retirement.  This may reduce the reliance of members on small loans and give increased access to overseas medical services for those not benefited by the general medical treatment scheme.  The draft bill is currently before Parliament for its first reading.  **Preparation of Financial Statements**  The Corporation again did not prepare their own financial statements and relied on auditors to assist in preparing them. This is unacceptable practice and has resulted in KPMG charging fees for preparation assistance, on top of fees for audits. It also creates an unfavorable auditing situation. Costs can be saved in this area.  **Loans from Other Financial Institutions**  When assessing loans, other Financial Institutions are using 100% of the applicant’s TNPF funds as security. TNPF already allows 30% to be borrowed from the funds with no security. This puts the security of the other Financial Institutions below the full amount. The other issue is that lending against TNPF contributions is totally in opposition to the idea of retirement saving. The idea that people will have some funds to draw on in retirement is not supported if they will have to use these retirement funds to pay back a debt first.  **CONTROL ISSUES**  We identified opportunities for improvement in the following areas:   * Loans system requires enhancement to provide relevant management reports * Loan approvals and credit checking need to be performed * Overcharging of interest on members loans requiring rectification * Reconciliation’s needed between the general ledger and subsidiary ledgers for the loan management system, members contributions, and also bank accounts * No cash flow planning function is in existence   These and other matters have been formally raised in a management letter to the Board.  **FINANCIAL INFORMATION**  **Year ended 30 June 2007 2006**  **$’000 $’000**  **Operating income 2,909**  **Operating expenses 457**  **Net surplus attributed to members of the fund 2,552**  **Current Assets 724**  **Non-Current Assets**  Investments 23465  Loans to members 5,187  Property, plant and Equipment 158  **Total Assets 29534**  **Liabilities 28**    **Total members funds 29507**  \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ *Auditor-General’s Report to Parliament 2007*  **FUND ACTIVITIES**  The Provident Fund is constituted under the *National Provident Fund Act 1984*.  The Provident Fund is responsible for collection of contributions, payments of benefits and administration expenses, investing and accounting for all money collected, paid or invested under *The Act*.  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.   |  | | --- | | **Tuvalu Telecommunications Corporation** |   **AUDIT OPINION**  The audit of the Corporation’s financial report for the year ended 30 June 2007 resulted in a qualified Independent Audit Report. The report was qualified in respect of debtors’ management issues. No aged debtor listing was kept, and large variances could not be substantiated.  **KEY ISSUE**  **Implementation of new network platform**  The Corporation is in the process of replacing its current network platform in 2007 and 2008 financial periods. The cost of the new system has been estimated to be around $1.8m. The Government has agreed to grant $1.8m (2007 $1.2m, 2008 $0.6m). This project will provide enhanced telecommunications infrastructure to the country.  **Fraudulent Scam**  Former executives have been involved in fraudulent activities during their terms of employment. The Corporation has undertaken no follow-up on the status of this case. The police raided and seized documents and hard-drives in 2005. These items are still with the police awaiting action. The time delay in settling this criminal matter not only reflects poor quality of police investigation, but also sets a bad example to the community that such crimes will not be properly pursued. This matter should be finalized as soon as possible.  **Audit management letter**  The Tuvalu Telecommunications Corporation management letter is the size of a small novel. It is currently approaching 50 pages in length, and details many deficiencies in operations that have been existence over multiple periods. No effective remediary action has been undertaken to resolve these issues. This is a poor reflection on the operations of this corporation.  **CONTROL ISSUES**  We identified opportunities for improvement in the following areas:   * Lack of segregation of duties for cash receipting. * Inadequate monitoring of Cash over night shifts * Need for the use of Purchase Order booklets * Inadequate fixed assets policies and procedures * Inadequate debtors management, aging and billing software * Tax returns not being lodged in a timely fashion. * Lack of proper accounting and control system.   These and other matters will be formally raised in a management letter to the Board.  It is unacceptable that the Corporation has done so little to address issues that have been raised over a number of years.  **FINANCIAL INFORMATION**  **Year ended 30 June 2007 2006**  **$’000 $’000**  **Operating Revenue**  Telephone revenue 1,240  Other Revenue  527  **Total Revenue  *1,767***  **Total Expenditure** 2,208    **Income Tax (65)**  **Net Profit/(Loss) (376)**  Net assets (at 31 December)  ***2***,845  \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ *Auditor-General’s Report to Parliament 2007*  Telephone Revenue fell by $412,000 and other revenue fell by $256,000. This reflects a declining trend in revenues that has been going on for the last 4 years. This revenue is critical to the profitability of the Corporation.  **BOARD ACTIVITIES**  The Board is constituted under the provisions of the *Tuvalu Telecommunications Act 2003*. 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 Act*, the Telecommunications is given an exclusive right to operate these services and sy |