REPORT OF THE AUDITOR-GENERAL

ON THE RESULTS OF FINANCIAL STATEMENT AUDITS

OF PUBLIC ENTERPRISES

AND OTHER STATUTORY BODIES

for the year ended 31 December 2011

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TUVALU GOVERNMENT

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Our Reference: 05/05/10 4 April 2013

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: Public Accounts Committee Members
Secretary to Government
All heads of Public Enterprises
All heads of Statutory Bodies
Director of PERMU

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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
PBE: Public Beneficial Enterprise
PE Act: The Public Enterprises and Accountability Act of 2009.
PE: Public Enterprise
PEFA: Public Expenditure and Financial Accountability
PERMU: Public Enterprise Reform and Monitoring Unit
PFM: Public Financial Management
PFM-PR: Public Financial Management Performance Report
PFTAC: Pacific Financial Technical Advisory Centre
PTE: Public Trading Enterprise
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

Introduction

The format of this report

This report is tabled under section 42 of the *Audit Act*. Individual audit reports have been issued to each of the entities audited for inclusion in their annual reports (which entities are required to table in Parliament), along with management letters recommending improvements. This report contains 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.

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 has the mandate to perform the 2011 audits of the public enterprises under the *Public Enterprises (Accountability and Performance) Act* (PE Act) and the *Public Finance Act.*

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

The accounting standards used for the preparation of the public enterprises and statutory bodies financial statements were the International Financial Reporting Standards (IFRS). IFRS is required under section 6.2.1(a) of the PE Act. The Tuvalu Audit Office (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 risk based, 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 (EOM) 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.

Summary of Audit Opinions Issued

Entity	2011 type of audit opinion	2010 Audit Opinion
NBT	Unqualified	Unqualified
DBT	Unqualified	Unqualified
TEC	Qualified (except for) with EOM	Qualified (disclaimer)
TPB	Unqualified with EOM	Qualified (except for) with EOM
TTC	Unqualified with EOM	Unqualified with EOM
VLH	Unqualified	Unqualified
NAFICOT	Not performed	Not performed
TMTI	Qualified (except for)	Qualified (except for)
TNPF	Unqualified	Unqualified

Additional detail surrounding the qualifications and emphasis of matter (EOM) paragraphs can be found at the individual audit results section in this report.

Listing of all audit recommendations from report and their page number

The monitoring environment of the Public Enterprises

The Public Enterprise (Performance and Accountability) Act

The PE Act specifies Government of Tuvalu (GoT) requirements and 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 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 a commercial manner, thereby reducing the GoT's ability to influence business decisions. The PE Act removes GoT representatives from boards (except under limited circumstances) and seeks to reduce expectations of GoT 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 creates the Public Enterprise Reform and Monitoring Unit (PERMU) to monitor the performance of all public enterprises on behalf of the shareholding ministers, and advise these ministers with respect to the GoT's investment in public enterprises. This provides for a coordinated approach to monitoring public enterprise performance.

The use 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

The PE Act requires that Community Service Obligations of the public enterprises follow a stringent process stipulated in part III and IV of the PE Act. This is attempting to distance the public enterprises from the GoT to ensure that they are acting in the interest of making a profit, rather than providing services to the GoT.

Independence of Board of Directors

The Board of directors are required to be independent of the GoT. No Member of Parliament, public servant or Constitutional officer is permitted to be appointed as a director unless Cabinet certify that it 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 in a timely manner

The 2010, 2009 and 2008 audit report noted the lack of annual reports which were tabled into Parliament. There has been an improvement through the 2011 year, with most PEs getting up to date with their reporting requirements.

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 reports by the board of directors are to be tabled in Parliament 4 months after their annual reporting date. None of the public enterprises were able to table their annual reports in Parliament by this due date. While the tabling of annual reports is encouraging, the timeliness still needs to be improved.

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

Name	2007	2008	2009	2010	2011
NBT	✓	✓	✓	✓	✓
DBT	✓	✓	✓	✓	✓
TTC	✓	✓	✓	✓	
TEC	✓	✓	✓	✓	✓
VLH	✓	✓	✓	✓	✓
TMTI	✓	*	*	*	*
NAFICOT					
TPB	✓	✓	✓	✓	✓
TNPF	✓	✓	✓	✓	✓

* TMTI at time of report had completed their annual report for 2008 to 2011, however, are yet to sign and table into Parliament.

Annual reports are necessary to highlight the operations of the organisation during the year. They should include achievements and progress against milestones in each entity's corporate plan. The Public Enterprises should be reporting against key performance indicators and be justifying their performance. Without a reporting mechanism in place there is a lack of accountability.

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**: 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. Tabling of the annual reports in Parliament makes the public enterprises and statutory entities accountable 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.*

Annual reporting timelines

Annual reports for public enterprises are required in the PE Act to be tabled in Parliament before 30 April the following year. The annual reports are required to contain the financial statements and audit reports. Given Parliament normally sits in March/ April, this deadline is quite tight. Annual reports should be drafted before the end of the year to enable prompt tabling after the completion of the audit process.

***Recommendation 2:** That a change is made to the PE Act requiring PEs to submit their annual reports (with audited financial statements) on or before 30 April to Parliament and that with the submission the reports become public documents. Otherwise, given the low frequency and inconsistency of Parliament sitting days completed annual reports are only tabled and made public up to 12 months after the end of the financial year. This is considered unacceptable.*

Audit signing process

A new process to ensure timely signing and communication of the issues in the management letter was instigated during the 2011 audits. Boards were requested to invite the TAO to a special board meeting to discuss the financial statements with the TAO. The Board would then sign the financial statements and representation letter. During the same Board meeting the TAO would sign the audit opinion and leave a copy with the public enterprise. This process aimed to decrease the delay in the completion of the audits. This process was partially successful in 2011 and will continue to be implemented in the 2012 audit. During the board meetings the TAO also took the opportunity to explain the issues contained in the management letter.

***Recommendation 3:** That the discussing of issues contained in the management letter is performed at Board level and the streamlined signing process is continued and improved for the 2012 audits.*

PE director's payments

The PE Act states that directors holding positions in the public offices including members of parliament, public servants or Constitutional officers are not entitled to directors allowances from GoT owned statutory entities.

We noted in the 2011 audits that directors of the following public enterprises are public servants who are not entitled to board fees, however, had been paid director's allowances.

- National Bank of Tuvalu
- Tuvalu Electricity Corporation
- Vaiaku Lagi Hotel
- Development Bank of Tuvalu

- Tuvalu Maritime Training Institute

The payment of allowance to directors of statutory owned entities who hold position in the public office including public servants depicts a non-compliance with the requirements of the law with regards to the PE Act.

Recommendation 4: *The Public Enterprise should request the respective directors to refund the allowances paid during the year to the PEs. Going forward the PEs should ensure that no allowances are paid to board of directors who hold public office including Members of Parliament, Public Servants or Constitutional Officers.*

No Formal Community Service Obligations in place

The PE Act requires that the principal objective of every Public Trading Enterprise (PTE) shall be to operate as a successful business; be as profitable and efficient as comparable businesses that are not owned by the State; and meet any community service obligation (CSO). A CSO is the provision of a good or service by a PTE to a consumer or user on any terms other than normal commercial terms applying from time to time. Full definitions are contained in Appendix 1 to this report.

CSOs are required to have a formal agreement between the GoT and the PTE and are required to be tabled in Parliament and disclosed in the PTE's financial statements.

During the audits, we found that there were no formal CSOs in place, however, payments had been made to the PTEs for CSOs as well as PTEs providing services which were unprofitable and not in line with their principle objectives.

Recommendation 5: *That the process of applying for and receiving payments for CSOs in the PE Act is adhered to and that there is formal documentation of the CSO agreements. PTEs should discontinue unprofitable operations if they are not receiving compensation under a CSO.*

PERMU strengthening and monitoring

The PERMU's role is to provide support to the public enterprises as well as play a monitoring role. PERMU's full role as described by the PE Act is contained in Appendix 1 of this report. The PERMU requires further strengthening and improvement in order to effectively monitor the public enterprises.

Recommendation 6*: That PERMU actively follow up Public Enterprises on their reporting requirements. This includes quarterly reporting, corporate plan reporting, annual accounts submission and also monitoring progress that is being made by the Public Enterprises on the management letter recommendations.*

Performance Measures to be defined.

The individual Acts of establishment for each PTE require that their annual reports include details of the financial performance and effectiveness of the entity as judged by performance measures that are relevant to the their sector of the Tuvalu economy and are prescribed by the Minister by notice. No performance measures have been prescribed by the Minister for the PTEs. The PTEs currently do not report against any performance measures in their annual reports.

Recommendation 7*: That PERMU draft performance measures for each Public Enterprise to be prescribed by the Minister. The measures should be communicated with the PTEs and PERMU should monitor the PTE's performance against these measures.*

Assistance in preparation of financial statements to produce IFRS compliant accounts

Most of the entities were reliant on the TAO 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. The following table shows our rating of the entities ability to compile IFRS compliant accounts, without audit assistance:

	NBT	DBT	TEC	TPB	TTC	VLH	TNPF	TMTI
Rating	40%	0%	20%	60%	60%	0%	60%	40%

Recommendation 8: *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

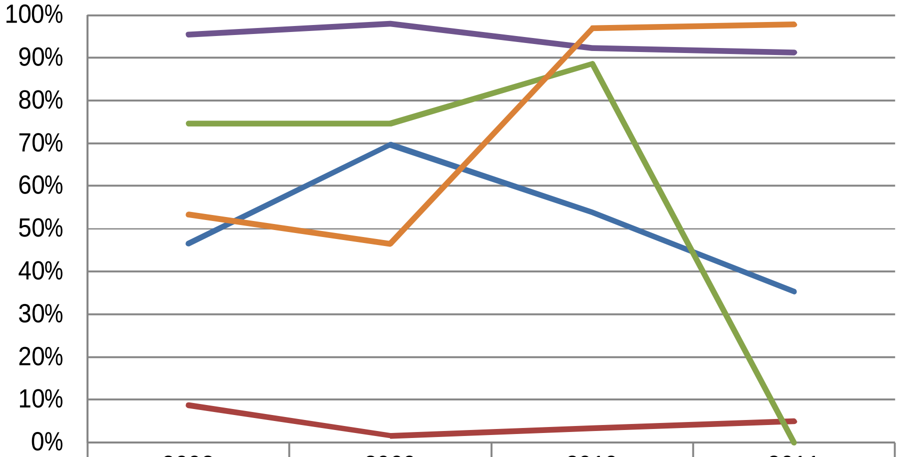
Audit observed the under usage of the MYOB accounting package within the public enterprises. Supplementary spreadsheets which are liable to keystroke errors and which do not have system controls are being used. Accounting packages are considered to be more efficient and effective compared with excel or manual accounting, with less manual errors being made due to system controls. The following table shows our rating of each entities usage of their accounting software:

	NBT	DBT	TEC	TPB	TTC	VLH	TNPF	TMTI
Rating	60%	40%	60%	0%	40%	0%	60%	60%

Recommendation 9: *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.*

Recovery of debtors

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



	2008	2009	2010	2011
TEC	47%	70%	54%	35%
TPB	9%	2%	3%	5%
TTC	75%	75%	89%	0%
VLH	95%	98%	92%	91%
TMTI	53%	47%	97%	98%

Apart from the Tuvalu Philatelic Bureau and the Tuvalu Telecommunications Corporation, the provision for doubtful debts as percentage of total receivables for the non financial entities is above 35%. In other words, for every $1 owed to the entities, they can expect to recover less than 65cents. This has a great impact on cash flow and also going concern. Note that NAFICOT has been excluded as it has not submitted financial statements for audit in 2011.

Recommendation 10: *That the Public Enterprises should make assessments about likelihood of customers making repayment and only offer credit if appropriate, closely monitor their receivables, discuss receivables every board meeting, send reminder notices, make follow up phone calls to their debtors and commence legal action against long term 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	TPB	TMTI	TEC	VLH	DBT	TNPF	NBT
2008	(2,397)	(49)	132	33	53	248	1,703	15,510
2009	(964)	(42)	38	9	118	978	1,739	14,302
2010	(930)	(49)	95	22	103	800	859	15,229
2011	(1,219)	(49)	121	27	115	920	2,030	17,310

Note that NAFICOT have not presented financial statements for audit since 2002 and 1999 respectively.

TPB and TTC 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 amount of cash on hand is closely related to an entity's ability to pay its debts as and when they fully due. When a Public Enterprise is insolvent it is no longer able to continue as a going concern and must cease operations.

Recommendation 11: *That TTC and TPB are recapitalised, other 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 going concerns and who may require assistance to continue trading. The following entities had either emphasises of matter or qualified audit opinion surrounding their ability to continue as a going concern during 2011. The entities not mentioned here did not have significant risk surrounding their ability to continue as going concerns for 2011.

Entity	DBT	TEC	TPB	TTC	VLH
Going Concern Issues	**yes**	**yes**	**yes**	**yes**	**Yes**
Net Assets $'000s	2,411	-937	-157	-984	29
Net profit/loss	-177	100	-19	-290	-61

There are different reasons for the uncertainty surrounding the ability of each of these entity to continue as going concerns. See the individual analysis of each entity for more details. Some common causes noted by TAO are the pricing of goods and services, the lack of robust collection of debts owed and proper recording of revenues and amounts owed.

Recommendation 12: *That management of each of the entities with going concern issues implements change to ensure that they are 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 GoT for unprofitable segments which are required to be delivered and being more stringent with debtors (both collection and approval).*

Stocktake and cash count process

At the end of each financial year, the TAO witnessed the entities perform their stocktakes of assets and inventories. The public enterprises should have documented procedures surrounding:

- updating asset, inventories and portable and attractive registers;
- performance of the independent counts;
- investigation of missing stock; and
- compilation, approval and actioning of stocktake reports.

No public enterprise had this documentation. The TAO had to request that most entities perform their stock count. The stocktakes should be completed regardless of audit attendance.

Recommendation 13: *That entities perform regular stock counts during the year, using registers updated for purchases and disposals during the year. The results should be used to update their respective accounting systems. These counts could also be used to monitor theft and consumption statistics in order to further plan and budget.*

At the end of the year, entities should perform a full stocktake using the asset register as a base. A report on the missing assets and stock take should be compiled and the report should be approved by the Board of Directors.

Stocktake procedures should be documented, including: regularity of the count, how to conduct a stocktake, independence requirements, how to compile a countsheet, what to do if an asset is located which is not on the register, what to do if an asset on the register is unable to be located, report signoff and recommendations.

Internal Control environment weaknesses

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.

Although the control environment differs between entities, TAO raised numerous serious points in the management letters of each entity. Overall, the strength of the internal control environment of the entities audited was considered weak. The number and seriousness of the issued raised by the TAO in the management letter points in each entity demonstrates a weak control environment. These management letters 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 to ensuring that all data in the general ledger and the financial statements are complete, and that no unauthorised payments are being made out of the bank accounts. If subsidiary ledgers agree to the general ledger, all transactions are able to be explained. If there are major errors in reconciliations, these should be investigated and brought to the attention of the board. Appropriate action should be taken to reconcile and explain 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. Registers of assets and inventory were either not present or out of date. Stock counts which are a major component of the internal control environment were not performed. Stock counts provide management with information regarding stolen stock, spoiled stock, slow moving stock and as ensure that all stock is recorded.
- Collection of and accounting for receivables: In most of the entities the assessment of the collectability of overdue receivables was only performed at year end when requested by the auditors. Controls should be in place, to ensure that credit is not provided to customers without appropriate assessment of the likelihood of recovery. Additionally there should be controls surrounding the follow up of outstanding receivables as mentioned in recommendation ten.

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 were discussed with the auditee at the end of the audit, and the auditee was encouraged to respond to the recommendations with their planned strategy to rectify the issues.

Where management letter findings are not adequately addressed, they are again 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	TNPF	TMTI	NAFICOT
2007	25	16	20	6	30	18	11	15	n/a
2008	22	21	16	6	24	15	14	6	n/a
2009	25	0	12	9	25	19	8	7	n/a

2010	26	21	7	3	25	13	5	0	n/a
2011	29	24	23	1	22	6	5	13	n/a

Number of recurring management letter points

	NBT	DBT	TEC	TPB	TTC	VLH	TNPF	TMTI	NAFICOT
2008	11	21	18	6	7	7	14	4	n/a
2009	13	0	16	9	16	13	4	6	n/a
2010	19	21	9	3	18	6	9	0	n/a
2011	17	12	11	4	12	5	12	12	n/a

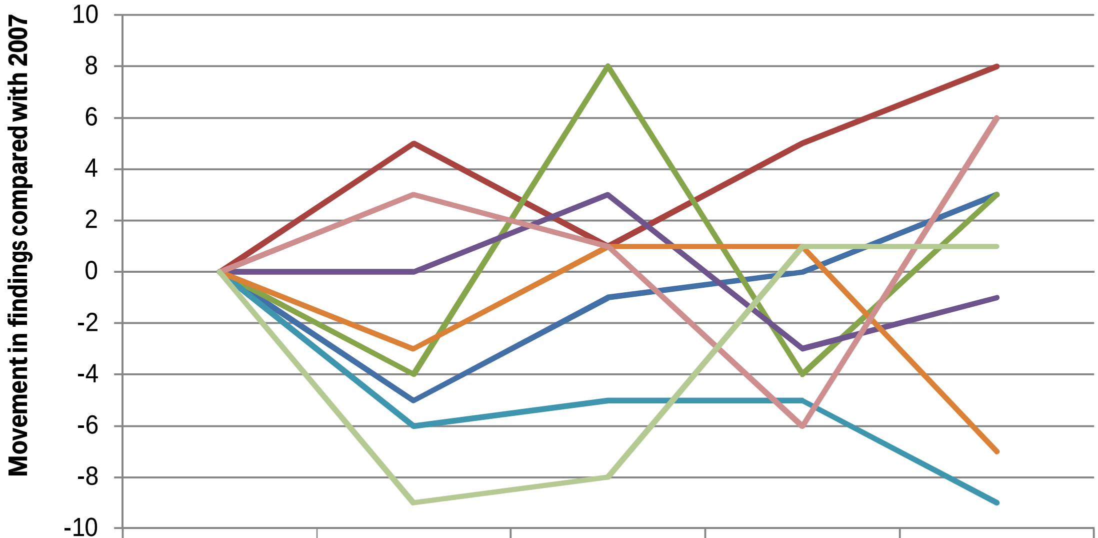
n/a: financial statements have not been presented for audit at time of publication, hence no management letter issued.

This is a poor reflection on the operations of the public enterprises and TNPF as a whole. Management letters should get smaller over time. Where there is improvement in the organizations. No significant effective remediation is being undertaken to resolve these issues

Recommendation 14: *That the entities take active measures to resolve the issues raised in the management letters. These measures should involve management reporting to the board of directors every meeting on the progress to resolve the findings, making plans to prioritise and resolve findings and requesting for assistance/ advice from the TAO or PERMU when they are unsure how to proceed.*

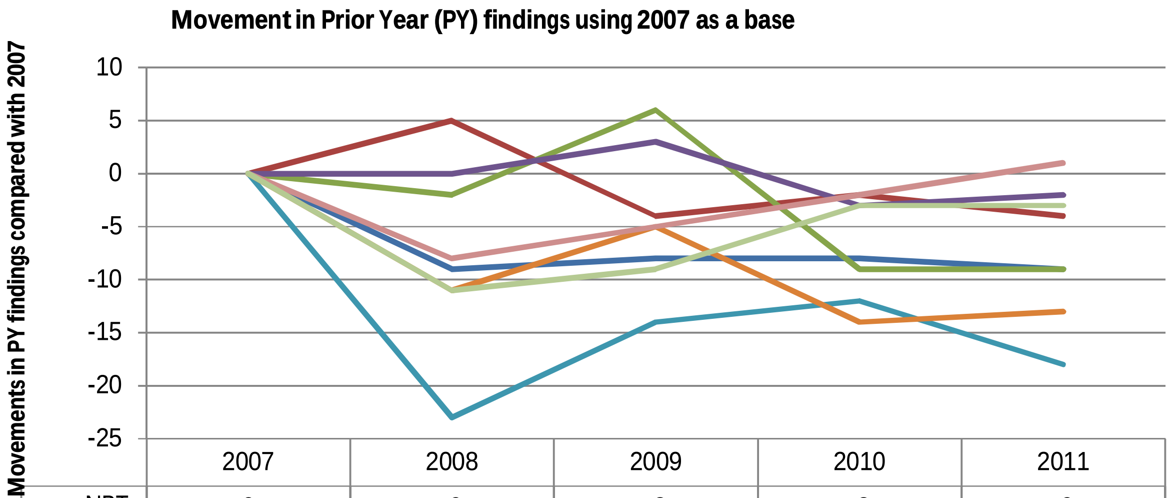
The graph below shows the movement in the number of management letter points (findings) for each year for each entity compared with the number in 2007. What is expected when continual improvement is being made is a consistent reduction in the number of management letter points (i.e. a downward trend).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

Movement in Findings since 2007



	2007	2008	2009	2010	2011
NBT	0	-5	-1	0	3
DBT	0	5	1	5	8
TEC	0	-4	8	-4	3
TPB	0	0	3	-3	-1
TTC	0	-6	-5	-5	-9
VLH	0	-3	1	1	-7
TNPF	0	3	1	-6	6
TMTI	0	-9	-8	1	1

The graph on the following page 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 have not yet been resolved. Note that there is a slight decrease in the number of recurring findings. If consistent improvements are made the number of recurring findings would be on a downward trend.



	2007	2008	2009	2010	2011
NBT	0	-9	-8	-8	-9
DBT	0	5	-4	-2	-4
TEC	0	-2	6	-9	-9
TPB	0	0	3	-3	-2
TTC	0	-23	-14	-12	-18
VLH	0	-11	-5	-14	-13
TNPF	0	-8	-5	-2	1
TMTI	0	-11	-9	-3	-3

Amounts owing between entities and the GoT

According to the PE Act, the public enterprises are to be become more and more independent of the GoT with a formal Community Service Obligation (CSO) agreement being the only time the board approves operations that are likely to be unprofitable. During the audits we identified offsetting of receivables from the GoT with payables to the GoT. 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. Offsetting the receivables and payables together with expecting offsets in the future complicates anticipated cashflows and makes it more difficult to assess the true performance of the entity.

Recommendation 15: *The amounts owing and owed between the GoT and entities should be settled as soon as possible. Any loan arrangement should be formally documented. Interest charges should be levied on the GoT by the entities on outstanding payables, and vice versa.*

In kind donations

In kind donations are payments made without consideration by the receiving entity that are not made in cash, but in the provision of goods and services. Where an entity receives in kind donations the goods or services rendered are normally treated as an asset and should be included in the financial statements of the particular entity.

Recommendation 16: *Entities should ensure that they correctly account for an in kind donations received. The pricing of the goods or services sold by the entities should take into account depreciation charges against any in kind assets donated to the entity to ensure that their business model remains viable if or when donations cease. Assets provided free of charge 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 entities. A fraud policy is a key document in the prevention and detection of fraud. It emphasises to employees and other stakeholders 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 may not know what procedures to follow.

Recommendation 17: *That each entity creates a fraud policy, which is explained and is accessible to each employee of the entity. The TAO has provided model fraud policies on request, however, we have not seen any implemented.*

Policies and Procedures

There are a lack of documented policies and procedures relating to the primary and day to day functions of the Public Enterprises and TNPF. 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 18: *The financial institutions should document detailed policies and procedures for day to day functions. This will assist to ensure that a consistently high level of service is delivered.*

Common issues with Financial Institutions

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

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 19: *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.*

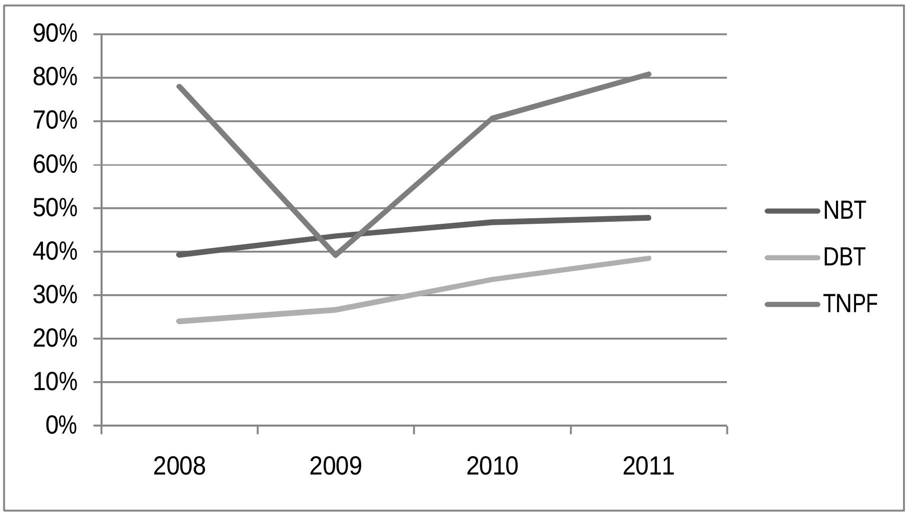
Credit Worthiness and valuation of Loan Security

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 20: *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.*

Debtors management

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



The graph above shows an increasing trend in the allowance for credit impairment for the three financial institutions from 2008. 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 61%.

Allowance for credit impairment as a percentage of total loans

Years	NBT	DBT	TNPF	Average
2008	39%	24%	78%	47%
2009	44%	27%	39%	36%
2010	47%	34%	71%	50%
2011	48%	38%	81%	56%
Average	56%	58%	68%	61%

Recommendation 21: *The three lending institutions should impose a stricter loan assessment process, ensure that collateral is provided and 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.

National Bank of Tuvalu

Activities

The National Bank of Tuvalu (NBT) is constituted under the *National Bank of Tuvalu Act*. 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.

Audit opinion

The audits of the National Bank of Tuvalu's (NBT) financial reports for the year ended 31 December 2011 resulted in Unqualified Independent Audit Report. (2010 Unqualified)

Key issues

CORPORATE GOVERNANCE

The NBT does not have in place a formal and documented policy in relation to their corporate governance framework. For the nature of the operations of the NBT and the critical role it plays in the financial market and economy of Tuvalu, it is fundamental and critical to have a good corporate governance framework including policy and guidelines.

Corporate governance includes policies, processes, and structures used by the NBT to direct and control its activities, to achieve its objectives, and to protect the interests of its diverse stakeholder groups including GoT, customers, international agencies and its staff. It sets out the key responsibilities and accountabilities of the board and management including promotion of ethical practices with consideration of conflict of interest issues.

OPERATIONAL

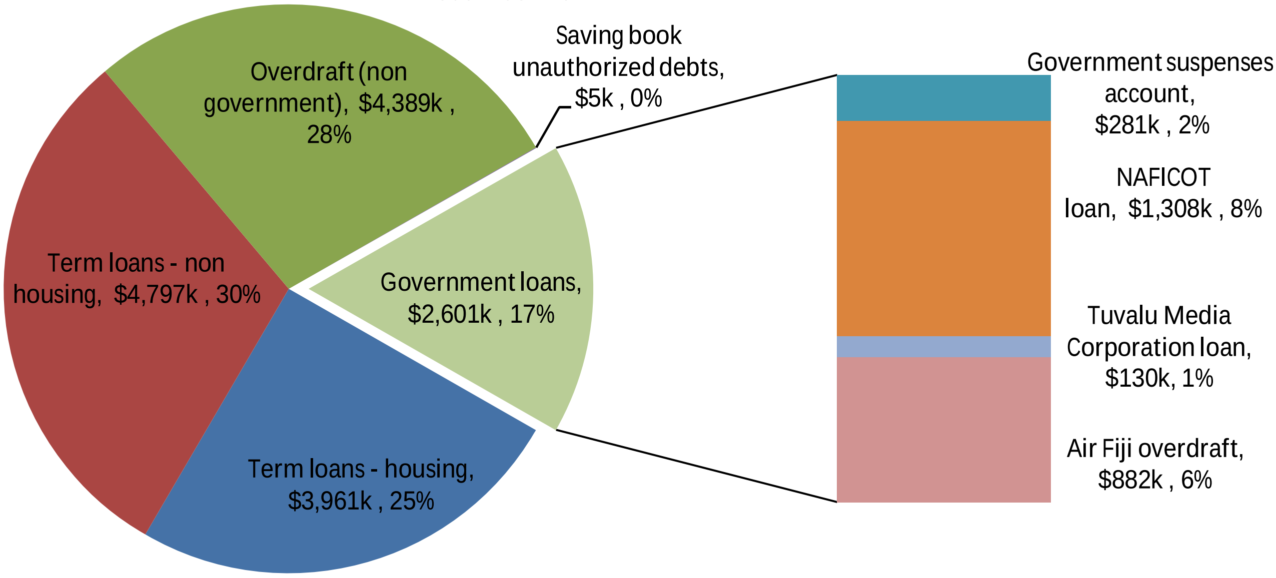
Significant issues and recommendations that have been indentified in past audits are not being adequately addressed by the NBT. The issues identified concern the NBT's control systems, fraud policies, procedures and processes in the lending and savings operations, management of lending practices, lack of a formal disaster recovery plan, lack of back up procedures and lack of IT security policies.

The poor management of the banking system and the inability to produce appropriate reports resulted in weak performance - particularly the lending department. Allowance payments were made to directors who were not permitted to receive allowances from NBT under the PE Act.

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 NBT needs to keep a high-level of liquidity to meet these potential withdrawals.

NBT loan portfolio breakdown, including loans to the Tuvaluan Governement as at 31 December 2011



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

17% of the NBT's loan portfolio relates to GoT debt or GoT guaranteed debt. When the GoT has used the NBT to finance its budget deficit, it results in a severe depletion of the NBT's liquidity level. We note the significant repayment of the GoT's suspense account, however, $2.6 million remains outstanding from the GoT.

If steps are not taken to address the diminishing liquidity level, recapitalisation may be required in the near future. The NBT should train staff, improve bank discipline and overall management in order to maintain capital adequacy within prudential limits. GoT should consider seeking out a strategic banking partner to assist in the overall management and operation of the NBT.

LENDING

Poor lending and credit assessment practices have contributed to the poor quality of the NBT's loan portfolio. Grading of loans is not performed accurately which can lead to understatement of bad and doubtful debts. These have resulted from a lack of technical expertise, an inadequate lending policy and a failure to adhere to existing policies. Unnecessary credit risks should not be taken with lending. Restructuring of non performing loans should be performed in a timelier manner and a robust strategy should be developed to recover delinquent loans.

Control issues

We identified scope for improvement in the following areas:

- adhering to delegated level of authority in the approval of loans;
- monitoring and recovery of overdue loans;
- improvement in IT access controls;
- obtaining proper security documentation for loans;

- credit assessment for loans and advances;
- the generation of daily arrears report; and
- strengthening of management reports.

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

Financial Information – National Bank of Tuvalu

Year ended 31 December	2011 $'000	Change $'000	Change %	Notes	2010 $'000	Change $'000	Change %	Notes	2009 $'000
Operations									
Net Interest Income	**1,340**	-7	-1%		**1,347**	72	6%		**1,275**
Other Operating Income	**1,757**	100	6%		**1,657**	-368	-18%	2	**2,025**
Operating Expense	**-1,470**	-51	4%		**-1,419**	17	-1%		**-1,436**
Bad Debts write off	**-**	-	0%		**-**	14	-100%		**-14**
Credit Impairment Expense	**49**	-58	-54%	1	**107**	465	130%	3	**-358**
Income Tax Expense	**-503**	4	-1%		**-507**	-58	13%		**-449**
Comprehensive income (loss)	**1,173**	-12	-1%		**1,185**	214	9%		**1,043**
Assets	**29,261**	1,107	4%		**28,154**	-69	0%		**28,223**
Liabilities	**21,884**	1,522	7%		**20,362**	-1,253	-6%		**21,615**
Net assets (at 31 December)	**7,377**	-415	-5%	5	**7,792**	1,184	18%	4	**6,608**

NOTES:

1. $58k decrease in credit impairment expense from 2010 to 2011, due to less loans in 2011 being assessed as impaired versus loans in 2010.
2. 18% decrease in net operating income in 2010 was a result of no reversal of allowance for unauthorised debts in 2010 compared with 2009, and a $249k fall in foreign exchange income.
3. $465k increase in allowance for credit impairment from 2009 to 2010 due to more loans being considered impaired.
4. The NBT's net asset amount has been increasing from 2009 to 2010. This change was mainly due to increases in 'cash and cash equivalent' assets and 'loans and advances' liabilities of the bank during the periods. This is due to increased business activity within the NBT.
5. Decrease in Net assets due to increase in deposits from customer liabilities of $1.6m, decrease in loans and advances liabilities $0.4m, due from other banks assets $0.5m, offset by increases in cash and cash equivalents asset of $1.5m.

Development Bank of Tuvalu (DBT)

Activities

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

Audit opinion

The audit of the Development Bank of Tuvalu's financial reports for the year ended 31 December 2011 resulted in an Unqualified Independent Audit Report. (2010 Unqualified)

Key Issues

CORPORATE GOVERNANCE

The DBT does not have in place a formal and documented policy in relation to its corporate governance framework. Corporate governance includes policies, processes, and structures used by the DBT to direct and control its activities, to achieve its objectives, and to protect the interests of its diverse stakeholder groups including GoT, customers, international agencies and its staff. This includes development of a fraud policy and training.

The corporative governance framework should sets out the key responsibilities and accountabilities of the board and management including promotion of ethical practices with consideration of conflict of interest issues. The development of a corporate governance framework should also include staff development to ensure that the policies are understood and are fully implemented. Allowance payments were made to directors who were not permitted to receive allowances from DBT under the PE Act.

ADOPTION OF MANAGEMENT LETTERS (REPEATED ISSUE)

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

Significant management letter points which have been raised for the past two years relate to:

- systems, processes and procedures around loan assessment, loan approvals, credit management, loan monitoring and collections;
- loan files not being updated;
- provisioning for loan losses;
- regular assessment of the allowance for doubtful debts;
- hiring of in house legal counsel to commence legal action to recover long overdue loans;
- sufficiently detailed arrears reports to be produced;
- valuation of security during assessment of loan losses; and
- approval of loans with sub standard security presented as collateral.

The improvements recommended are considered important for the DBT to minimise their risk of losses and to continue to operate as a going concern. The DBT made a loss in 2011 of $178k with credit impairment expense contributing $412k to this loss. The slower the implementation the more the DBT exposes itself to financial and operational inefficiencies.

LENDING POLICY

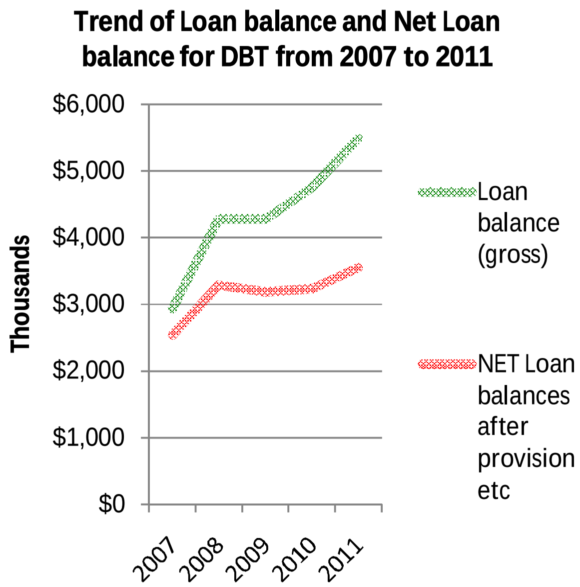
A more aggressive collection and recovery action on loans in arrears needs to be undertaken to improve the quality of the DBT's loan portfolio. Where customers make reduced repayments, consideration should be given to charging penalties.

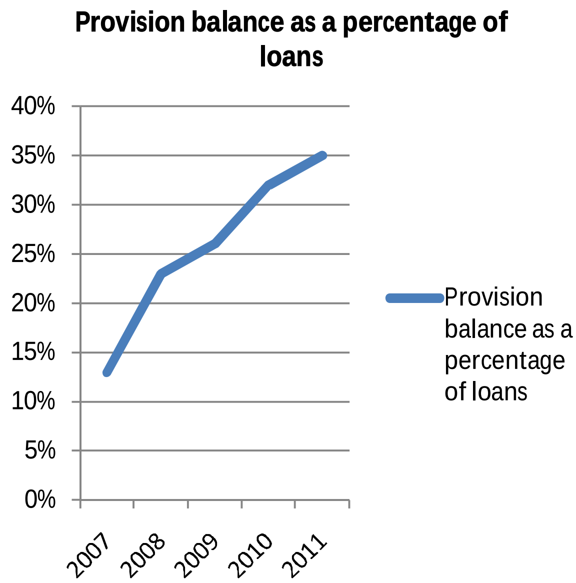
The DBT's credit lending policy is outdated and needs to be revised. Interest rates and charges in the lending policy inadequately cover the DBT's operational costs and working capital requirements. These have resulted from the current economic and political condition of the Tuvaluan economy, as well 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 DBT'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 2011. A detailed analysis of the loan book is shown below:

Particulars (all figures in thousands of AUD)	**2009**	**2010**	**2011**
Loan balance (gross)	4,282	4,761	5,483
Interest in suspense (suspended interest)	-178	-227	-457
Provision for doubtful debts	1,092	1,523	1,935
Accounts overdue > 5 months	341	779	1,083
NET Loan balances after provision etc	3,190	3,238	3,548
Provision balance as a percentage of loans	26%	32%	35%





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 DBT 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 DBT's cash flow could be severely affected and could lead to further deterioration of loans accounts if the recommendations are not implemented. The provision rates which are used in the DBT's impairment analysis is considered to be inadequate.

Control Issues

We identified scope for improvement in the following areas:

- establishment of internal audit function;
- segregation of duties in the finance division;
- detailed arrears report to be produced;
- deficiencies in general IT controls;
- variances between the general ledger and the deposit listing;
- review of ledger cards; and
- anomalies in the bank reconciliation from the general ledger to the bank statement;

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	2011 $'000	Change $'000	Change %	Notes	2010 $'000	Change $'000	Change %	Notes	2009 $'000
Operations									
Net Interest Income	**447**	171	62%	7	**276**	73	36%		**203**
Operating Income	**182**	(149)	-45%	6	**331**	(134)	-29%		**465**
Operating Expense	**(395)**	20	5%		**375**	10	3%		**365**
Credit Impairment Expense	**(411)**	(20)	-5%		**431**	330	327%	3	**101**
Income Tax Expense		-			**-**	-	0%		**-**
Operating surplus/(deficit)	**(178)**	21	-11%		**(199)**	(401)	-199%	2	**202**
Assets	**4,050**	194	5%	4	**3,856**	(361)	-9%		**4,217**
Liabilities	**1,639**	272	20%	5	**1,367**	(586)	-30%		**1,953**
Net assets (at 31 December)	**2,411**	(78)	-3%		**2,489**	225	10%	1	**2,264**

NOTES:

1. Loans and advances liabilities decreased, partially offset by cash and cash equivalents assets decrease.
2. The operating loss in 2010 was the result of a decrease in operating income compared to 2009.
3. Allowance for credit impairment expense increased from 2009 to 2010 indicates the increase in the number of loans and advances assessed to be uncollectable for the years 2009 and 2010 respectively.
4. The increase of net Assets by $194k from 2010 to 2011 due to the increases of cash and cash equivalents by $120k also the increases of loans and advances to customers by $81k
5. The increases of liabilities by $272k from 2010 to 2011 due to the increases of deposits from customers by $300k and EIB loan by $80k
6. Decrease in arrears fees, and no unrealized exchange gain for 2011 as the EURO dollar strengthened against the Aussie dollar in 2011 partially offset by increase in fees revenue and service fees.
7. Interest income increased by the $170k as at reporting date. This is consistent with a 6% increase in the loan portfolio of $187k and an increase in interest rates during the year.

Tuvalu Electricity Corporation

Activities

The Tuvalu Electricity Corporation (TEC) operates under the provisions of the *Tuvalu Electricity Corporation* Act. 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.

Audit opinion

The audit of TEC financial report for the year ended 31 December 2011 resulted in a qualified opinion with an emphasis of matter. The report was qualified on the basis of the inability to confirm the existence, completeness and accuracy of fuel inventory at year end. In addition an emphasis of matter regarding the TEC's deficiency of working capital and shareholder's equity indicates the existence of uncertainty in TEC's ability to continue as a going concern. (2010 result was Qualified with a Disclaimer)

Key Issues

TUVALU ELECTRICITY CORPORATION POTENTIAL DECORPRATISATION

The *Tuvalu Electricity Corporation (Repeal) Act* was passed in Parliament in late 2011. This Act is removing TEC from the PE Act and is transferring management and ownership to the GoT. This Act comes into effect on such date that the Minister may by notice appoint, which is yet to occur. This means that TEC continues as a Public Enterprise until the Minister gives notice.

This is not an ideal position for the TEC, as if while they are striving to be a successful business they causes upset to the Minister, the Minister will decorprotise TEC.

Recommendation 22: *The GoT should repeal the Tuvalu Electricity Corporation (Repeal) Act as soon as possible. This will ensure that the TEC can fulfil its role as a public enterprise*

ADOPTION OF THE MANAGEMENT LETTER

Management letter points in prior years have been accepted by management, but have not been adequately addressed and implemented. Financial matters may take some time to address. However, TEC should be able to immediately address system, processes and procedural issues.

Management and the Board should agree on setting a formal timeline to address issues raised. A senior staff member or members should be assigned to regularly follow up on the progress against the timeline and report to the board. TEC should aim to reduce the severity of the qualification in future audits.

IDENTIFICATION OF NON PROFITABLE OPERATIONS

The TEC currently does not identify and assess the costs relating to its non profitable operations. This includes the outer islands electrification project and provision of street lighting in Funafuti. The costs of providing these CSOs are not accurately assessed.

As a result, the financial assistance from GoT is not based on accurate assessment of the costs incurred by the CSOs. Failure by the TEC to carry out this assessment of non profitable operations may result in the TEC not being able to identify any significant financial and operational issues in relation to the separate outstations.

Management should undertake a comprehensive review to identify non profitable operations and operations that are considered to be social responsibility in nature. Non profitable CSO are to be approved by Cabinet if they are to be funded by the GoT. The cost relating to the provision of the CSOs should be accurately assessed.

CORPORATE GOVERNANCE TO BE STRENGTHENED

TEC does not have in place a corporate governance framework. In the absence of sound corporate governance policy and procedures, there may be potential misunderstandings on the respective roles and accountabilities of the management and board of directors. TEC does not have a fraud policy in place, nor was any training undertaken with staff about fraud. TEC has no formal documented policy in regards to provision of doubtful debts.

Allowance payments were made to directors who were not permitted to receive allowances from TEC under the PE Act.

FINANCE FUNCTION TO BE IMPROVED

The overall effectiveness and efficiency of the finance function continues to be unsatisfactory. The coordination and supervision of work needs to be strengthened to ensure that tasks allocated are properly carried out.

The following issues were noted:

- non completion of the bank reconciliation, fixed asset accounting depreciation schedule, inventory listing, creditors and accruals and provision for annual leave were not prepared on a monthly basis before the audit;
- non adjustment to the majority of the general ledger accounts for the entire year; and
- lack of experience and skill of the finance staff expected of their respective position, which is a major contributing factor to the lack of discipline and diligence in the finance function.

DISASTER RECOVERY PLAN AND BUSINESS CONTINUTY PLAN TO BE FORMALISED.

The TEC does not have a Disaster Recovery Plan (DRP) and a Business Continuity Plan (BCP) to guide it in the event of disaster damaging the assets that are critical to TEC's operation. Without a DRC and BCP in place there can be significant delays in recovering from a disaster which may critically impact the supply of power to the nation.

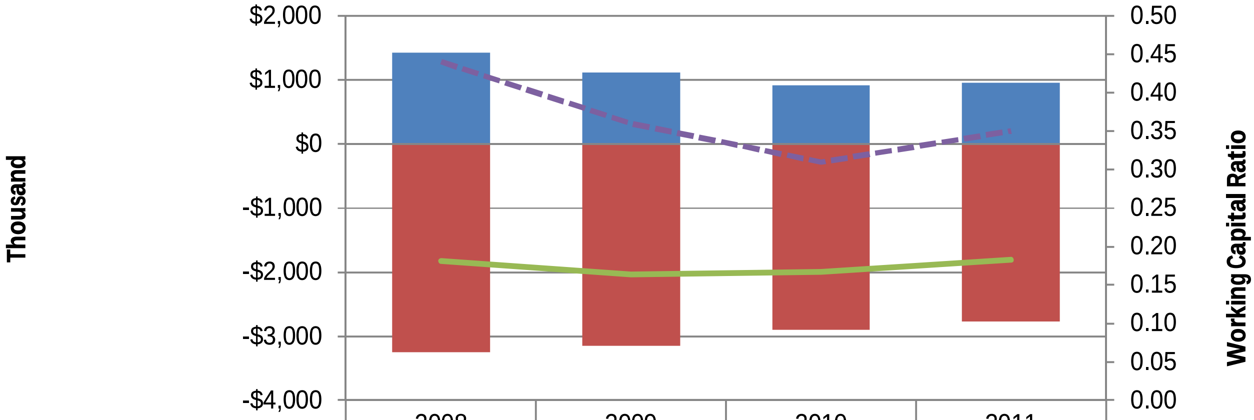
A formal DRP and BCP needs to be documented to ensure minimal disruption to operations and downtime in the event of natural or other disasters as well as to ensure the continued operation of TEC.

HIGH OPERATIONAL AND FINANCIAL RISK

The TEC continues to face a deficient working capital position, which persisted since its inception in 1996. Even though working capital and shareholder's deficiency position marginally improved, it continues to be significantly deficient.

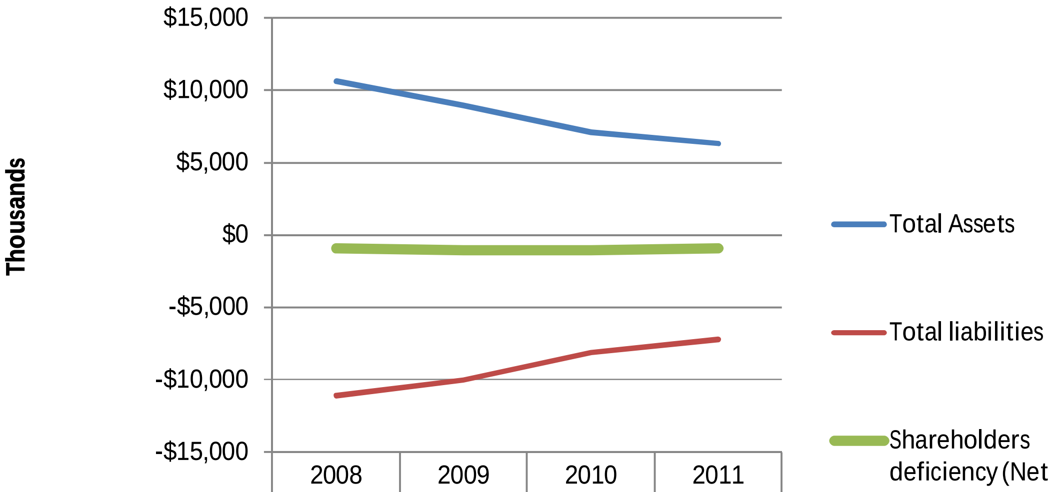
The table below shows the capital position and shareholder's deficiency of the TEC's working capital:

Analysis of TEC's working capital



	2008	2009	2010	2011
current assets	$1,425	$1,116	$915	$959
current liabilities	-$3,250	-$3,144	-$2,905	-$2,767
net current assets	-$1,825	-$2,027	-$1,990	-$1,808
working capital	0.44	0.36	0.31	0.35

Analysis of Shareholder's deficiency in TEC



	2008	2009	2010	2011
Total Assets	$10,613	$8,953	$7,094	$6,307
Total liabilities	-$11,086	-10017	-$8,132	-$7,232
Shareholders deficiency (Net assets)	-$923	-$1,063	-$1,038	-$925

In addition to the above, TEC also experienced significant cash flow difficulties as reflected in the balance of bank overdraft, which continues to remain at high level as in past years.

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. The cost of fuel continued to increase through 2011;
- High level of debtors due to poor management of customers' debt with a significant part of the debt balance outstanding from GoT. While this has improved from 2010, the level of long outstanding debtors over 90 days is still considered high and needs to be addressed; and
- Fixed tariff rate, which is strictly controlled by the GoT and the decline in GoT assistance over the years in relation to fuel subsidy and the operational grant.

The working capital and cash flow difficulties experienced by TEC have led to high level of operational and financial risk which continues to increase over the years.

There is a continuous need for GoT financial support to alleviate the high costs of operations. The major factors contributing to the cash flow difficulties should be promptly addressed to ensure that TEC can operate more effectively.

Consideration should be given to carrying out a thorough financial and operational review to determine causes for the deficiency in working capital and shareholders' equity.

Control Issues

We identified scope for improvement in the following areas:

- ❖ development and implementation of proper journal forms;
- ❖ proper management of inventory and fixed assets;

- improvement of trade debtors turnover;
- review of bank account reconciliation;
- strengthening of IT management;
- improvement in maintenance of annual leave records;
- improvement of internal controls for outer island billing processes;
- review and compilation of outer island reports by management;
- provision of finance reconciliation on a timely basis;
- improve management of the Fixed Asset Register and fixed assets process;
- review and update finance manual;
- improve validation controls over the billing process; and
- review and improve depreciation method.

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

Financial Information – Tuvalu Electricity Corporation.

Year ended 31 December	2011 $'000	Change $'000	Change %	Notes	2010 $'000	Change $'000	Change %	Notes	2009 $'000
Operations									
Revenue	**4,221**	(2,015)	-32%	3	**6,236**	1,927	45%		**4,309**
Expenses	**(4,063)**	2,113	-34%	4	**(6,176)**	(1,831)	42%		**(4,345)**
Financing cost	**(58)**	(23)	66%		**(35)**	69	-66%		**(104)**
Operating surplus/(deficit)	**100**	75	300%		**25**	165	-118%	1	**(140)**
Current Assets	**959**	44	5%		**915**	(201)	-18%		**1,116**
Non-current assets	**5,348**	(832)	-13%	5	**6,180**	(1,657)	-21%		**7,837**
Current Liabilities	**(2,780)**	125	-4%		**(2,905)**	239	-8%		**(3,144)**
Non-current liabilities	**(4,465)**	762	-15%	6	**(5,227)**	1,646	-24%		**(6,873)**
Net assets (at 31 December)	**(938)**	99	-10%		**(1,037)**	27	-3%	2	**(1,064)**

NOTES:

1. Operating surplus predominantly due to increase in grants received in 2010.
2. Decrease in net assets due to the bank overdraft liability increasing and uncollected debts resulting in decrease in net receivables asset.
3. Decrease in revenue in 2011 resulted from a decline in private and commercial consumption. Better control of private and commercial users has lowered actual revenue, which means that receivables are more likely to be collected.
4. Decrease in total expenses in 2011 was due to the decrease in fuel and oil expense by 5% which is in consistent with the 9% decrease in electricity sales, decrease in doubtful debt expense by $699k due to no further provisioning for doubtful debts for 31 December 2011, and decrease in depreciation by $143k which resulted from fully impairment of assets in 2010 thus no depreciation charged in 2011.
5. The decrease was due to depreciation charged amounting to $821k and loss on disposal of $90k on property plant and equipment at year end.
6. The decrease was due to GoT granting various fixed assets worth $3.6m over the years and about $8.6m was granted for upgrading the power supply on Funafuti Island by the Japan as a token of friendship. The grant is initially recorded as a liability and is reduced over the useful life of the assets.

Tuvalu Philatelic Bureau

Activities

The Tuvalu Philatelic Bureau (TPB) is constituted under the provisions of the *Tuvalu Philatelic Bureau Act*. 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.

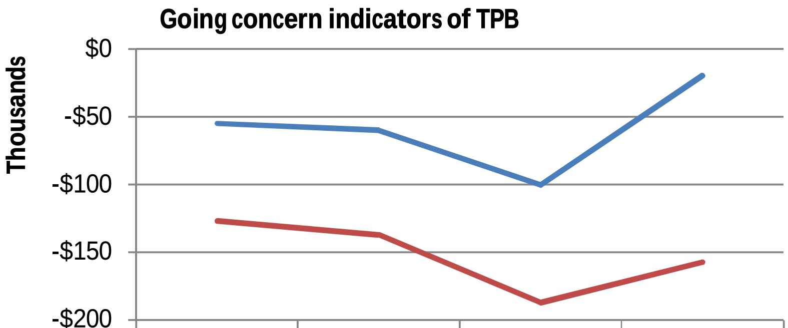
Audit Opinion

The audit opinion for the year ended 31 December 2011 was Unqualified with an emphasis of matter surrounding the TPB's ability to continue as a going concern. (2010 – Qualified 'except for' with an emphasis of matter surrounding the TPB's ability to continue as a going concern)

Key issues

GOING CONCERN (REPEATED ISSUE)

The TPB made significant losses in 2011 and has a negative net asset position. The viability of the TPB will continue to be under severe strain if no injection of capital is provided by the GoT. Measures should be taken to increase profitability by decreasing expenditures.



	2008	2009	2010	2011
Comprehensive income	-$55,094	-$59,966	-$100,472	-$19,754
Net assets	-$126,978	-$136,944	-$187,416	-$157,170

LACK OF ELECTRONIC FINANCIAL MANAGEMENT AND INFORMATION SYSTEM (FMIS)

The TPB does not have in place an electronic Financial Management and Information System (FMIS). Financial statement and management accounts are compiled out of the paper based ledgers which are inefficient and create an increased risk of transposition errors being made. A FMIS is owned by the TPB, but is not used.

Control issues

We identified opportunities for improvement in the following areas:

- preparation of bank reconciliations;
- maintenance of a daily back up of work not performed;
- lack of fraud policies and procedures; 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	2011 $'000	Change $'000	Change %	Notes	2010 $'000	Change $'000	Change %	Notes	2009 $'000
Operations									
Gross profit	**51**	(4)	-7%		**55**	(4)	-7%		**59**
Other Income	**24**	(11)	-31%	1	**35**	(1)	-3%		**36**
Total Expenses	**(96)**	95	-50%	2	**(191)**	(36)	23%	6	**(155)**
Operating surplus/(deficit)	**(21)**	80	-80%		**(101)**	(41)	68%		**(60)**
Current Asset	**72**	(16)	-18%	3	**88**	6	7%		**82**
Non-current Asset	**5**	(4)	-44%		**9**	(1)	-10%		**10**
Current Liabilities	**(234)**	51	-18%	4	**(285)**	(56)	24%	5	**(229)**
Net Assets surplus/(deficit)	**(157)**	30	-16%		**(188)**	(51)	37%		**(137)**

NOTES:

1. Decrease due to royalty fees of 25% in 2011 as well as royalty fees being paid in USD which has depreciated against the AUD.
2. Decrease to total expenses as due to the Marketing Manager retiring in early 2011, as well as the TNPF surcharge payable being forgiven.
3. Decrease due to the accrued royalty fee revenue of $14k in 2010 being written down to $0 in 2011.
4. Decrease due to the forgiving of the TNPF surcharge of $34k, forgiveness of debt to IGPC of $14k, partially offset by an increase in bank overdraft liability of $6k.
5. Increase in current liabilities due to unpaid TNPF surcharges as well as other amounts owed to creditors.
6. Increase in expense due to interest surcharge on unpaid TNPF contributions ($23k) and employee expenses ($9k) due to long service leave payouts.

Tuvalu Telecommunication Corporation

Activities

The Tuvalu Telecommunications Corporation (TTC) is constituted under the provisions of the *Tuvalu Telecommunications Act*. 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. The TTC is given an exclusive right to operate these services and system.

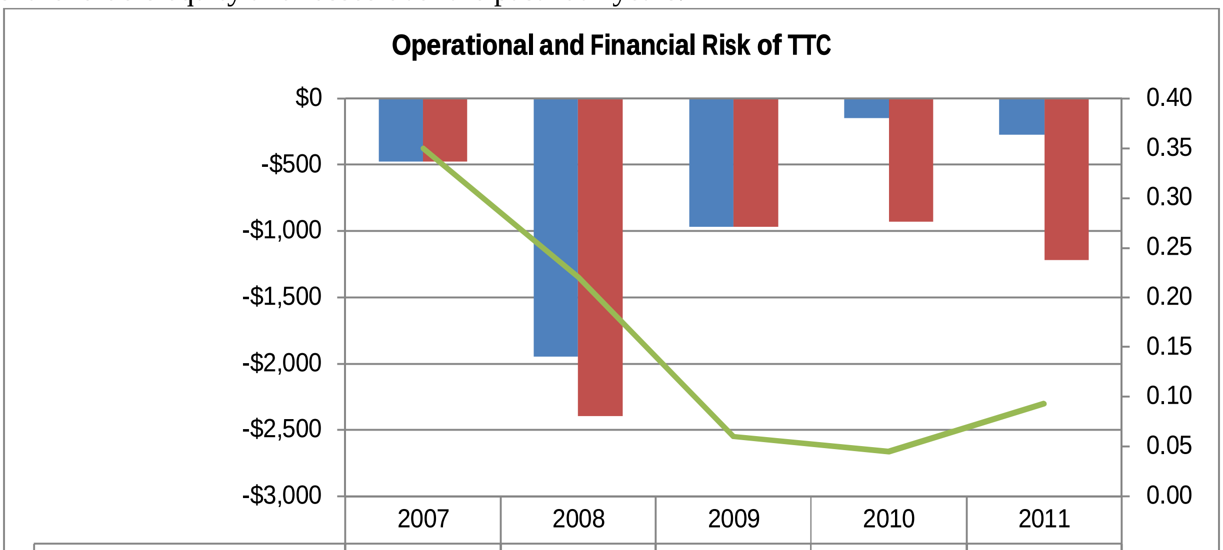
Audit opinion

The audit of the TTC for the period ending 31 December 2011, an Unqualified Audit Report with an emphasis of matter surrounding the deficiency of working capital and shareholder equity was issued (2010 - Unqualified Audit Report with an emphasis of matter surrounding the deficiency of working capital and shareholder equity) .

Key issues

HIGH OPERATIONAL AND FINANCIAL RISK

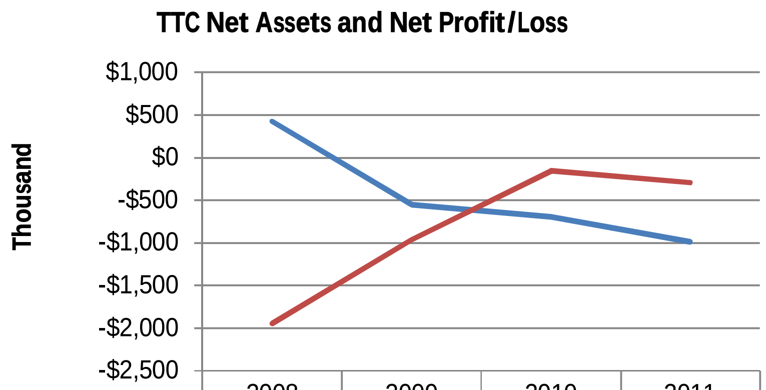
The TTC's financial position and operating performance over the years has been deteriorating significantly, which has resulted in cash flow issues, a working capital deficiency, negative shareholders equity and losses over the past four years.



	2007	2008	2009	2010	2011
net loss	-$478	-$1,946	-$965	-$150	-$275
cash & cash equivalent	-$478	-$2,397	-$964	-$930	-$1,219
current assets ratio	0.35	0.22	0.06	0.05	0.09

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 TTC's Net Asset and Net Loss trend for the period 31 December 2008 to 31 December 2011 are as follows:



	2008	2009	2010	2011
Net Assets	$422	-$544	-$695	-$984
Net Profit/loss	-$1,945	-$964	-$151	-$290

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

DEFICIENCY IN WORKING CAPITAL/FINANCIAL PERFORMANCE

TTC incurred an operating loss after income tax expense of $275k for the year ended 31 December 2011 (2010: $151k) and, as at that date it had a net deficiency in working capital of $2,554k (2010: $2,430k).

The TTC's financial performance has continued to deteriorate over the years. There does not appear to be a firm strategy in place to reverse this situation. The bank overdraft position and cash flow have also continued to deteriorate. Most telecommunication companies in the region that are in a monopoly situation do not have this trend.

We also note with the increasing use of VOIP (Skype), the TTC will come under increasing pressure due to the loss of the traditional form of telecommunications income.

FRAUD POLICY AND TRAINING

The TTC does not have a formal documented policy in relation to fraud. The fraud policy should require training and awareness sessions to be provided to staff and specify the disciplinary actions to be undertaken by the TTC in the event of a fraud.

FIXED ASSETS POLICIES AND INSURANCE TO BE CONSIDERED

The TTC does not have a fixed assets policy in place. Without a proper fixed asset policy, the management of the TTC's assets may be weak.

The TTC does not have any insurance or reserve in place to cover losses over fixed assets especially losses due to fire, or natural disasters. Any breakdown in key assets could cause a major disruption to the TTC's ability to deliver its services if recovery procedures are not implemented in a timely manner.

HIGH INTEREST RATES ON OVERDRAFT ACCOUNT

The TTC's overdraft account is currently incurring an interest of 12% per annum. This year the finance cost for the entity was $140,705 (2010: $124,363). As a result of the high interest and overdraft balance, the TTC is incurring a significant financing cost. This has led to a significant pressure being placed on its liquidity.

MORE TRAINING TO STAFF TO BE PROVIDED

TTC staff had difficulties in generating reports from the TTC's accounting system (MYOB). This is mainly due to staff not having adequate knowledge, skills and experience to effectively operate and fully utilize the accounting software. We noted that the quality of reconciliations have eroded compared to prior years. The number of errors and audit differences were higher in 2011 than in past years.

Control Issues

We identified scope for improvement in the following areas:

- reconciliation of inventories;
- review of journal entries;
- strengthening of financial and internal controls;
- correction of anomalies in property, plant and equipment;
- deficiencies in general IT controls;
- disclosure of intangible assets in compliance with IFRS;
- review depreciation rates over property, plant and equipment;
- reconciliation of income tax payable;
- improvement of revenue recognition policies to comply with IFRS;
- perform calculations of employee benefits according to IFRS; and
- monitoring of staff leave balances to be improved.

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

Financial Information – Tuvalu Telecommunication Corporation

Year ended 31 December	2011 $'000	Change $'000	Change %	Notes	2010 $'000	Change $'000	Change %	Notes	2009 $'000
Operations									
Revenue	**1,608**	(4)	0%		**1,612**	508	46%	3	**1,104**
Expenses	**(1,743)**	111	7%		**(1,632)**	(297)	-15%	4	**(1,929)**
Financing cost	**(141)**	17	14%		**(124)**	9	8%		**(115)**
Tax Expense	**(15)**	9	150%		**(6)**	(18)	-75%		**(24)**
Operating surplus/(deficit)	**(291)**	(141)	94%		**(150)**	814	-84%	5	**(964)**
Current Assets	**262**	147	128%	1	**115**	(43)	-27%	6	**158**
Non-current assets	**2,202**	(188)	-8%	2	**2,390**	(204)	-8%		**2,594**
Current Liabilities	**(2,816)**	271	11%		**(2,545)**	(77)	-3%		**(2,622)**
Non-current liabilities	**(632)**	(22)	-3%		**(654)**	(20)	-3%		**(674)**
Net assets (at 31 December)	**(984)**	(290)	42%		**(694)**	(150)	28%		**(544)**

NOTES:

1. Increase in current assets is due to the increase in trade and other receivables by $162k in 2011, other assets by $2k partially offset by the decrease in cash by $14k and Inventories by $2k in 2011.
2. Consistent with 2010, decrease in non-current assets result from the decrease in property, plant and equipment by $188k due to deprecation.
3. Increase in revenue due to increase in telephone revenue $105k, increase in GoT Grant revenue $264k, Licence fee revenue $75k and other income increasing by $134k.
4. Decrease in expenses due to decrease in doubtful debt expense $113k, a decrease in personnel expenses $41k and decreases in other operating expenses related to rent subsidies $100k and satellite charges $52k.
5. Decrease in deficit due to the increase in revenue from debt recovery and phone rental, as well as decrease in doubtful debts expense and other operating expenditure.
6. 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.

Vaiaku Lagi Hotel

Activities

The Vaiaku Lagi Hotel (VLH) is constituted under the provisions of the *Vaiaku Lagi Hotel Corporation Act*. 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, and providing laundry services.

Audit opinion

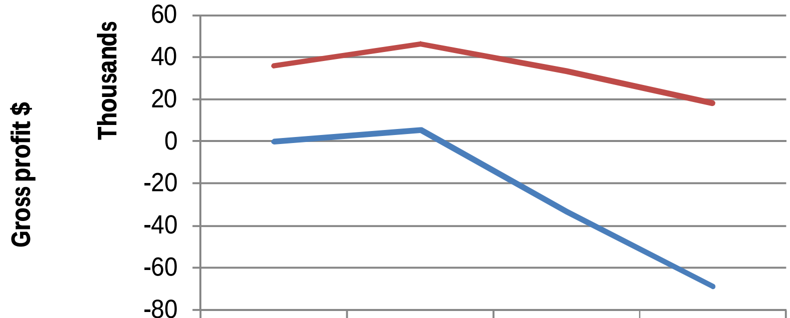
The audit of the VLH financial report for the year ended 31 December 2011 resulted in an unqualified Audit Report (2010 – unqualified).

Key issues

PROFITABILITY OF BAR AND KITCHEN TO BE IMPROVED

The bar and food departments have incurred low and declining gross profits in the 2011 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



	2008	2009	2010	2011
Gross Profit/(loss) from food	-142	5592	-33353	-68863
Gross profit from Beverage	35777	46407	33100	18205

FINANCIAL PERFORMANCE

The VLH continues to operate unprofitably and there does not appear to be any significant steps taken to reverse this trend. Gross margins have worsened compared to prior year. The gross margin from food shows losses since 2010, which suggests poor management of this department. Sales of beverage have high margins and contribute positively to all VLH operations.

CORPORATE GOVERNANCE TO BE IMPROVED

The VLH does not have in place a formal and documented corporate governance framework. In the absence of sound corporate governance policy and procedures, there may be misunderstandings on the respective roles and accountabilities of the management and board of directors. There was no fraud policy in place, nor was any training undertaken with staff in relation to fraud. Allowance payments were made to directors who were not permitted to receive allowances from VLH under the PE Act.

ACCOUNTING IMPROVEMENTS

The value of the VLH is not properly reflected in the financial statements and could be understated. A valuation needs to occur to ensure that the value of the building and improvement is properly reflected in the financial statements.
The aged debtor listing contains debts which are no longer recoverable. With proper assessment and approval of the board, these debts should be written off.

Control issues

We identified scope for improvement in the following areas:

- authorisation and review of significant journals;
- implementation of a computerized accounting environment;
- reconciliations of general ledger to accounts receivable and trade payables;
- strengthening of review process for reconciliations;
- improvement of debt collection; and
- improvement of financial and internal controls.

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

Financial Information - Vaiaku Lagi Hotel

Year ended 31 December	2011 $'000	Change $'000	Change %	Notes	2010 $'000	Change $'000	Change %	Notes	2009 $'000
Operations									
Revenue	**456**	(119)	-21%	3	**575**	2	0%		**573**
Other operating income	**111**	34	44%	1	**77**	43	126%	6	**34**
Cost of Sales	**(346)**	29	-8%		**(375)**	(57)	18%	7	**(318)**
Expenses	**(281)**	43	-13%	2	**(324)**	(14)	5%		**(310)**
Operating surplus/(deficit)	**(61)**	(13)	-27%		**(47)**	(25)	144%		**(22)**
Current Assets	**141**	6	4%		**135**	(18)	-12%		**153**
Non-current assets	**58**	(23)	-28%	4	**81**	19	31%		**62**
Current Liabilities	**(169)**	(43)	34%	5	**(126)**	(47)	59%	8	**(79)**
Net assets (at 31 December)	**30**	(60)	10%		**90**	(46)	-34%		**136**

NOTES:

1. Increase due to internet charges of $15k and rental of old hotel out for the majority of 2011 for $17k
2. Decrease due to decrease in doubtful debts expense in 2011 of $24k, other expenses, electricity $3k. These decreases in expenses were partially offset by employee expense increase of $6k due to increases in salaries for staff.
3. Decrease due to decrease in accommodation sales $44k, food $44k, and bar sales of $30k. Due to the decrease in accommodation sales, bar and food sales decreased accordingly with less demand from occupants.
4. Decrease due to depreciation $29k offset by purchases of washing machines and air conditioners $6k.
5. Increase in current liabilities primarily due to outstanding room tax $47k which was incurred in 2011.
6. Increase in other operating income due to increase in internet charges, hotel laundry and function rental.
7. Increase in cost of sales surrounding increases in room rental and food costs.
8. Increase due to other payables increasing.

National Fishing Corporation of Tuvalu

Activities

The National Fishing Corporation of Tuvalu (NAFICOT) is required to comply with the *Public Enterprises (Accountability and Performance) Act*. The main requirement is that the NAFICOT's principal objective is to be a successful beneficial enterprise.

Audit Opinion

No set of financial statements were presented for audit for 2011. 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 23: *That PERMU and the GoT continue to request and follow up with NAFICOT financial statements for the past 12 years. In the event that the NAFICOT refuse to submit financial statements, take action to wind them up in accordance with the Public Enterprises (Accountability and Performance) Act and the Companies Act.*

Tuvalu Maritime Training Institute

Activities

The Tuvalu Maritime Training Institute (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.

Audit opinion

The audit of the TMTI for the periods ending 31 December 2010 and 31 December 2011 both resulted in a Qualified Independent Audit Report. The qualification for 2010 and 2011 accounts was based on the uncertainties surrounding the inventories balances and the subsequent effect on the inventory consumption figures on the income statement.

Key issues

LACK OF STOCK COUNTS ON INVENTORY AND ASSETS

The TMTI had not performed any stock counts during 2010 and 2011. Regular stock counts using the asset register should be performed during the year to monitor theft and consumption statistics in order to further plan and budget. No stocktake procedures were documented which increases the risk that stocktakes are performed inconsistently and not to a high standard.

MANAGEMENT OF DEBTORS

Accounts receivable sales and overdue debts are not being followed up or actioned. In 2011 over 97% of the Accounts receivable raised is unlikely to be collected. If debtors are not paying their debts, after multiple attempts to request payment from the debtor, the TMTI should commence legal action to recover the amount. The cashflow of the TMTI and also the ability for the TMTI to continue as a going concern is affected by the non collection of debts. With more diligence surrounding the follow up and collection of these debts, the TMTI's cash flow position and future sustainability will improve.

PAY AS YOU EARNED (PAYE) TAX OWED TO GOT.

The TMTI owes a substantial amount of money for PAYE taxes to the GoT. This has not been paid due to a disagreement with the GoT surrounding the TMTI receiving full payment of scholarship monies due to TMTI. In order to solve this issue, the TMTI should formally correspond with the GoT 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. Tax obligations are different from debts and TMTI risks prosecution for failure to pay PAYE tax to GoT.

FINANCIAL STATEMENT PREPARATION

The financial statements for 2010 and 2011 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. A comprehensive review of the TMTI's financial statements by the accountant and responsible staff for compliance is required before being presented for audit.

LACK OF DOCUMENTATION OF ACCOUNTING PROCESSES AND DECISIONS (INCLUDING FRAUD POLICIES)

No accounting processes or accounting decisions were documented at the TMTI. Without written instructions, processes are not performed consistently, there is no guidance to follow and processes will be performed potentially without improper authorisation. Significant processes should be drafted and then approved by the Board. File notes should be written, signed off and approved by the CEO for any accounting decisions made and implemented.

ALLOWANCE TO DIRECTORS

Allowance payments were made to directors who were not permitted to receive allowances from TMIT under the PE Act.

Control issues

We identified scope for improvement in the following areas:

- budget analysis;
- segregation of duties;
- management of inventory;
- management of debtors;
- backups of computer systems;
- documentation of policies and procedures; 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	2011 $'000	Change $'000	Change %	Notes	2010 $'000	Change $'000	Change %	Notes	2009 $'000
Operations									
Revenue	**501**	5	1%		**496**	(14)	-3%		**510**
Other Income	**121**	(16)	-12%		**137**	4	3%		**133**
Total Expenses	**(713)**	609	-46%	**3**	**(1,322)**	(640)	94%	**2**	**(682)**
Tax Expense	**(2)**	2	-50%		**(4)**	(4)	0		**-**
Operating surplus/(deficit)	**(93)**	**600**	**-87%**		**(693)**	**(654)**	**1677%**		**(39)**
Current Asset	**573**	21	4%		**552**	(599)	-52%	**1**	**1,151**
Non-Current Asset	**6,001**	(45)	-1%		**6,046**	(6)	0%		**6,052**
Current Liabilities	**(5,799)**	(70)	1%		**(5,729)**	(88)	2%		**(5,641)**
Net Assets surplus/(deficit)	**775**	**(94)**	**-11%**		**869**	**(693)**	**-44%**		**1,562**

Notes:

1. Decrease in current asset in 2010 due to the allowance for credit impairment for receivables being properly assessed. The amount of receivables considered unlikely to be recovered was revised and increased by $630k
2. Increase in expenditure was due to the allowance for credit impairment being properly assessed in 2010 and the amount of receivables unlikely to be recovered revised. This had the effect of a one off increase in bad debts expenses of $630k.
3. Decrease in expenditure is due to the one off bad debts expense in 2010, not recurring in 2011. The increase of expenditure in 2010 and 2011 (excluding the bad debt provision in 2010) is due to trainees living expenses increasing, increase in other expenditure, partially offset by a decrease in teaching expenses due to removal of the salary supplements.

Tuvalu National Provident Fund

Fund activities

The Tuvalu National Provident Fund (TNPF) is constituted under the *National Provident Fund Act 2008*.The TNPF board 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 TNPF financial report for the 31 December 2011 resulted in unqualified Independent Audit Report (2010 – unqualified).

Key issues

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 2011; and
- back dated reports for audit.

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 2011 approximately $314k is owed to the Fund for surcharges of 5% levied to employers who fail to make contribution on their employees' behalf.

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 in using the LMS, staff 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 LMS and the members contribution recording system.

SET UP SEPARATE PROFIT CENTRE

The TNPF has recently constructed a market complex as an investment. For management purposes no separate reporting is carried to show the cost, the expenses and income associated with this project. Without the reports the TNPF will not be able to monitor the return on this investment.

STRENGTHENING MANAGEMENT AND SUSTAINABILITY OF MEMEBERS' CONTRIBUTION

Poor management of members' contribution resulted in a significant cash outflow and a decrease in values of members' retirement funds. This was due to members taking out loans using their contributions as collateral and then not making repayment. The TNPF instead of closing out on the loan and offsetting it against the member's contribution has been letting the interest charged on the loan in arrears erode the member's contribution.

This continues to significantly affect the cash flows of the TNPF and the sustainability and security of members' funds.

FRAUD POLICY AND TRAINING

There was no fraud policy in place, nor was any training undertaken with staff in relation to fraud. In the absence of documented fraud policy and procedures and staff training on the policy, the board and senior management may not be aware of practices to be followed when fraud is suspected. This exposes the TNPF to increase risk of fraud and to inconsistent treatment of fraud.

LOANS PROCESS TO BE STRENGTHENED

Loans continued to be an issue with the TNPF including:

- recognition of loan approval fees should be performed over the period of the loan;
- strengthening of debt collection process for small member loans on the outer islands;
- distortion of arrears balance; due to sytem not being up dated;
- improvement of arrears recovery;
- devlopment of credit monitoring tools over loans
- review of policy on recognition and accounting of interest;
- review of loans repayment terms to take into account retirement age; and
- maturity analysis for loans and advances to be performed for the financial statements.

Control issues

We identified scope for improvement in the following areas:

- clearance of long outstanding reconciling items;
- calculation of employees benefits according to IFRS;
- review of monthly bank reconciliation;

- review of loans repayments and debt collection process;
- review of policy surrounding recognition and accounting of interest;
- developed credit monitoring tools over loans
- recognition of loan approval fees;
- improved and strengthen processes and controls over posting to members' contribution account; and
- review and tighten loan approval procedures

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	2011 $'000	Change $'000	Change %	Notes	2010 $'000	Change $'000	Change %	Notes	2009 $'000
Operations									
Revenue	**2,290**	(650)	-22%	5	**2,940**	(571)	-16%	4	**3,511**
Expenses	**(722)**	(126)	21%	3	**(596)**	(88)	17%	3	**(508)**
Operating surplus/(deficit)	**1,568**	(650)	-28%	8	**2,344**	(571)	-19%	6	**3,003**
Current Assets	**2,113**	1,196	130%	2	**917**	(935)	-50%		**1,852**
Non Current Assets	**37,506**	2,133	6%	7	**35,373**	4,041	13%		**31,332**
Total Liabilities	**(18)**	13	42%		**(31)**	7	18%		**(38)**
Net Assets surplus/(deficit)	**39,601**	3,342	9%	1	**36,259**	3,113	9%	1	**33,146**

NOTES:

1. Movement in net asset due to the asset balance of member's contributions and the market fluctuations to which these assets are subject to.
2. The 130% increase in current assets results from Board announcement to change off shore policy as the fund held back injection of the 2011 contribution received, cash & cash equivalent containing the major increase from prior year ($1.1 m).
3. Increase due to increase in employee expenses, doubtful debts expense due as well as training and travel costs.
4. 2010 revenue decreased compared to 2009 due to the decrease in interest income from $642k in 2009 to $626k in 2010 and unrealized gain decreased from $2.6m in 2009 to $2.1m in 2010.
5. Decrease in revenue from 2010 to 2011 derives from a decrease in the number of approved loan due to the legislation passed that members should not have more than 40% of their total income committed to loan repayment. The 22% revenue decrease from prior year also results from lower returns due to deteriorations noted in the international market (esp. Australian market),opposed to a $2m gain compared to prior year.
6. The 130% increase in current assets results from Board announcement to change off shore policy as the fund held back injection of the 2011 contribution received, cash & cash equivalent containing the major increase from prior year ($1.1 m).
7. The 6% increase in noncurrent assets results from a investment portfolio increase by $1.3m, increase in property, plant and equipments of $390k and also small increase of loan and advance to members attributed to the interest charge on the members (8.75% per annum).
8. Decrease due to falls in gains on investments as well as expenses increasing, due to staff and doubtful debts expenses.

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: Definitions

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 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)

COMMUNITY SERVICE OBLIGATION (SECTION 9 OF PE ACT)

(1) For the purposes of this Act a Community Service Obligation means:

(a) The provision of a good or service by a Public Trading Enterprise to a consumer or user on any terms other than normal commercial terms applying from time to time; or

(b) The entering into an agreement by a Public Trading Enterprise on any terms other than normal commercial terms applying from time to time; or

(c) The forbearance by a Public Trading Enterprise to exercise a right or entitlement other than on normal commercial terms applying from time to time.

(d) The forgiveness or reduction by a Public Trading Enterprise of a debt or an amount of money owed to the Public Trading Enterprise other than on normal commercial terms applying from time to time

(2) Nothing in this part shall prevent a Public Trading Enterprise from exercising a commercial judgement to make donations to worthy causes or to price goods and services at or below the cost of their production.

PRINCIPLE OBJECTIVE OF PUBLIC TRADING ENTERPRISES (SECTION 8 OF PE ACT)

Subject to the Companies Act 1991, the principal objective of every Public Trading Enterprise shall be:

(a) to operate as a successful business; and

(b) be as profitable and efficient as comparable businesses that are not owned by the State; and

(c) meet any community service obligations established under Part III; and

(d) be a good employer (as defined in subsection (2); and

(e) be an organisation that shows social responsibility by considering the interests of the community in which it operates.

SUPPORT BY THE PUBLIC ENTERPRISE MONITORING UNIT, MINISTRY OF FINANCE (SECTION 28 OF THE PE ACT)

(1) The Public Enterprise Monitoring Unit, Ministry of Finance shall provide any Shareholding Minister, director and board of directors of a Public Enterprise with:

(a) advice and assistance concerning Corporate Plans, Statements of Corporate Objectives and financial reports;

(b) analysis, advice and information concerning the performance of any Public Enterprise and compliance with the Act by any Public Enterprise or person;

(c) advice to shareholding Ministers on expenditure, advances, credit support, and guarantees to be made, sought or provided in relation to a Public Enterprise:

(d) financial, commercial and public policy analysis and advice in relation to Public Enterprises and in relation to corporatization and/or privatization of Public Enterprises;

(e) advice on the appointment of directors and boards of Public Enterprises and the performance of such directors and boards;

(f) information and advice relating to best practice by Public Enterprises so as to encourage and enhance efficiencies and service delivery; and

(g) information and advice to shareholding Ministers when requested to do so.

(2) The Public Enterprise Monitoring Unit, Ministry of Finance shall be responsible for monitoring the performance of Public Enterprises on behalf of the Shareholding Ministers and advising the Shareholding Ministers in respect of the Government's investment in Public Enterprises.