



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

AUDIT REPORT

MANAGEMENT AND OVERSIGHT OF SELECTED CONSTRUCTION CONTRACTS, REPUBLIC OF PALAU

**REPORT NO. 00-I-537
JULY 2000**



United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

July 12, 2000

Honorable Kuniwo Nakamura
President
Republic of Palau
P.O. Box 100
Koror, PW 96940

Subject: Audit Report on Management and Oversight of Selected Construction Projects,
Republic of Palau (No. 00-I-537)

Dear President Nakamura:

This report presents the results of our audit of the Republic of Palau's management and oversight of selected construction projects.

Section 5(a) of the Inspector General Act (5 U.S.C. app. 3) requires the Office of Inspector General to list this report in its semiannual report to the U.S. Congress. In addition, the Office of Inspector General provides audit reports to the Congress.

Please provide a response to this report by September 15, 2000. The response should provide the information requested in Appendix 6 and should be addressed to our Pacific Field Office, 415 Chalan San Antonio - Suite 306, Tamuning, Guam 96911.

Sincerely,

Earl E. Devaney
Inspector General

EXECUTIVE SUMMARY**Management and Oversight of
Selected Construction Projects,
Republic of Palau
Report No. 00-I-537
July 2000****BACKGROUND**

The Compact of Free Association between the United States and the Republic of Palau became effective on October 1, 1994. Under Title 2, Section 212(b), of the Compact, the Republic of Palau received funding to promote economic development through capital improvement projects. As of September 30, 1998, Palau had received Compact Section 212(b) funds of \$36 million and related Section 215 funds of \$16.5 million.¹ Palau invested these funds in various securities and earned an additional \$17.9 million in investment income (net of investment expenses), which the Compact requires to be used for economic development. For the 4-year period ending September 30, 1998, Palau received Compact funds totaling \$70.4 million (\$36 million plus \$16.5 million plus \$17.9 million), had 277 approved projects totaling \$53.4 million, and had expended \$34.4 million. Prior to implementation of the Compact, Palau was part of the Trust Territory of the Pacific Islands and had received capital improvement funds through the Office of Insular Affairs, U.S. Department of the Interior. As of September 30, 1998, 11 Trust Territory capital improvement projects totaling \$48.3 million were still active.

OBJECTIVE

The objective of the audit was to determine whether the Republic of Palau provided adequate management and oversight of construction projects funded by either the Trust Territory of the Pacific Islands or Section 212(b) of the Compact of Free Association. The scope of the audit included a review of the project management activities related to a sample (53 projects, totaling \$6.7 million) of the 277 Compact-funded capital improvement projects that were active during the period of October 1994 to May 1999 and a sample (3 projects, totaling \$17.5 million) of the 11 Trust Territory projects that were active as of September 1998.

¹Under the Compact of Free Association, the Republic of Palau was to receive all Section 212(b) funding (\$36 million) during the first year of the Compact. However, the Compact, which was actually signed by the United States and the Republic of Palau in January 1986, did not become effective until October 1, 1994 because the citizens of Palau did not ratify the agreement until November 1993. As a result of the delay, an inflation adjustment provision contained in Compact Section 215 provided for \$16.5 million in addition to the \$36 million specified in Section 212(b).

RESULTS IN BRIEF

We found that the Republic of Palau did not adequately manage National Government capital improvement projects funded by the Trust Territory of the Pacific Islands and the Compact of Free Association and did not ensure that Compact funds appropriated for state capital improvement projects were used efficiently and effectively as follows:

- The National Government did not (1) ensure that cost estimates were prepared prior to procuring construction services, (2) perform or adequately document inspections made at project construction sites, (3) provide clear bidding instructions to potential bidders, and (4) adequately document administrative charges to projects. These conditions existed because Palau's Division of Design Engineering did not have an adequate number of properly trained staff to effectively perform the construction procurement and project management functions. As a result, capital improvement project funds totaling more than \$2 million were not used efficiently, and 11 Trust Territory-funded projects valued at \$48.3 million were not completed for periods ranging from 5 to 25 years after the funds were made available for the projects.

- The \$5.15 million Malakal sewage treatment plant expansion project funded under a fiscal year 1993 Trust Territory capital project has not been started, and as a result, the existing sewage treatment plant continued operating beyond its design capacity and was discharging pollutants into the coastal waters adjacent to the plant, potentially having an adverse impact on Palau's environment and the health and safety of its residents.

- The National Government (1) used Section 212(b) funds to finance state capital improvement projects that were short-term in nature and did not meet the long-term economic development needs of the states and (2) allowed the states to procure construction services and manage construction projects without the skilled personnel needed to effectively perform these functions. These conditions occurred because the National Government's policy was to allow each state to manage its own economic development projects. In addition, although the National Government had identified problems with the states' administration of their projects, corrective actions were not implemented as a condition for future appropriations of Compact Section 212(b) funds. As a result, the National Government lacked assurance that \$4.3 million appropriated to the 16 states during fiscal years 1995 through 1999 would result in long-term economic development improvements and that costs of \$250,000 incurred on two state-administered construction projects were reasonable for the services provided. In addition, we identified problems related to road construction and land use on Babeldaob Island that could significantly hamper future economic growth if corrective action is not taken.

RECOMMENDATIONS

We made 13 recommendations to the President of the Republic of Palau to address the deficiencies disclosed by our review. Specifically, we recommended that the National Government request a technical assistance grant to assist in strengthening the Division of Engineering, establish professional requirements for engineering positions and fill those

positions, develop a methodology for distributing the fringe benefit costs of inspectors among all pertinent projects, and take action to expedite the completion of the Malakal sewage treatment plant expansion project. We also recommended, with regard to state projects, that the National Government prohibit the use of Compact Section 212(b) funds for such short-term purposes as the repair and maintenance of roads, equipment, and structures; develop a plan to consolidate the road maintenance resources of the states on Babeldaob Island and integrate the National and state road systems; assist the states in developing master land use plans; enforce the National zoning laws and assist the states in developing local zoning laws; require the Bureau of Public Works to procure construction and project management services for Compact-funded state projects; and require the establishment of a uniform building code.

AUDITEE COMMENTS AND OIG EVALUATION

The President of the Republic of Palau's response to the draft report agreed with 11 of the 13 recommendations. The response disagreed with and provided additional information on two recommendations concerning Babeldaob Island roads and National zoning laws. Based on information provided in the response, we revised the remaining two recommendations and requested an additional reply.

CONTENTS

	Page
EXECUTIVE SUMMARY	1
INTRODUCTION	7
BACKGROUND	7
OBJECTIVE AND SCOPE	8
PRIOR AUDIT COVERAGE	9
FINDINGS AND RECOMMENDATIONS	10
A. NATIONAL GOVERNMENT PROJECTS	10
B. STATE PROJECTS	20
APPENDICES	
1. CLASSIFICATION OF MONETARY AMOUNTS	35
2. COMPACT SECTION 212(b) AND RELATED FUNDING PROVIDED TO THE REPUBLIC OF PALAU	36
3. CAPITAL IMPROVEMENT PROJECTS FUNDED BY THE TRUST TERRITORY OF THE PACIFIC ISLANDS	37
4. COMPACT SECTION 212(b) FUNDS APPROPRIATED TO THE STATES OF THE REPUBLIC OF PALAU	38
5. OFFICE OF THE PRESIDENT RESPONSE	39
6. STATUS OF AUDIT REPORT RECOMMENDATIONS	48

INTRODUCTION

BACKGROUND

The Compact of Free Association between the United States and the Republic of Palau became effective on October 1, 1994. Under Title 2, Section 212(b), of the Compact, the Republic of Palau received funding to promote economic development through capital improvement projects. The types of projects for which the Section 212(b) funds could be used and annual reporting requirements were contained in a supplemental agreement to the Compact. As of September 30, 1998, Palau had received Compact Section 212(b) funds of \$36 million and related Section 215 funds of \$16.5 million.² Palau invested these funds in various securities and earned an additional \$17.9 million in investment income (net of investment expenses), which the Compact requires to be used for economic development. Therefore, Palau, for the 4 fiscal years reviewed ending September 30, 1998, received Compact funds totaling \$70.4 million (\$36 million plus \$16.5 million plus \$17.9 million) and had expenditures totaling \$34.4 million, unexpended appropriations totaling \$10.3 million, and unappropriated funds totaling \$25.7 million (these amounts are detailed in Appendix 2).

Under the Constitution of the Republic of Palau, the National Government consists of an Executive Branch, with an elected President; a bicameral Legislative Branch (National Congress); and a Judicial Branch. In addition, the Constitution created 16 separate states, each with a governor and a legislature. The expenditure of Compact funds is authorized by appropriations passed by the National Congress as part of the National Government's annual budget. Compact Section 212(b)-funded projects are divided into two categories: projects administered by the National Government and projects administered by the individual states.

In addition to the Compact funds, Palau, prior to implementation of the Compact in October 1994, was a part of the Trust Territory of the Pacific Islands and received capital improvement funds on a discretionary basis through the Office of Insular Affairs, U.S. Department of the Interior, which provided administrative oversight through a capital project coordinator located in Palau. The U.S. Naval Facilities Engineering Command, through an agreement with the U.S. Department of the Interior, directly managed the Trust Territory capital projects in Palau. Since implementation of the Compact, the remaining Trust Territory capital projects have been managed by the Division of Design Engineering of Palau's Bureau of Public Works, with the U.S. Naval Facilities Engineering Command providing construction inspection services on behalf of the Office of Insular Affairs. As of September 30, 1998, 11 Trust Territory capital project grants, totaling \$48.3 million, were still active (see Appendix 3).

²Under the Compact of Free Association, the Republic of Palau was to receive all Section 212(b) funding (\$36 million) during the first year of the Compact. However, the Compact, which was actually signed by the United States and the Republic of Palau in January 1986, did not become effective until October 1, 1994 because the citizens of Palau did not ratify the agreement until November 1993. As a result of the delay, an inflation adjustment provision contained in Compact Section 215 provided for \$16.5 million in addition to the \$36 million specified in Section 212(b).

Title 40, Chapter 6, Section 608, of the Palau National Code Annotated states, "The Procurement Officer for construction and architectural and engineering contracts shall be the Director of the Bureau of Public Works." However, each state governor was allowed by the Code to be the procurement officer for the respective state and had the authority to procure construction services for state construction projects, including Section 212(b)-funded projects. Unless a state voluntarily had the National Government perform the project procurement and construction management functions, the individual states were responsible for ensuring that the funds appropriated by the National Government were spent in accordance with applicable procurement laws and used to complete the projects successfully. The National Government maintained some control over the states' administration of the Section 212(b) funds through an allotment process by which the Section 212(b)-appropriated funds were transferred to the individual states upon request. In addition, each state was required to prepare annual financial statements, which were audited by the Republic's Office of the Public Auditor as part of the single audits required by the Compact.

OBJECTIVE AND SCOPE

The objective of the audit was to determine whether the Republic of Palau and the Office of Insular Affairs, U.S. Department of the Interior, provided adequate management and oversight of construction projects funded by either the Trust Territory of the Pacific Islands or Section 212(b) of the Compact of Free Association. To accomplish our objective, we interviewed officials of the Palau National Government, 12 of the 16 state governments, the Office of Insular Affairs, and the U.S. Naval Facilities Engineering Command. We also reviewed applicable financial and administrative records for National and state projects to obtain information regarding the status of the capital improvement projects selected for review. The scope of the audit included a review of the project management activities related to a sample (53 projects totaling \$6.7 million) of the 277 Compact-funded capital improvement projects, totaling \$53.4 million, that were active during October 1994 through May 1999 and a sample (3 projects, totaling \$17.5 million) of the 11 Trust Territory projects, totaling \$48.3 million, that were active as of September 1998.

Our review was made, as applicable, in accordance with the "Government Auditing Standards," issued by the Comptroller General of the United States. Accordingly, we included such tests of records and other auditing procedures that were considered necessary under the circumstances.

As part of the audit, we evaluated the accounting and management controls over National and state government capital project appropriations, expenditures, procurement, and construction management. Based on our review, we identified major internal control weaknesses in all four areas. The internal control weaknesses are discussed in the Findings and Recommendations section of this report. Our recommendations, if implemented, should improve the internal controls in these areas.

PRIOR AUDIT COVERAGE

During the past 5 years, neither the General Accounting Office nor the Office of Inspector General has issued any audit reports on Trust Territory- or Compact-funded capital improvement projects in the Republic of Palau. However, the Office of the Public Auditor, Republic of Palau, issued single audit reports on 14 of Palau's 16 individual states for fiscal year 1996. (Two states had not prepared financial statements for fiscal year 1996.) The single audit reports disclosed internal control weaknesses related to the states' accounting systems and compliance with the requirement that Section 212(b) funds should be expended by the states only on projects for which funds were appropriated by the National Government. In addition, the single audit report on the National Government for fiscal year 1997 disclosed weaknesses related to compliance with the National Government's procurement law, compliance with reporting requirements for U.S. Department of the Interior-funded capital improvement projects, and the recording of project expenditures. The weaknesses were similar to the procurement, administrative charges, and project specification problems that we found during our current audit, which related to the internal controls over project procurement, accounting for expenditures, and formulating appropriations for capital improvement projects.

FINDINGS AND RECOMMENDATIONS

A. NATIONAL GOVERNMENT PROJECTS

The Republic of Palau did not adequately manage construction projects funded by the Trust Territory of the Pacific Islands and the Compact of Free Association. Specifically, the National Government did not (1) ensure that cost estimates were prepared prior to starting projects, (2) perform or adequately document inspections made at project sites, (3) provide clear bidding instructions to potential bidders, and (4) adequately document administrative charges to projects. The requirements for the administration of the capital improvement projects were contained in the grants by which Trust Territory and Compact funds were provided to the National Government. However, Palau's Division of Design Engineering was not staffed with sufficient professional and technical personnel for the scope and complexity of projects under its control, did not have written project inspection procedures, and did not have a training program for Division staff. As a result, capital improvement project funds totaling almost \$1.8 million were not used efficiently, and 11 Trust Territory-funded projects valued at \$48.3 million were not completed for periods ranging from 5 to 25 years after the funds were made available for the projects. We also found that the \$5.15 million grant to expand the Malakal sewage treatment plant was not used as planned and that the existing plant was operating beyond its design capacity, resulting in the discharge of pollutants into the coastal waters adjacent to the plant.

Project Management

Based on a review of four National capital improvement projects (three Trust Territory-projects and one Section 212(b)-funded project), we found that the Division of Design Engineering did not adequately manage these projects. As a result, the Division approved questionable change orders representing cost increases of \$755,919 and may have to pay \$255,000 more for a construction project because of unclear bidding requirements. In addition, the National Government had to absorb labor and other administrative costs totaling \$765,731 that were disallowed by the Office of Insular Affairs.

Cost Estimates. Cost estimates were not prepared prior to starting the projects or negotiating contract change orders. Consequently, the National Government had little assurance that infrastructure projects were negotiated at the most advantageous prices. For example, on January 31, 1997, the Division issued a Notice of Award for a \$235,000 contract to construct a waterline and storage tank in the Village of Imeong in the Ngeremlengui State under a Section 212(b)-funded project. The scope of work was expanded through a change order on November 17, 1997 to add five additional waterlines. The justification for the change order stated that the five additional waterlines were not included in the original bid proposal because the Division believed that the combined costs would exceed project funding. However, after the bid opening on November 8, 1996, the Division realized that the whole system for the village, including the five additional waterlines, could be constructed within available funding limits. Therefore, on May 14, 1997, the Division requested that the contractor develop an estimate for the additional work. On October 20, 1997, the contractor provided the estimate of \$284,475 for the additional work, which was

accepted by the Division. However, we could not find documentation showing that cost estimates for each of the six waterlines had been prepared by the Division prior to the original solicitation of bids for the project. When we requested the National Government's estimated cost for the additional five waterlines, we were given an estimate dated February 5, 1997, which showed that the National Government's estimate was \$255,656, or \$28,819 lower than the contractor's estimate and the actual change order amount. We were not provided any documents that explained why the contractor was not required to accept the National Government's lower estimate. The Manager of the Division of Design Engineering stated that he did not solicit bids for the additional five waterlines because soliciting bids would have delayed the project.

In another example, during the trenching for sewer lines on the Trust Territory-funded Koror Wastewater System Improvements Project (No. T-224), the contractor encountered hard rock. The Division of Design Engineering issued a change order to cover the contractor's first invoice of \$62,926 for rock removal on a "time and materials" basis,³ and the Office of Insular Affairs approved this change order. After more rock was found, the Director of Design Engineering approved, on an incremental basis, subsequent contractor billings totaling \$375,393 to remove the rock. However, the Division of Design Engineering did not perform any testing to estimate the total amount of rock that would have to be removed and did not consider changing the method of payment to a more favorable "volume" basis.⁴ Under the time and materials basis, a contractor has little incentive to perform work timely, since the contractor's payments are not dependent on performing the work within specific time frames. Because there was no estimate on what the total cost would be and no preapproval of any other change orders to cover the additional charges, as were required under the grant agreement, the National Government incurred an additional \$375,393 that was not approved by the Office of Insular Affairs and that will not be reimbursed under the project grant agreement. Furthermore, the project was delayed for more than 1 year when the contractor stopped work in April 1997 because of nonreceipt of payment on outstanding invoices. The contractor resumed work in January 1999 after the National Government agreed in writing to compensate the contractor for the outstanding invoices. As of May 1999, the project had not been completed.

Project Inspections. The Division did not perform or adequately document inspections made at the project sites. For example, two contract change orders, totaling \$351,707, were approved to repair leaks in the Peleliu State's existing waterlines as part of the Trust Territory-funded Rural Water Systems Project (No. T-209). However, the U.S. Naval Engineering Command inspector stated in his field inspection report that during his August 22, 1996 oversight visit to Peleliu, the Division's inspector accompanying him could not identify where the contractor had made repairs to the waterlines except for three areas where water valve replacements could be verified. The Naval inspector also reported that there were no signs of recent excavation along the existing waterlines to indicate that

³The time and materials method provides for the payment of the actual labor, equipment, and material costs incurred.

⁴The volume method establishes a rate to be paid per cubic measure of material excavated or filled in.

leaks had been identified and repaired. The Naval inspector further reported that the Division was unable to provide any records, including contractor documentation, showing the scope of the contractor's work or its approval by the Division's inspector. The project grant agreement between the Office of Insular Affairs and the National Government required the Division to inspect and verify construction work prior to the approval of progress payments. However, in this case, the contractor was paid the total amount of \$351,707 without such inspections and approvals having been performed and/or documented. The Minister of Resources and Development, whose ministry has oversight responsibility for the Division of Design Engineering, stated in a June 19, 1997 letter to the Office of Insular Affairs that the National Government had initially had an inspector on site but that the inspector's employment contract expired during the project and he was not replaced. The Minister further stated in the letter that it was a "mistake" to rely on the contractor to perform the required work without an inspector present to verify that the work had been performed. As a result of not being able to verify the extent of repair work performed under the change order, the Office of Insular Affairs capital improvement project coordinator rejected the National Government's claim for \$351,707, an amount that ultimately will have to be absorbed by the National Government.

Procurement Requirements. In October 1998, the Division of Design Engineering solicited sealed bids for the Trust Territory-funded Koror Sewage Treatment Plant Expansion Project (No. T-232). However, the award of the contract was delayed because of protests by the two firms that were bidding on the contract. The dispute related to whether the National Government required the bid bond to be issued by a surety firm approved by the U.S. Treasury Department or whether that requirement had been waived by the Division's Manager. According to the Palau Attorney General, the Manager may have given conflicting and unclear bidding instructions to the lowest bidder and that because of this procedural error, the bidder, who was otherwise considered responsive, was eliminated from consideration because he did not submit a bid bond issued by a U.S. Treasury-approved surety firm. In April 1999, the Palau Attorney General ruled that the contract could be awarded to the second bidder, resulting in the awarded contract being \$255,000 higher than if the contract had been awarded to the lowest bidder.

Administrative Charges. We determined that the Office of Insular Affairs capital improvement project coordinator had rejected National Government claims against Trust Territory-funded grants totaling \$765,731 that included vacation pay and administrative costs because the charges could not be related directly to specific projects. For example, the Office of Insular Affairs coordinator stated that he had denied the claim for the entire cost of an inspector's vacation pay because the inspector had not worked on the project during his vacation. A pro rata portion of the cost of the inspector's vacation is a legitimate project cost, provided that (1) the Division uses an equitable basis to allocate the cost to all the projects on which the inspector works in the same proportion that the inspector's time is charged and (2) the cost has not been recovered through the approved indirect cost rate. Therefore, the Division should develop a method for allocating the vacation time and other fringe benefit costs of inspectors equitably among all projects on which the inspectors work and ensure that detailed distribution records are maintained to document the basis of the allocations.

Division Staffing

We determined that the deficiencies relating to project management occurred because the Division of Design Engineering did not have (1) adequate staffing, (2) a properly qualified manager, and (3) an active staff training program. These conditions are discussed in the paragraphs that follow.

Project Management Staff. As of May 1999, the Division's technical staff consisted of 1 licensed civil engineer, 2 civil engineers (with degrees), 1 architect (with a degree), and 13 support staff (4 surveyors, 8 inspectors, and 1 draftsman). However, this level of technical staffing was not in compliance with the requirements of the Trust Territory grant agreements for capital improvement projects and was insufficient to effectively perform construction management for the National Government's Section 212(b)-funded and Trust Territory-funded projects. For example, under the Koror Wastewater System Improvements Project (No. T-224), which was started in 1992 and was in progress as of May 1999, the Division was to be staffed by a manager/chief engineer, a structural engineer, an electrical engineer, and a mechanical engineer. Although the Division had a civil engineer⁵ on staff during the review, it did not have structural, electrical, or mechanical engineers on staff. We were unable to determine, because of the lack of documentation, whether the engineers were included in the Division's budget.

The National Master Development Plan for the Republic of Palau, issued in April 1996, recognized the critical function of the Division of Design Engineering in implementing capital improvement projects and specifically recommended that the Division be staffed with additional personnel who had recognized engineering qualifications and "substantial experience" in project design and management. The most recent position classification plan for the Division was completed in April 1987 under the National Civil Service System. According to the Director, Bureau of Public Service System, none of the engineering disciplines were included because the former Director of the Bureau of Public Works had not requested that Palau's Public Service System include engineering positions in the civil service study. As such, the National Government had not taken actions to fully staff the Division with qualified personnel. Engineers were hired under contract when local qualified engineers were not available, but the salary rates were not competitive, which made it more difficult to hire qualified replacements if the existing engineers did not renew their employment contracts.

Division Manager. We found that the Division Manager, who had held that position since September 4, 1994, did not have an engineering degree or prior construction management experience. Therefore, he did not meet the position classification requirements that the Manager should be a graduate engineer or an architect with 8 years of progressively responsible work experience, including 4 years in a supervisory capacity. In addition, since May 1998, the Manager was also functioning as the Acting Director of both the Bureau of

⁵A civil engineer would have an understanding of the structural, electrical, and mechanical disciplines but would not have the in-depth knowledge that an engineer specializing in these disciplines would have.

Public Works and the Bureau of Public Utilities. In our opinion, the day-to-day operations of three technical organizations should not be managed by one individual.

Staff Training. The Division did not have an adequate training program to improve the skills of its staff with regard to project inspection and construction procurement procedures. The U.S. Naval Facilities Engineering Command inspector stated that Division staff did not have sufficient training or experience in reviewing construction plans or were not trained in all inspection tasks. Based on the personnel files, we found that only one inspector had received extensive training in inspection and trade techniques and that he had received this training during his employment as a civilian with the U.S. Navy from 1973 to 1991. The Division's Manager stated that a training program had not been established because the work load associated with the high number of projects and budgetary constraints would have precluded staff from attending the classes. The Manager also said that on May 20, 1999, he had requested assistance from the Office of Insular Affairs project coordinator in obtaining training for his staff from the U.S. Naval Facilities Engineering Command on Guam in the areas of contract administration; field inspection procedures in civil, mechanical, and electrical work; document control; and project cost accounting and reporting. The Office of Insular Affairs had not responded to the Manager as of the completion of our fieldwork.

The need for training in construction procurement procedures was emphasized and recommended in April 1999, when Palau's Attorney General, in an opinion concerning the construction procurement dispute for the Koror Sewage Treatment Plant Expansion Project, stated, "There are certainly many procedural problems in this procurement which need to be avoided in the future. These problems appear to result from a lack of familiarity with the procurement system and training." Furthermore, the Attorney General said that the position of procurement officer at the Bureau of Public Works had been vacant for about 1 1/2 years, which we believe may have contributed to the lack of oversight in detecting the procedural errors occurring during the procurement process. The Attorney General stated that unless procurement activities were conducted in an "orderly manner," the process "will suffer and so will the quality of the procurements."

We believe that if the National Government cannot augment existing Division staff with qualified and sufficient numbers of personnel and implement an effective staff training program, it should explore the option of contracting out these functions to a private engineering firm or to a U.S. Government agency, such as the U.S. Naval Facilities Engineering Command.

Malakal Sewage Treatment Plant

The Malakal sewage treatment plant expansion project in the Koror State was authorized \$5.15 million in fiscal year 1993. However, at the time of our audit, construction of the plant had not begun because the National Government had not determined which of two alternate expansion options to pursue and because of deficiencies in soliciting bids for the original construction contract. Because the project has not been completed, the Office of Insular Affairs indicated it may reprogram the funds to projects outside Palau. In addition, the

existing sewage treatment plant continued to operate beyond its design capacity, resulting in the discharge of pollutants into the coastal waters adjacent to the plant.

Existing Treatment Plant. The Bureau of Public Utilities, Ministry of Resources and Development, operates the Malakal sewage treatment plant (see Figure 1), which is the only sewage treatment plant serving the Koror State, the most heavily populated area in Palau. The facility is a mechanical treatment plant that was built in 1976.

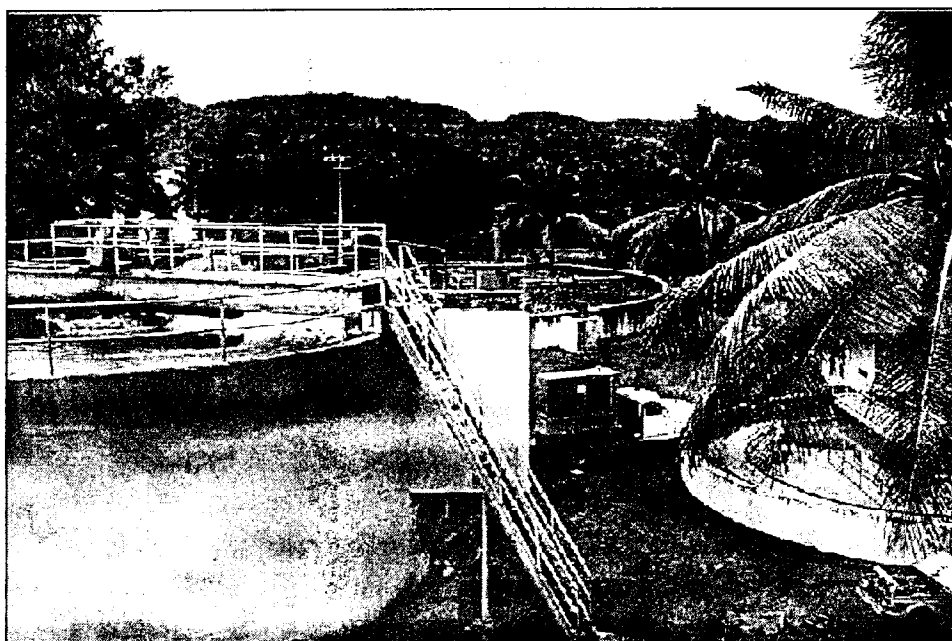


Figure 1. Overview of the Malakal sewage treatment plant. The tanks hold wastewater during the treatment process. (Office of Insular Affairs photograph)

In September 1985, authorization was given by the U.S. Environmental Protection Agency for the discharge of treated wastewater from the plant in accordance with limitations for treated wastewater, monitoring requirements, and other conditions imposed by the Environmental Protection Agency. However, since 1993, the treatment plant's operations have not met these requirements, and the Bureau of Public Utilities has been cited on a continuous basis by Palau's Environmental Quality Protection Board⁶ for exceeding the discharge limitations (that is, excessive floating materials, scum, turbidity, odors, and coliform bacteria counts) and for not properly operating and maintaining the treatment plant.

In August 1994, the Wastewater Facilities Plan, which was commissioned by the National Government, reported that the Malakal sewage treatment plant was operating beyond its

⁶The Palau Environmental Quality Protection Board, which is responsible for enforcing Palau's environmental laws, was created on May 25, 1983 with enactment of Republic of Palau Public Law 1-58, the Environmental Quality Protection Act. Palau has adopted the U.S. National Pollution Discharge Elimination System regulations that became effective in October 1994.

design capacity and was in critical need of capital improvements for plant expansion and upgrading, such as repairing or replacing the compressor and the blower (see Figure 2).

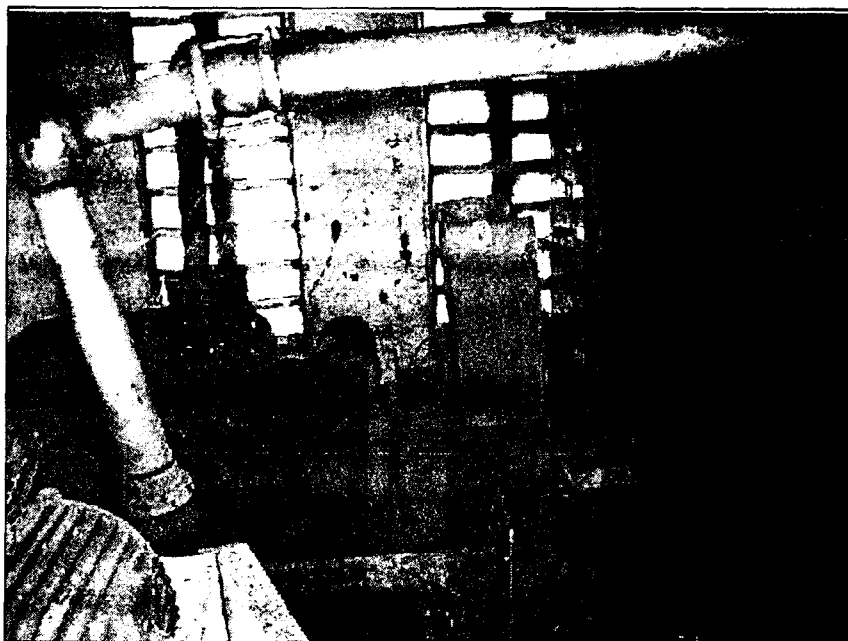


Figure 2. The compressor and the blower at the Malakal sewage treatment plant used to oxygenate sewage during the initial stage of the treatment cycle were inoperative. (Palau Environmental Quality Protection Board photograph)

The need to expand the capacity of the treatment plant to meet not only the present demand but also the increased demand expected from future economic development was also addressed in the Republic of Palau's National Master Development Plan, which was issued in April 1996. The Master Development Plan stated, with respect to the wastewater system, "Unless this expansion takes place in the next few years, the Koror sewer system and the Malakal sewage treatment plant will not be able to protect the environment and the public health of the people of Koror." In June 1997, an engineering consulting firm issued its report "Study of Wastewater Treatment & Disposal Alternatives," which confirmed the need for expanded capacity. The report stated that since 1995, the estimated water flow at the plant had exceeded both the plant's overall rated capacity and the permitted effluent flow of 0.75 million gallons per day and concluded that the treatment plant was "overloaded."

Expansion Proposals. In an effort to assist the Republic of Palau with its public infrastructure needs, the Office of Insular Affairs has provided, since 1989, through the U.S. Army Corps of Engineers, periodic independent reviews of the status of Palau's public infrastructure. The most recent review was completed in February 1998. In addressing deficiencies with the sewage treatment plant that were identified through these reviews, Palau received, during fiscal years 1993 through 1995, Trust Territory funds totaling

\$5.15 million for the Koror Sewage Treatment Plant Expansion Project⁷ (No. T-232), which were intended to double the capacity of the existing treatment plant. In March 1997, the final design for a "mirror-image" mechanical treatment plant was completed by the National Government's consulting engineer. However, in June 1997, the National Government contemplated redesigning the project to incorporate a ponding system that would interface with the existing mechanical treatment plant. The ponding concept, which requires the use of man-made ponds to hold the wastewater as part of the treatment cycle, was advocated by a consulting engineering firm contracted by Koror State. In August 1998, the Office of Insular Affairs informed National Government officials that while it did not have strong objections to the construction of a ponding system, the project needed to be implemented soon, since funding for the project was appropriated in 1993 because of its urgency. The representative further stated that if actions were not taken to implement the project, the Office of Insular Affairs would consider reprogramming unused project funding to other capital improvement projects outside Palau.

In October 1998, the National Government solicited sealed bids for the project based on the original plans for a mechanical treatment plant. However, the award of the construction contract was delayed because of deficiencies in the bidding process (see the section "Procurement Requirements" in this report). The project was further delayed because, as recently as May 1999, a traditional high chief for Koror State requested that the National Government repair the existing plant and design and build the alternate ponding system plant. The Office of Insular Affairs project coordinator stated that the concept of a ponding system was a "promising alternative" as long as the necessary land could be made available. However, the U.S. Environmental Protection Agency recommended against the ponding and wetland system because acreage was insufficient at the Malakal Island site to construct the needed wetland of adequate size to meet future population growth in Koror State. Because the National Government has not acted expeditiously to expand the sewage treatment facility, pollutants continue to be discharged into the coastal waters adjacent to the plant.

Recommendations

We recommend that the President of the Republic of Palau:

1. Direct the Minister of Resources and Development to request a technical assistance grant from the Office of Insular Affairs, U.S. Department of the Interior, for the purpose of contracting with the U.S. Naval Facilities Engineering Command to perform an assessment of the technical and administrative staffing and training needed by the Division, to develop an implementation plan to correct any deficiencies identified by the assessment, and to assist Palau in implementing the staffing and training plans.

2. Direct the Minister of Resources and Development to hire individuals for the positions of Director, Bureau of Public Works, and Director, Bureau of Public Utilities, in

⁷Although the grant for expansion of the sewage treatment plant is officially titled the "Koror Sewage Treatment Plant Expansion Project," referring to Koror State, the sewage treatment plant is located on Malakal Island and therefore is commonly referred to as the "Malakal Sewage Treatment Plant."

accordance with established civil service regulations and rescind the designation of the Manager, Division of Design Engineering, to these positions.

3. Direct the Director of the Public Service System to establish civil service position classifications for professional engineering and other technical positions identified in the assessment performed in accordance with Recommendation 1.

4. Direct the Minister of Resources and Development to ensure that the Division of Design Engineering develops a method for allocating the vacation time and other fringe benefit costs of inspectors equitably among all projects on which the inspectors work and maintains detailed distribution records to document the basis of the allocations.

5. Direct the Minister of Resources and Development to take actions to expedite the completion of the Malakal sewage treatment plant expansion project.

Republic of Palau Response and Office of Inspector General Reply

The April 7, 2000 response (Appendix 5) to the draft report from the President of the Republic of Palau said that the Republic has "already taken or will soon take" the actions specified in Recommendations 1 through 5. The Republic, however, should provide the additional information on the recommendations detailed in Appendix 6.

General Comments on Finding

The President's response provided additional comments on the finding, which are addressed in the paragraphs that follow.

Project Inspections. The response provided a historical perspective on Peleliu Island's water system problems and the capital improvement projects implemented to correct the problems. Although the response did not address the lack of inspections by the Division of Design Engineering for the particular project identified in our report, the response did indicate that additional funding and inspectors had been provided. In addition, Palau Public Law 5-34, which became effective on September 28, 1999, included specific language for the Division of Design Engineering to provide a greater level inspection of nationally funded construction projects.

Procurement Requirements. The response stated that the basis for selecting the second lowest bidder for the sewage treatment plant was that the National Government was concerned that awarding the contract to the lowest bidder could put the project at risk if the contractor should default because the contractor had not obtained a bid bond from a U.S. Treasury-approved surety firm. While we agree with the National Government's concern about the potential risk if the contractor should default on the contract, our audit concern was with the apparent informal modification of the bonding requirement for the contractor that had the lowest bid, which resulted in a protest being filed and the next lowest bidder receiving the contract. The lack of uniformity in the procurement process for the sewage

treatment plant was part of the reason why our report emphasized the need for procurement training.

Project Management Staff. The response stated that it is the goal of the Division of Design Engineering, with the guidance from the Minister of Resources and Development, to improve the implementation of national and state capital improvement projects through the application of approved construction standards at the lowest cost. In that regard, two professional engineers are being recruited, with additional funding being provided in fiscal year 2000 to hire two more inspectors.

Staff Training. The response stated that the Division of Design Engineering had made considerable progress in its ability to manage capital improvement projects and that since 1994, 108 (90 percent) of 120 projects had been completed. The response also commented that technical assistance was needed to develop a training program for the Division and that the development of the training courses, as well as the actual conduct of the training, was a long-term process. The response included a description of some of the construction-related training offered in 1995 and 1998 and stated that the Palau Community College had been requested to develop a construction inspection course to be held at night for inspectors. We fully agree with the National Governments's efforts to hire additional technical staff for the Division and to provide job-related training. Implementation of Recommendation 1, that a technical assistance grant should be requested from the Office of Insular Affairs, U.S. Department of the Interior, for an assessment of the Division's staffing and training needs, should help to improve the National Government's ability to manage construction projects.

Reprogramming of Unused Funds. Although the reprogramming of residual balances of funds for completed Trust Territory capital projects was not an audit issue, the response stated that Palau had requested approval from the Office of Insular Affairs, U.S. Department of the Interior, to have any unspent project appropriations reprogrammed for use on national water and sewage system improvements and other infrastructure purposes within Palau, such as school building repairs. However the response further commented that such reprogramming was not allowed by the Office of Insular Affairs.

B. STATE PROJECTS

The Compact Section 212(b) funds appropriated by the National Congress of the Republic of Palau to the individual states of the Republic were not used effectively and efficiently. Specifically, the National Government funded state capital improvement projects that did not appear to meet the long-term economic development needs of the states but were based on short-term operating needs, such as routine repairs and maintenance of roads, bridges, and other facilities and the purchase of heavy equipment. In addition, the Republic allowed the states to procure construction services and manage construction projects without the skilled personnel needed to effectively perform these functions. The Implementation Agreement of the Compact of Free Association describes the types of projects for which Section 212(b) funds can be used. However, the National Government did not take actions to correct the deficiencies because the Palau National Code allowed each state to procure and manage its construction projects. As a result, the National Government had little assurance that almost \$4.3 million appropriated to the 16 states during fiscal years 1995 through 1999 would result in long-term economic development improvements or that two states received full value for facilities constructed at a total cost of \$205,000. In addition, we believe that future economic growth could be hampered for the states on Babeldaob Island if deficiencies related to road construction and land use planning are not addressed.

Project Selection

Compact Section 212(b) funds were provided for "capital account purposes" to assist the Republic of Palau in its efforts to "advance economic development and self-sufficiency of the people of Palau." The Agreement Concerning Procedures for the Implementation of United States Economic Assistance, Programs and Services Provided in the Compact of Free Association between the Government of the United States and the Government of the Republic of Palau (hereafter referred to as the Implementation Agreement) further required that Section 212(b) funds be used for the "construction or major repair of capital infrastructure, the financing of public sector projects identified in the official overall economic development plans, or public sector participation in private sector projects which are so identified." The Implementation Agreement specifically excluded "normal operations and maintenance" as allowable uses of Section 212(b) funds.

Our review of 52 state-administered projects, totaling \$5.2 million, that were funded by Compact Section 212(b) disclosed that the National Government was aware of problems with the type of capital improvement projects implemented by the states and with the states' administration of the projects. This resulted in little assurance that almost \$4.3 million in appropriations would result in long-term economic development improvements. The National Government attempted to address these problems as follows:

- The Public Auditor's reports on the annual audits of each state's financial statements disclosed significant deficiencies in the states' accounting for Section 212(b) funds and with the states' use of Section 212(b) funds for projects other than those for which the funds were appropriated. These deficiencies occurred, according to the reports, because of the lack of accounting systems that could track how the Compact funds appropriated to

the states were spent and the lack of trained accounting personnel at the state level. As a result, the National Government provided technical assistance to the states to establish accounting systems and to train state personnel to use the accounting system. The National Government also established internal controls that required each state to justify the release of project allotments from the Bureau of National Treasury to the state. However, according to the Public Auditor for Palau, accounting deficiencies still existed.

- During April and June 1997, the Senate Committee on Capital Improvement Projects and Land Matters of the National Congress reviewed state capital improvement projects to determine past performance of the states and to set new priorities for future appropriations. Their report addressed problems with the administration of state capital projects funded with local and compact funds, such as regrading dirt roads instead of paving them and purchasing heavy equipment and constructing buildings without providing routine repair and maintenance.

- The President of Palau periodically performed site visits to the states to view the progress of ongoing projects, but reports on these visits were not prepared to summarize the results of the President's visits. However, the President's transmittal letters that accompanied appropriations bills to the National Congress highlighted similar deficiencies in the selection and administration of state capital improvement projects, as well as suggestions for correcting the deficiencies. In fiscal year 1998, the President vetoed all state projects proposed for funding with Section 212(b) funds because of the deficiencies he had identified in the proposed projects.

- Officials at two agencies within the National Government's Executive Branch said that they were concerned that the environment on Babeldaob Island would be negatively impacted by the construction of new roads and the lack of zoning to control development in the states.

Examples of deficiencies related to state capital improvement projects that we identified during our review are discussed in the paragraphs that follow.

Roads and Bridges. During fiscal years 1995 through 1999, the states received appropriations of Section 212(b) funds totaling \$2.02 million for road and bridge projects. This amount included \$629,500 for the maintenance of roads, although the use of Section 212(b) funds for regular road maintenance was unallowable under the terms of the Implementation Agreement and had been questioned by the National Congress 1997 report on state projects as an inefficient use of Section 212(b) funds. For example, the National Congress report was critical of the states for building roads without paving them, which resulted in the continuous need to regrade the roads and cover them with coral aggregate. The report stated that it would have been more economical to pave each road as it was being built. During our site visits to 7 of the 10 states on Babeldaob Island, we identified deficiencies in road maintenance projects that were funded with Section 212(b) funds as follows:

- In fiscal year 1996, one state received Section 212(b) funds of \$40,000 for road maintenance. According to the state governor, the project was to "clear and clean ditches along the roads." The state governor said that he could not maintain his state's roads without the Section 212(b) funding.

- In fiscal year 1996, another state received Section 212(b) funds of \$50,000 to, according to the state governor, "patch up the existing paved road with work performed by state employees" and perform "monthly maintenance of the road." In fiscal year 1999, this same state received \$250,000 to be used to resurface roads and for other state projects.

In our opinion, recurring repairs and maintenance of roads are normal operating functions that should be funded through the operating funds of the National Government and/or the state governments. Section 212(b) funds should be used only for the construction or major reconstruction of roads.

We also determined that the National Government allowed the states on Babeldaob Island to develop their own interstate and intrastate road systems without any central coordination or oversight from the National Government, which, according to the Palau Environmental Quality Protection Board, has had a negative environmental impact beyond the boundaries of the individual states. Specifically, in an April 15, 1998 letter to the President of Palau, the Board said that many of the newly constructed state roads had been "poorly planned, executed and maintained" and were contributing "heavily" to the sedimentation of streams and surrounding reefs on Babeldaob Island, which will "eventually lead to their destruction." Further, the Board requested the President of Palau's support in declaring a moratorium on all state road construction on Babeldaob Island until the Compact Road⁸ had been constructed to ensure that future planning and construction of state roads would complement the Compact Road, ensure accessibility between the Compact Road and state roads, and minimize the negative environmental impact of road construction. However, the President did not support the Board's request, and for fiscal year 1999, the National Government appropriated Section 212(b) funds of \$831,000 for roads, including \$821,000 for states on Babeldaob Island, which consisted of \$643,500 for new roads and pavings and \$177,500 for road maintenance.

Heavy Equipment. The Implementation Agreement allows Section 212(b) funds to be used for the purchase of heavy equipment but not for the cost of normal repair and maintenance of such equipment. Despite this restriction and awareness by the National Congress and the President (as detailed in the paragraphs that follow) of the inefficiency of allowing each individual state to purchase equipment without adequate provisions for repairs and maintenance, appropriations of Section 212(b) funds continued to be made to individual states for heavy equipment.

⁸Compact Section 212(a) required the U.S. Government to build a paved road around Babeldaob Island. The contract for this project was awarded in April 1999, and the project was being managed by the U.S. Army Corps of Engineers. This Compact-funded road is commonly referred to as the "Compact Road."

During fiscal years 1995 through 1999, the states received Section 212(b) funds totaling \$846,000 for various types of heavy equipment to be used in building and maintaining roads and other construction projects. The President of Palau, in the November 5, 1997 transmittal letter accompanying his veto of the National Congress proposed fiscal year 1998 state appropriations, stated that "the Republic cannot afford to finance separate public works road departments for state governments. Much of the Republic's road construction and repair [of] equipment could be performed in a more cost-effective manner if the equipment were consolidated at the national level." Additionally, the National Congress 1997 report on state capital improvement projects was critical of the states for not maintaining their equipment, which resulted in equipment being "abandoned due to lack of parts, repairs, and maintenance." The report said that this practice was a "waste of resources that the Republic could ill afford." The report further stated that the states should coordinate to develop plans to more efficiently provide for the repair and maintenance of equipment.

During our site visits to 7 of the 10 states on Babeldaob Island during the period of January 18 to April 5, 1999, we observed 13 pieces of state-owned heavy equipment, 9 that worked and 4 that were in various stages of disrepair. One state had a garage where equipment could be worked on in inclement weather, while other states had no equipment maintenance facilities. In another state, we observed a broken road grader that had been left on a dirt road for at least 3 months. A member of the U.S. Navy's Community Action Team stationed in Palau, which maintained its own heavy equipment, stated that the action team had offered to transport the state's grader to the state's storage yard at no cost but that the state official responsible for the equipment declined the offer and left the grader on the road until the needed parts arrived and could be installed. Without performing an in-depth analysis of the actual maintenance work performed on the grader, we could not determine whether the grader had broken down because of misuse or because of poor preventative maintenance. However, in fiscal year 1999, this state had been appropriated Section 212(b) funds of \$80,000 for "repair of heavy equipment."

In discussing with state officials on Babeldaob Island the President's November 1997 request for equipment to be consolidated at the national level, one state governor stated that consolidating state public works departments would not be workable because the states might not cooperate. However, another state official said that he believed that consolidating state public works departments would be workable, at least on Babeldaob Island, because the island is only 27 miles long. We were unable to identify any National Government official who was responsible for working with the states to implement the President's request for consolidation. In fiscal year 1999, four states on Babeldaob Island received Section 212(b) appropriations totaling \$414,000 for the purchase and maintenance of heavy equipment. Therefore, we concluded that actions had not been taken to consolidate the public works departments of the states to use Section 212(b) funds more efficiently and effectively to meet the heavy equipment needs of the states.

Buildings and Facilities. During fiscal years 1995 through 1999, the states received Section 212(b) funds totaling \$3,267,800 as follows: \$465,000 for sports facilities, \$427,000

for community centers, \$520,000 for bais,⁹ \$40,000 for school buildings, and \$1,815,800 for state administration buildings. The National Congress 1997 report stated that many of the state capital improvement projects financed with Section 212(b) funds were "non-revenue generating and do not meet the economic development objectives of each state and the nation." The report was critical of the appropriation of Section 212(b) funds for the construction of the bais, stating that "most of these bais have been abandoned, neglected and some are not being used at all." During our site visits to selected states, we inspected a youth center that had been constructed with Section 212(b) funds of \$175,000. A National Congress Senator stated that the facility did not appear to be used and was showing signs of neglect. Based on our observations, we believe that, without additional state revenues or supplemental operational funding from the National Government, the states will not be financially able to provide an adequate level of routine maintenance of facilities constructed with Section 212(b) funds. This lack of routine maintenance may result in the deterioration of the structures and the eventual need for additional funds to renovate the facilities. If this occurs, Section 212(b) funds of \$3.3 million will have been spent without long-term economic development that produces additional revenues for the Republic of Palau and the individual states.

Land Use Planning. The National Congress 1997 report on state capital improvement projects stated that, in developing plans for such projects, the states should consider the planned location of the projects. The report, to illustrate this point, described a situation in which a state built its state capitol approximately 10 feet from an existing road, noting that if the road was ever expanded, the building would have to be relocated. The following year, two agencies of the National Government's Executive Branch cited the lack of control over development and land use planning as follows:

- In an October 8, 1998 letter to the President of Palau, the Environmental Quality Protection Board stated that the potential existed for uncontrolled development on Babeldaob Island and emphasized that each state should develop a land use master plan and enact zoning laws to ensure that development in each state proceeded in an "environmentally sound and sustainable manner."

- In a December 1998 report titled "Land Use Implementation Strategy for the Republic of Palau," the Bureau of Lands and Survey recommended that the National Congress reinstate the Palau Planning Commission, which was established by Title 31 of the Palau National Code Annotated, to implement land use master plans. The report stated that "only rudimentary" land use planning and zoning existed in Palau (which has only 188 square miles of land) and that improper land use, such as that related to constructing roads, dumping waste, and clearing land, can have a significant negative impact on Palau's *terrestrial and marine environments*.

During our visit to 7 of the 10 states on Babeldaob Island, we also noted that urban planning had not been considered. For example, in one state, a \$100,000 community center had been

⁹Bais are traditional meeting houses in Palau where the cultural leaders within each state meet to discuss various issues affecting their community.

constructed on filled land on the ocean side of a road that followed the shoreline. The placement of the building was approximately 6 feet from the edge of the filled land, which was exposed to wave action. The governor of the state where the building was located said that the state did not have any zoning laws which required that buildings be set back a specific minimum distance from the shoreline. In our opinion, because of the placement of the building so close to the shoreline, wave action during a storm could erode the filled land, resulting in the loss of or damage to the community center.

We also found that only 4 of 16 states of the Republic of Palau had land use master plans and that only 1 of the 16 states adhered to some form of zoning regulation. Two of the state governors told us that rather than developing land use master plans on their own, they were working on the development of a combined master plan for all of the states. One state governor further stated that all 16 state governors supported the development of a combined master land use plan for all the states. The state governor also said that a combined approach should be used for land-use planning for Babeldaob Island because not every state had sand beaches for resort hotels and that the strengths and weaknesses of the states should be viewed as a whole when planning for future development. However, as of September 1999, work on a combined land use master plan had not reached the contracting stage. In our opinion, because of the negative impact that inadequate land-use planning can have on the long-term economic development and the environment of Palau, a moratorium should be placed on future Section 212(b) funding of state capital improvement projects until the recommendations made in the Land Use Implementation Strategy for the Republic of Palau, issued by the Bureau of Lands and Surveys, are implemented.

Project Specifications. We found that there was a general lack of uniformity and sufficient detail in the information provided to the Office of the President and the National Congress by the states in justifying proposed capital improvement projects. As a result, key officials of the Executive Branch and the National Congress were not fully aware of the scope of work and of the total funding required for each proposed project. Therefore, sufficient funds were not always appropriated to ensure successful completion of the projects. The National Congress 1997 report indirectly commented on this lack of information when it stated that docks and piers were not built strong enough to prevent erosion from the ocean and recommended that "sufficient sums be appropriated on a one-time basis" to construct more durable docks, which would save financial resources in the long term. The report also stated that approved projects were not always started in the year for which funds were appropriated and that the delays resulted in the costs of the projects being increased. Additionally, a state official told us that, in his opinion, approved projects should not be started until sufficient funds have been appropriated and are available to properly carry out the projects. However, we found that the Office of the President and the National Congress had not taken corrective actions to require states to standardize project proposals and to provide greater detail as to the costs and other considerations related to their proposals. We found, for the fiscal year 1999 appropriation process, that the lack of adequate information on proposed projects was evident. For example:

- The written justification submitted by a state for Section 212(b) funding of \$100,000 in fiscal year 1999 for the Back-Hoe & Round Island Road Project stated that the

state, "for infrastructure purposes, . . . has a great need for a heavy equipment" and that this "single equipment" would be used "to clear a single road around the island and for other purposes." The justification further stated that the road is included in the state's Master Development Plan and that \$100,000 is needed for equipment, manpower, and other tools. However, the information provided in the justification did not identify the estimated costs of labor, equipment, and materials needed to build the road; the estimated time frame to complete the project; a description of any environmental and zoning considerations or lack thereof; and an estimate of future costs to maintain the road. The National Congress approved the appropriation of \$100,000, but the President of Palau subsequently vetoed the appropriation without explaining the reasons for the veto.

- The National Congress approved another appropriation of \$141,000 for a state project to pave a 2-mile portion of a state road. The President of Palau subsequently reduced the appropriation to \$121,000 without explaining the reasons for the reduction. The state's executive officer stated that the original \$141,000 amount was not based on an engineering estimate but was developed arbitrarily. The executive officer also stated that he was not sure whether the original estimate had included the cost of preparing the roadbed for paving. In this case, the National Congress made an appropriation, and the President changed the amount without detailed information as to the extent of work required or a reasonable estimate of the project's cost.

The President of Palau said that he had not historically requested that the individual states submit detailed information and in a standardized format for proposed projects. However, both the President of the Senate and the Speaker of the House for the National Congress agreed that project proposals were not sufficiently detailed or standardized in format for the Office of the President and the National Congress to use in deciding which projects to fund and the amount of funding to provide. The Chief of the Division of Budget and Management, which coordinates and summarizes the detailed budget for the National Government, said that it would be helpful to have standard budget submissions for all state capital improvement projects.

Project Procurement and Management

States were performing the construction procurement and management functions without adequately trained personnel. This condition existed because the Palau National Code allowed each state governor or his/her designee to be the procurement officer for construction services without specifying the qualifications needed to function in that capacity. We determined that states had little assurance that costs totaling \$205,000 incurred on two Section 212(b)-funded projects were reasonable for work performed or that the projects were properly designed and built.

Title 40, Section 608(a), of the Palau National Code Annotated designated the Director of the Bureau of Public Works as the National Government's procurement officer for construction, architectural, and engineering contracts. However, the Code states that "the Procurement Officer for each state government shall be that person designated by each state governor." Further, Section 608(b) of the Code states, "The Procurement Officers are

authorized [to]: . . . procure or supervise the procurement of all goods, services, and construction needed by the government; . . . [and] . . . establish and maintain a program for the inspection, testing, and acceptance of supplies, services, and construction." Since the law did not require any minimum qualifications for the person designated as the Procurement Officer, there was no assurance that the procurement and project management functions were performed by qualified individuals at the state level. In addition, there was no requirement in the Code that a National Government agency, such as the Division of Design Engineering of the Bureau of Public Works, should inspect the construction work performed.

In that regard, the National Congress 1997 report stated that the quality of construction was questionable and recommended that projects involving construction be inspected by the Division of Design Engineering. However, the Division participated in state projects only if requested by the individual states. Additionally, in December 1998, as a result of problems with the use of construction funds by the states, the President of Palau requested that a manager/engineer from the Ministry of Resources and Development assist the states with the design, engineering, and procurement functions as a "project coordinator." However, this "project coordinator" position was not filled because of staff shortages at the Ministry.

The Republic of Palau did not have a uniform building code; thus, there were no construction standards for all buildings, roads, bridges, and other structures. The National Master Development Plan, which was issued in April 1996, emphasized the need for a uniform building code and stressed that electrical wiring, sanitary facilities, structural design, and energy insulation should be major elements of a uniform building code. The negative impact of allowing states to administer construction projects without National Government oversight and without the benefit of a uniform building code is illustrated by two state projects as follows:

- State Capitol Expansion. A state received Section 212(b) funds of \$65,000 to add a second floor to its state capitol building (see Figure 3). In August 1998, the state competitively awarded a \$35,000 construction contract, even though the original project estimate was between \$45,000 and \$50,000. After the project was started, the state governor approved an \$8,182 change order that was requested by the contractor to add a concrete beam and a column to the original construction designs. The state governor (who was the state procurement officer and who also performed the construction management functions) told us that he approved the change order without checking with the architect who designed the second floor addition because the contractor had concerns about the roof sagging from its weight.



Figure 3. The front of the state capitol building with the second floor addition. (Office of Inspector General photograph)

During a visit to the project site on January 18, 1999, we observed signs of honeycombing¹⁰ in the bottom portion of the beam that had been added to the structure. The honeycombing existed to such an extent that we could see the reinforcing steel bars within the beam (see Figure 4). We also observed that channels were chipped into the walls to accommodate the installation of electrical conduits. When we revisited the project site on March 30, 1999, we noted that the additional beam and a column that had been observed in January had been removed. Additionally, the channels that had been chipped for electrical conduits had been covered and plastered over, thereby concealing the conduits.

¹⁰Honeycombing is a condition in which air pockets or voids are left in concrete structures. This condition is prevented by vibrating the concrete when it is poured into the forms to allow it to settle and fill all air pockets.

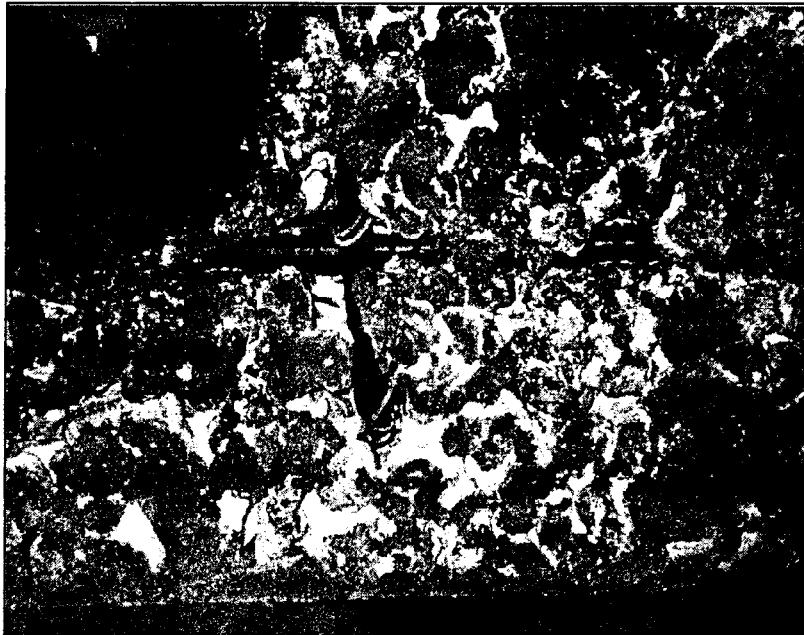


Figure 4. Close-up of the air pockets and the exposed steel reinforcement bars in a beam added to the state capital building shown in Figure 3. (Office of Inspector General photograph)

The contractor stated that the additional beam was removed by his workers "without [his] permission" and that his concerns over the need for additional support for the roof had not been resolved. The designer of the project, who was an architect at the Bureau of Public Works, stated that he was never contacted by the state governor or the contractor regarding their concerns about the adequacy of support for the roof. The designer further stated that his plans called for the electrical conduits to be laid within the wall when it was constructed and not placed in channels chipped into the wall after its construction.

On September 29, 1998, the state governor requested that the Director of the Bureau of Treasury allot the remaining \$30,000 of the project balance. The governor stated that he needed the \$30,000 to pay for the contract change order of \$8,182, purchase furniture costing \$13,381 for the capitol building, and perform renovation work costing \$8,437 on the first floor of the building. The governor also stated that the work on the first floor was not included as part of the initial scope of work because he was not certain that there would be sufficient funds to do all the desired work. The governor further stated that completion of the second floor work would cost about \$49,000. When we asked the governor how the \$49,000 related to the \$43,182 (\$35,000 plus \$8,182) the contractor had received for work on the second floor, the governor indicated that he was not certain.

Bridge Construction. A state received Section 212(b) funds of \$140,000 to build a 46-foot-long and 20-foot-wide bridge over a river as part of a road building project. The state obtained the services of an off-island engineer to design the bridge without charge.

When we reviewed the plans and specifications that were used for soliciting bids, we noted that there was no indication on the documents of the designer's professional qualifications or of the standards used in the design of the bridge, which, according to the specifications, was supposed to be able to accommodate an "80-ton crawler crane." The state governor, who was also the state procurement officer, awarded a contract of \$139,481 to the highest of three bidders after two of the bidders were disqualified for not complying with bidding instructions. The governor stated that he managed the project himself, including performing inspections, without oversight by the Division of Design Engineering. He also said that the contractor had hired an individual experienced in bridge building to manage the construction project for the contractor. However, when we asked the governor for inspection records documenting that the five steel "H" piles needed to support one end of the bridge had been driven to the required depth,¹¹ records were not provided. In addition, during our site visit to the bridge on March 30, 1999 (see Figure 5), we observed that the wing wall¹² on one side of the bridge was cracked and that, because the wing wall on the same side was not long enough to prevent erosion of the embankment, a makeshift structure of sheet metal and tree branches was used to stop erosion (see Figure 6).

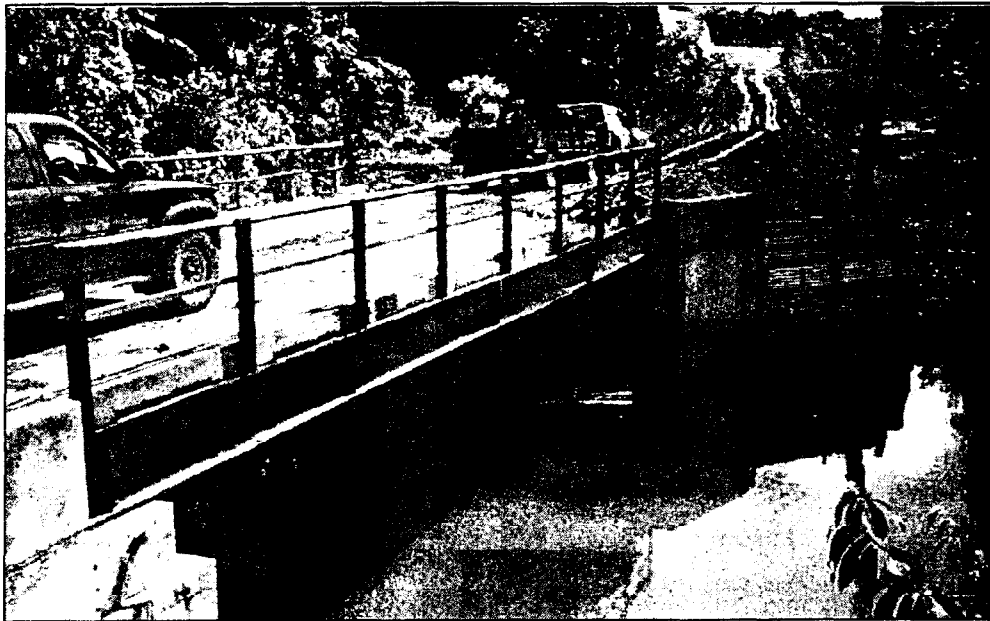


Figure 5. A 46' x 20' bridge constructed as part of a road building project. The tree branches and sheets of galvanized steel (right side) were used to prevent soil erosion because the wing wall was built too short. (Office of Inspector General photograph)

¹¹Documentation on the driving of each pile should be detailed enough to show that the contractor met the design specifications for the driving of the piles. In this case, the specifications required that each pile be driven to a depth of 39.37 feet. The driving could be stopped only if "hard rock" was encountered before the required depth was reached. Accordingly, an inspector's documentation of this portion of the contractor's work should have been detailed enough to show how deep each pile was driven and the basis for determining that "hard rock" was reached for piles driven less than the required 39.37 feet.

¹²Wing walls are retaining walls adjoining the ends of the bridge that are used to keep the backfill on each side of the bridge from eroding into the river.

The state's executive officer said that he was uncertain of the status of the cracked wing wall but that it would "probably" be repaired prior to completing the backfilling of the area adjoining the bridge ends and that the embankment would also be stabilized.



Figure 6. Close-up of cracks in the wing wall adjoining the bridge shown in Figure 5. (Office of Inspector General photograph)

In summary, we believe that because of inadequate oversight of capital improvement projects at the state level and no uniform building code, there was little assurance that projects were designed and built properly. In discussing these deficiencies, both the President and the leadership of the National Congress said that they were concerned that implementation of corrective actions might be perceived as an infringement of the National Government on the sovereignty of the individual states. However, because the states receive Compact Section 212(b) funds through appropriations, the National Government is ultimately responsible for ensuring that the funds are used efficiently and effectively for Palau's long-term economic development.

Recommendations

We recommend that the President of the Republic of Palau:

1. Take actions, in accordance with the Compact, to prohibit the use of Section 212(b) funds for the repair and maintenance of roads, equipment, and structures.
2. Identify and develop an inventory of the existing and proposed state roads that make up the National interstate road system for Babeldaob Island so that future state road construction can be properly integrated into an overall roadway system encompassing the Compact Road and individual state roads.

3. Develop and implement a plan to consolidate the heavy equipment resources for road maintenance of the states on Babeldaob Island.

4. Provide technical assistance to the states for the development and implementation of master land use plans on either a national or a state level.

5. Enforce Title 31 of the Palau National Code Annotated regarding zoning and request that the Office of Insular Affairs, U.S. Department of the Interior, provide technical assistance to the states for development and implementation of zoning laws on either a national or a state level.

6. Establish written procedures for the development of detailed state capital improvement project proposals, including a standardized format to be used by the states when they request Compact funding for such projects.

7. Submit proposed legislation to the National Congress to amend Title 40 of the Palau National Code Annotated to require the Director of the Bureau of Public Works to procure constructions services for all capital improvement projects appropriated to the states and to require the Division of Design Engineering to either provide or procure project management and inspection services for such projects.

8. Submit proposed legislation to the National Congress to require the National and state governments of the Republic of Palau to adopt a uniform building code and appropriate standards for bridge construction.

Republic of Palau Response and Office of Inspector General Reply

The April 7, 2000 response (Appendix 5) to the draft report from the President of the Republic of Palau indicated concurrence with Recommendations 1, 3, 4, 6, 7, and 8 and nonconcurrence with Recommendations 2 and 5. Based on the response, we considered Recommendation 1 resolved and implemented. Also based on the response, we revised Recommendations 2 and 5. We request that the Republic respond to the revised recommendations, which are unresolved, and provide target dates and/or titles of officials responsible for implementation of Recommendations 3, 4, 6, 7, and 8 (see Appendix 6).

Recommendation 2. Nonconcurrence indicated.

Republic of Palau Response. The response indicated nonconcurrence with Recommendation 2 in the draft report, which called for a moratorium on road construction until the Compact Road on Babeldaob Island was completed. The response also stated that construction of an "appropriately sited" interstate road system should continue.

Office of Inspector General Reply. The recommendation was based on concerns expressed by the Palau Environmental Protection Board in an April 15, 1998 letter to the President, which stated that previously constructed state roads on Babeldaob Island were poorly planned, executed, and maintained, which therefore contributed to sedimentation of

streams and surrounding reefs. Although the Environmental Protection Board's letter did not identify the funding sources, Compact Section 212(b) funds of more than \$2 million were used to fund state roads and bridges, of which \$629,500 was for unallowable road maintenance during fiscal years 1995 through 1999. Therefore, we believe that there should be a coordinated approach to constructing the Compact Road and individual Compact-funded state roads that will result in a well-planned interstate road system on Babeldaob Island. We were unable to determine whether such a coordinated approach was being followed because, during the audit, we were unable to identify which existing or proposed state roads had been officially designated as part of a national interstate road system. In keeping with our original intent and considering the President's response, we have revised the recommendation to require the National Government to develop an inventory of current and planned roads that will connect to the Compact Road as part an interstate road system for Babeldaob Island. This inventory should assist both the National Government and the individual state governments when identifying road projects to be financed through Compact Section 212(b) funding.

Recommendation 5. Nonconcurrence indicated.

Republic of Palau Response. The response stated that the National Government could not enforce existing zoning laws within Koror State, which already has state zoning laws, because of the separation of state and national government rights under Palau's Constitution. In addition, the response stated that the National Government did not presently have the manpower or the expertise to assist the states in developing and implementing zoning laws.

Office of Inspector General Reply. The response did not address the lack of land use planning and zoning that the National Government's Bureau of Lands had identified in a December 1998 report. The Bureau's report concluded that the lack of land use planning and zoning represented a serious threat to Palau's terrestrial and marine environments. While there may be concern on the part of the Republic about infringing on the rights of individual states, we believe that the National Government has a responsibility to identify problems on a national level and then to function as a catalyst for corrective action to ensure that all states address such problems as uncontrolled land use. Recommendation 5 took into account the conflict of National versus state rights by including the option for the National Government to "provide technical assistance to the states for development and implementation of zoning laws on either a national or state level." (Emphasis added.) This approach provides a measure of flexibility to the process and still provides a basis for addressing national concerns over unregulated land use. We have revised the recommendation to state that the National Government should request the Office of Insular Affairs, U.S. Department of the Interior, to provide technical assistance in developing zoning laws.

Recommendation 7. Concurrence indicated.

Republic of Palau Response. The response indicated concurrence with the recommendation but stated that because of the issue of states rights, a proposed amendment to the procurement law will be introduced to require the Director of Public Works to be the Procurement Officer for only nationally funded construction projects appropriated to the individual states. The response further stated that since this proposed amendment to the procurement law would include construction projects financed by Compact Section 212(b) funds, the types of problems identified in the report should be avoided in the future. The response also stated that, in anticipation of the increased work load at the state level, additional technical staff for the Division of Design Engineering will be requested for fiscal year 2001 to address the construction management and inspection of the nationally funded state construction projects.

Office of Inspector General Reply. The alternative action proposed by the President meets the intent of the recommendation. The target date and title of the official responsible for implementation of the recommendation, however, are needed.

CLASSIFICATION OF MONETARY AMOUNTS

<u>Finding Areas</u>	<u>Funds To Be Put To Better Use</u>
A. National Government Projects	
Cost Estimates	\$404,212 *
Project Inspections	351,707 **
Procurement Requirements	255,000 ***
Administrative Charges	<u>765,731 **</u>
Subtotal	<u>\$1,776,650</u>
B. State Projects	
Project Selection	\$4,311,300 ***
Project Procurement and Management	<u>205,000 ***</u>
Subtotal	<u>\$4,516,300</u>
Totals	<u><u>\$6,292,950</u></u>

* Amount consists of Federal funds of \$28,819 and local funds of \$375,393.

** Amount represents local funds

*** Amount represents Federal funds.

**COMPACT SECTION 212(b) AND RELATED FUNDING
PROVIDED TO THE REPUBLIC OF PALAU
AS OF SEPTEMBER 30, 1998**

Description	FY-1995	FY-1996	FY-1997	FY-1998	Totals
Compact Section 212(b) Funds Awarded	\$36,000,000	0	0	0	\$36,000,000
Compact Section 215 Inflation Factor Funds Awarded	16,560,000	0	0	0	16,560,000
Interest Earned on Compact Funds (Net Expense)	<u>3,568,086</u>	<u>\$4,509,119</u>	<u>\$7,839,085</u>	<u>\$1,949,366</u>	<u>17,865,656</u>
Compact Funds Awarded and Interest Earned	\$56,128,086	\$ 4,509,119	\$7,839,085	\$1,949,366	<u>\$70,425,656</u>
Prior Year Unappropriated Funds Brought Forward	0	42,409,286	31,021,205	30,689,290	
Net Compact Funds Available	56,128,086	46,918,405	38,860,290	32,638,656	
Less Unappropriated Funds Carried Forward	<u>- 42,409,286</u>	<u>- 31,021,205</u>	<u>- 30,689,290</u>	<u>- 25,658,656</u>	
Appropriations of Compact Funds	\$13,718,800	\$15,897,200	\$8,171,000	\$6,980,000	<u>\$44,767,000</u>
Prior Year Appropriations Brought Forward	0	10,840,973	16,249,439	11,168,885	
Total Available Appropriations	\$13,718,800	\$26,738,173	\$24,420,439	\$18,148,885	
Less Expenditures	<u>- 2,877,827</u>	<u>-10,488,734</u>	<u>-13,251,554</u>	<u>- 7,807,657</u>	<u>\$34,425,772</u>
Unexpended Appropriations Carried Forward	<u>\$10,840,973</u>	<u>\$16,249,439</u>	<u>\$11,168,885</u>	<u>\$10,341,228</u>	

**CAPITAL IMPROVEMENT PROJECTS FUNDED BY
THE TRUST TERRITORY OF THE PACIFIC ISLANDS
AS OF SEPTEMBER 30, 1998**

<u>Project Title</u>	<u>Project Number</u>	<u>Fiscal Year</u>	<u>Total Authorizations</u>	<u>Total Expenditures</u>	<u>Available Balances</u>
Rural Water Systems	T-209	1984	\$9,985,707	\$9,064,960	\$920,747
Koror Wastewater System Improvements	T-224	1991	2,370,479	1,278,641	1,091,838
Koror Wastewater System Deficiency Corrections	T-225	1991	654,081	28,399	625,682
Koror-Airai Water System Improvements	T-231	1993	500,000	452,517	47,483
Koror Sewage Treatment Plant Expansion	T-232	1993	5,150,000	285,915	4,864,085
Koror Wastewater System Pump Station Upgrade	T-233	1993	483,000	84,955	398,045
Palau National Hospital	T-268	1986	23,144,272	23,031,320	112,952
Palau National Hospital-Equipment	T-268	1992	1,974,800	1,077,998	896,802
Koror-Airai Electric Power Improvements	T-269	1973	1,452,547	0	1,452,547
Koror-Airai Electrical	CH6354	1990	35,000	0	35,000
Capitol Relocation	T-272	1988	<u>\$2,600,000</u>	<u>\$2,206,211</u>	<u>\$393,789</u>
Total Funding			<u>\$48,349,886</u>	<u>\$37,510,916</u>	<u>\$10,838,970</u>

**COMPACT SECTION 212(b) FUNDS APPROPRIATED TO
THE STATES OF THE REPUBLIC OF PALAU
AS OF SEPTEMBER 30, 1998**

<u>Project Category</u>	<u>FY 1995</u>	<u>FY 1996</u>	<u>FY 1997</u>	<u>FY 1998</u>	<u>FY 1999*</u>	<u>Totals</u>
Electrical Generators	\$65,500					\$65,500
Boats and Engines	0	\$728,000	\$200,000	0	\$390,000	1,318,000
Heavy Equipment	132,000	279,000	0	0	449,000	860,000
Buildings and Facilities	1,007,800	925,000	0	0	1,335,000	3,267,800
Docks and Marinas	345,000	333,000	0	0	405,000	1,083,000
Roads and Bridges	479,000	712,000	0	0	831,000	2,022,000
Water Systems and Other Projects	<u>291,500</u>	<u>2,012,000</u>	<u>0</u>	<u>0</u>	<u>986,000</u>	<u>3,289,500</u>
Total Appropriations	<u>\$2,320,800</u>	<u>\$4,989,000</u>	<u>\$200,000</u>	<u>0</u>	<u>\$4,396,000</u>	<u>\$11,905,800</u>

*Fiscal year 1999 Compact Section 212(b) appropriations were effective on November 24, 1998.



REPUBLIC OF PALAU

Office of the President

APPENDIX 5
Page 1 of 9

KUNIWO NAKAMURA

President

P.O. Box 100, Koror • Republic of Palau 96940
Phone: (680) 488-2403 / 2541 • Fax: (680) 488-1662

April 6, 2000

Serial: 141- 00

Mr. Robert J. Williams
Assistant Inspector General for Audits
Office of the Inspector General
U.S. Department of the Interior
Washington, D.C. 20240

Re: DRAFT AUDIT REPORT NO. N-IN-PAL-002-99-R

Dear Mr. Williams:

Thank you for the opportunity to respond to the draft audit report referenced above dated February 17, 2000, regarding management and oversight of selected construction projects in the Republic of Palau. Our response will follow the draft audit report findings and recommendations in terms of being divided into Part A, National Government Projects, and Part B, State Projects.

In response to Part A of the draft audit report, we are pleased to say that we have instituted significant improvements to the Palau National Government Capital Improvement Program/Design Engineering Office (hereafter, "CIP Office") related to the auditor recommendations offered while the audit was in progress. These efforts have been assisted by additional funding that has been provided this fiscal year for the CIP Office for additional necessary operating expenses and to hire two additional construction project inspectors. Other improvements are also discussed throughout this letter.

The Palau National Congress (the "Olbiil Era Kelulau," or "OEK") has authorized the Ministry of Resources and Development ("MRD") to prepare, design and implement national construction projects in accordance with appropriation laws and other relevant laws of the Republic of Palau. The CIP Office works in accordance with guidelines and procedures set forth by the Ministry of Resources and Development. Legislation enacted in October 1999 directed the CIP Office to inspect national and state construction projects to ensure proper

April 6, 2000
Serial: 141- 00
p.2

project implementation in accordance with accepted construction standards (ref: Republic of Palau Public Law No. 5-34, Section 26). Under this section, the CIP Office was directed to adopt regulations that set the standards for building government construction projects.

In specific response to audit recommendations, we have already taken or will soon take the following actions:

1. The Ministry of Resources and Development will work with the Office of Insular Affairs, U.S. Department of the Interior, regarding a request for a Technical Assistance Grant to contract with the U.S. Naval Facilities Engineering Command to perform an assessment and evaluation of the capabilities of the CIP/DEO.
2. The Ministry of Resources and Development and the Bureau of Public Service System have coordinated their efforts for recruitment of qualified individuals.
3. The Bureau of Public Service System follows an approved civil service classification system for all government employees. If the assessment described in point 1 above results in recommendations for classification of professional engineering and other technical positions, the Bureau of Public Service System will be directed to add any new classifications, or change existing classifications.
4. The Ministry of Resources and Development CIP Office has recently worked with the Bureau of National Treasury, Division of Finance and Accounting, to establish specific guidelines for the allocation of annual, sick and other leaves of absence of CIP Office staff to appropriate overhead, administration, or construction accounts.
5. The Ministry of Resources and Development have agreed to the request of the Koror State Government for the use of a combination mechanical/wetlands ponding system for the Malakal Waste Water Treatment Plant. Accordingly, a Request for Qualifications has been issued to interested contractors. We have also requested the Attorney General's Office for assistance in reviewing the legal aspects of the RFQ in light of a previous awarding of a contract to a local company to do the original work (prior to the change in scope to add ponding).

Enclosed are copies of correspondence and other documents related to the above points, for your reference.

We would like to clarify some of the questions and concerns mentioned in the audit report

April 6, 2000
Serial: 141- 00
p.3

about specific projects. For the Peleliu Water Project and the Echang Sewer Project, Mr. Mark Braccia, a U.S. Registered Professional Engineer, was assigned these projects while working in the CIP Office during the period 1995 - 1997. This conforms to the requirement that construction projects funded by the Department of the Interior ("DOI") are to be managed by a qualified professional engineer. Regarding the change orders for these two projects, these change orders were orally agreed upon at that time by the DOI construction consultant and Mr. Braccia, in order to proceed with the changes in the work in order not to delay the projects. Within the same period the DOI Palau office was closed, which affected project coordination with DOI. During that time also, the contractor was already working on the change orders without the normal change order procedure. By the time the CIP Office was notified by the DOI Palau office (when it was reopened) that the change orders were not approved, the contractor had already completed the work including the changes made on original scope.

Phase I of the Peleliu Water System project (done by OICC) was a Canvas Water Catchment at the Peleliu air strip (i.e., airport) and wood platform to hold 3 ten thousand gallon tanks situated on the hill were found not sufficient to satisfy its intended purpose. In 1995 - 1996, the CIP Office received approval from DOI to improve the water system at the school area and Imelechol Hamlet and at the same time the contractor, Monterey Mechanical Company ("MMC") replaced the wood platform done by OICC with concrete. This item was overlooked during the time of OICC and it had to be replaced with concrete in order for the platform to support the 3 water tanks without them breaking or collapsing. Before this change was made, the water operator had to stop using these tanks for safety reasons. In addition to the platform, the contractor (MMC) was also able to trace and repair the leak at the existing water line. These changes (platform and repair of leak) have benefited the people of Peleliu by providing them a 24 hours daily water supply system.

Regarding deficiencies on some of the old projects managed by OICC, the government was able to secure Grant Aid from Japan to correct several deficiencies. Notable among these projects is the additional water line from Ngerikiil in Airai to fill the 500,000 gallons water tank at Ketund (hill) at Meyuns Hamlet in Koror. This was necessary because upon project completion there was not sufficient water pressure to fill the tank. The same situation is also the case at the Malakal water tank where the pressure is not sufficient to reach the tank. Funding will be sought to install additional lines in order to utilize the tank.

The CIP Office with the guidance of the Minister of Resources and Development as the Contracting Officer always strives to improve the implementation of national and state CIP projects to meet approved construction standards at the lowest cost. This is done with the

April 6, 2000
Serial: 141- 00
p.4

support and cooperation of the CIP management, engineers, architects, surveyors, inspectors, and administrative staff available. In addition to the current staff, two professional engineers are presently being recruited to assist in the Compact Road and Capital Relocation CIP projects. Within this fiscal year it is also planned to hire an electrical and/or mechanical engineer to augment the technical staff.

The CIP Office is working closely with all parties involved in CIP projects to ensure that the implementation of projects throughout the country adheres to the procurement law of the Republic of Palau. In the case of bidding for the Malakal Waste Water Treatment Plant (i.e., the Koror Sewage Treatment Plant Expansion Project), the CIP Office and the Minister of Resources and Development after careful evaluation and study of the participants deemed it best not to put the Palau National Government at risk by awarding a contract of this magnitude (\$3 million) to a company from a foreign country that conducts business in a manner different from Palau. In addition, we were concerned about what recourse Palau would have in the case of a contract default by the contractor. It was believed that in the event the contractor could not fulfil its contractual obligations, recovering Palau's financial investment might prove to be difficult. Therefore, the issue involved was not simply a matter of bid bonds, it was a matter of having requiring a bid bond issued by a U.S. Treasury-approved surety firm so that Palau would have an acceptable legal avenue to recover damages. Procedural errors made in notifying the bidders, particularly the foreign contractor, of bid bond requirements will be avoided in the future by issuance of clearer bidding instructions.

The Republic of Palau is a young independent nation in the process of development and may require aid and technical assistance from other nations from time-to-time. Implementation of audit recommendations cannot happen overnight, as the process of systems development, staff training, and other improvements take considerable time. We will, however, continue to train and develop local staff to meet U.S. standards. For your information, the following is a list of training completed and planned for the CIP Office staff:

6. In late 1994 and early 1995, the CIP Office sent four inspectors to participate in an OICC electrical training for inspectors course. This was funded by the DOI.
7. In 1998, most of the CIP staff attended a computer training course specifically on Auto-CAD. This training assisting the CIP Office in being able to produce better and faster drawings (architectural and engineering, including surveys) thereafter.
8. We have requested additional staff training, through the DOI - Palau office. We are

April 6, 2000
Serial: 141- 00
p.5

waiting for a reply and to firm up the training courses, venue and schedule.

9. We have requested that Palau Community College ("PCC") draft a training course for construction inspectors to be held at night. PCC is currently working with us on this project.

Regarding the residual balances of several DOI-funded projects that have been completed, the CIP Office has made numerous requests to utilize the remaining funds for purposes related to original U.S. appropriations, with the intention of improving the scope of the work of key projects. This is similar to what has been done with several CIP projects funded with Palau National Government funds, whereby the lowest bid received is less than the amount budgeted/appropriated for a project, and the savings are used to improve the scope of the work. We have requested using DOI CIP project residual balances to improve existing water systems, to improve the Koror sewer system, and for other infrastructure purposes such as school building repairs. It is our understanding that Palau will not be allowed to use any of the residual balances of DOI CIP projects, that these funds will be either returned to the U.S. Treasury, or "pooled" to be re-used for high priority projects in the Freely Associated States, although Palau may not have projects that are as of high a priority as the other Freely Associated States.

Since 1994 the CIP Office has managed 120 projects, of which 90% have been completed. There is no doubt that these projects have provided great benefits to the people of Palau in terms of better infrastructure and the services they provide -- thereby improving the quality of life, and similarly, improving the economy of Palau. Although the changes may not be so obvious to an outsider, the CIP Office has through the years gained considerable knowledge about the administration and management of CIP projects through this varied and intense experience. Together, the Minister of Resources and Development, as Contracting Officer (i.e., Procurement Officer), and the CIP Office, as the construction projects manager, have always been very conscientious in the preparation and awarding of construction contracts. In cases where contracting questions arise, the Office of the Attorney General is requested to clarify and settle specific issues and concerns raised by the parties involved, prior to any decision on awarding of a contract. Processing contracts and change orders in accordance with applicable laws, and in the case of DOI-funded projects, with DOI approval, has always been a foremost concern of the CIP Office.

The audit findings and recommendations regarding Part B, State Projects, have also been reviewed and the response to the recommendations stated on page 24 of the report follows.

April 6, 2000
Serial: 141- 00
p.6

1. The President will ensure that Compact Section 212(b) funds are no longer utilized for the repair and maintenance of roads, equipment and structures, by taking all appropriate actions necessary to ensure that Palau remains in compliance with the letter and spirit of the Compact of Free Association. The President will not introduce appropriation legislation that proposes use of Section 212(b) funds for other than allowable purposes specified in the Compact. Because the Olbiil Era Kelulau ("OEK") frequently changes the President's proposed sources of funds for appropriations and also add new items to appropriation bills, the President will also carefully review legislation prior to passage by the Olbiil Era Kelulau, and upon the legislation's passage, to determine if Section 212(b) funds have been used inappropriately, and if so, to take whatever action is necessary to correct the funding problem.
2. While Palau agrees that road construction on Babeldaob must be done in a coordinated manner and should be undertaken with the ultimate goal of establishing a well-planned and fully-integrated interstate road system, the length of time which has gone into planning the Compact Road, the details with which such plans have been laid out, and the considerable amount of time it will take to complete the Compact Road makes a complete moratorium on all road construction throughout Palau unrealistic and unnecessary. The construction of new roads on islands other than Babeldaob should not have any impact on the Compact Road. The construction or upgrading of certain roads, especially appropriately sited connecting roads, on Babeldaob can be undertaken without compromising the goal of a well planned and fully-integrated road system largely because there is little or no room for changes to the existing plans for the Compact Road. The Compact Road's route and many of the necessary points of connection to the Compact Road can be plotted with certainty. As a result, planning and, to an extent, construction of additional roads on Babeldaob can be conducted while construction progresses on the Compact Road and still allow for the desired result.
3. The Ministry of Resources and Development will initiate efforts to develop a plan to consolidate national and state government heavy equipment resources for road maintenance, provided that a study corroborates the audit recommendations. The proposed study would address the feasibility and necessity of centralized heavy equipment pool compared to a decentralized heavy equipment system (in which states retain road construction and repair equipment for their own use). There are many policy issues involved in this matter, including states' rights and ownership of equipment, and manpower availability at the national government level. An equipment

April 6, 2000
Serial: 141- 00
p.7

- consolidation plan would have to have the full support and cooperation of the state governments. The national government does not have authority over state governments, and cannot force any state to turn its heavy road equipment into a "pool." The possibility of creating an equipment pool by law may also be explored.
4. RPPL No. 5-38 appropriated \$440,000 for development of master plans for all states. Within the constraints of limited manpower and finances, the national government will also make every effort to provide technical assistance to the states for the development and implementation of master land use plans.
 5. The National Government shares the Auditor's concern that the zoning laws of the State of Koror should be enforced in Koror. However, under the Constitutional government of the Republic, similar to that of the United States, there are federalism concerns implicated by the Auditor's recommendation which may limit the Republic's ability to implement this suggestion. Pursuant to the Constitution and laws of the Republic of Palau, the enactment, policing, and enforcement of the Koror Zoning Law has been committed to the discretion of the state, specifically, to the Building and Zoning Official of Koror State. It would be an illegal arrogation of authority for the National Government to attempt to enforce that law without an act of the Olbiil Era Kelulau rescinding the authority which has been granted to Koror State to establish zoning and building codes within its jurisdiction. Nonetheless, the National Government will confer with and, to the extent permitted by law, work with Koror State to see that the existing provisions of law are enforced there. The Executive Branch of the Palau National Government does not presently have the manpower and expertise to provide technical assistance to the states for development and implementation of zoning laws.
 6. The Ministry of Resources and Development will work with the Ministry of Administration to establish written procedures for the development of detailed state capital improvement program project proposals, including a standardized format to be used by the states when they request Compact funding for such projects. This is expected to be completed in time for states to submit CIP project funding requests for fiscal year 2001, late in fiscal year 2000. The state CIP proposals would require submission of preliminary cost estimates, the proposed scope of work, the projected future operations, maintenance and repairs costs of each project, as well as specifying future responsibilities in these areas.
 7. The existing provisions of Title 40, which expressly declare that the laws and

April 6, 2000
Serial: 141- 00
p.8

procedures set forth therein apply to all procurement actions within the Republic, whether by the National Government or the State Governments (see 40 PNCA §603), and also expressly identify the Director of the Bureau of Public Works as the Procurement Officer for construction projects (see 40 PNCA §608). However, part (a) of this later section of the PNCA also states that "The Procurement Officer for each state government shall be that person designated by each state government." Therefore, state governments have been responsible for procurement of goods, construction and contractual services for all funds under their authority, including national government appropriations for state CIP projects. Therefore, it is proposed to amend the law so that for the obligation and expenditure of funds resulting from revenues generated by the states, the Procurement Officer for each state government shall be that person designated by each state government. For funds which each state receives from the national government for state CIP projects, the Director of Public Works shall be the Procurement Officer. For funds which each state receives from the national government for the purchase of goods or contractual services (other than construction, architectural, design, and surveying) the states could remain responsible for their own procurement, with technical assistance available from the national government to assist the states with such procurement upon request.

In Part A on the audit report it has been recommended, and we concurred, that the contracting, management and inspection capacity of the Bureau of Public Works must be improved. At this time, there is insufficient manpower and expertise in the Bureau of Public Works to undertake additional state construction project responsibilities. Therefore, it is planned that when developing the fiscal year budget, sufficient funds will be requested to strengthen the Bureau of Public Works Division of Design Engineering to enable it to take over state procurement of construction and management and inspection of state projects, with the proposed legislation that would make this mandatory to follow -- if the OEK indicates that it is in favor of this approach and is willing to appropriate sufficient funding for the Division of Design Engineering.

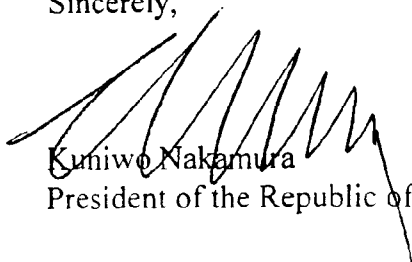
8. The National Government has begun examining options for establishing a national building code and has opened discussions with consulting firms with expertise in the subject for the possible drafting of such a code. The National Government will also explore appropriate opportunities for assistance in developing standards for bridge construction. The OEK has given the uniform building code considerable attention within the last two years, and is expected to work closely with the President in enacting uniform building code legislation. Building code legislation will likely

April 6, 2000
Serial: 141- 00
p.9

establish the broad requirements for a code, with the actual code to be established administratively. However, regarding the uniform building code, and particularly in respect to bridge construction, the efforts of the National Government are subject to the same concerns as those brought out in the response to zoning (item 5 preceding) with respect to the division of powers and authority between the national and state governments. Nonetheless, the National Government will confer with the various state governments in an attempt to establish appropriate uniform codes for building and bridge construction throughout Palau. Enactment of a uniform building code law and implementation of the code is planned for no later than December 31, 2000.

We look forward to a continued beneficial and productive relationship with the Office of the Inspector General.

Sincerely,



Kuniwo Nakamura
President of the Republic of Palau

Enclosures

STATUS OF AUDIT REPORT RECOMMENDATIONS

Finding/Recommendation Reference	Status	Action Required
A.1	Management concurs; additional information needed.	Provide the target date and the title of the official responsible for formally requesting an assessment and evaluation of the Division of Design Engineering by the Office of Insular Affairs.
A.2	Management concurs; additional information needed.	Provide the target date and the title of the official responsible for initiating the recruitment of the positions identified in the recommendation.
A.3	Management concurs; additional information needed.	Provide the target date and the title of the official responsible for developing new position classifications for positions identified in the assessment contemplated by Recommendation A.1.
A.4	Management concurs; additional information needed.	Provide the target date and the title of the official responsible for coordinating the establishment of cost allocation guidelines for fringe benefit costs of inspectors.
A.5	Management concurs; additional information needed.	Provide the target date and the title of the official responsible for completing the Malakal sewage treatment plan expansion project.
B.1	Implemented.	No further action is required.
B.2	Unresolved.	Respond to the revised recommendation, and provide the target date and the title of the official responsible for developing an inventory of state roads on Babeldaob Islands that will be integrated into a comprehensive interstate roadway system that includes the Compact Road.

Finding/Recommendation Reference	Status	Action Required
B.3	Management concurs; additional information needed.	Provide the target date and the title of the official responsible for developing the consolidation road maintenance plan.
B.4	Management concurs; additional information needed.	Provide the target date and the title of the official responsible for coordinating technical assistance to the states for development and implementation of master land use plans.
B.5	Unresolved.	Respond to the revised recommendation, and provide an action plan that includes the target date and the title of the official responsible for developing and implementing zoning laws on either the individual state or the national level.
B.6	Management concurs; additional information needed.	Provide the target date and the title of the official responsible for implementing standardized procedures for the development of state capital improvement project proposals.
B.7	Management concurs; additional information needed.	Provide the target date and the title of the official responsible for drafting the proposed legislation to amend Title 40 of the Palau National Code Annotated regarding the procurement authority of the Director of the Bureau of Public Works.
B.8	Management concurs; additional information needed.	Provide the target date and the title of the official responsible for implementing a uniform building code.

**ILLEGAL OR WASTEFUL ACTIVITIES
SHOULD BE REPORTED TO
THE OFFICE OF INSPECTOR GENERAL**

Internet Complaint Form Address

http://www.oig.doi.gov/hotline_form.html

Within the Continental United States

U.S. Department of the Interior
Office of Inspector General
1849 C Street, N.W.
Mail Stop 5341 - MIB
Washington, D.C. 20240-0001

Our 24-hour
Telephone HOTLINE
1-800-424-5081 or
(202) 208-5300

TDD for hearing impaired
(202) 208-2420

Outside the Continental United States

Caribbean Region

U.S. Department of the Interior
Office of Inspector General
Eastern Division - Investigations
4040 Fairfax Drive
Suite 303
Arlington, Virginia 22203

(703) 235-9221

Pacific Region

U.S. Department of the Interior
Office of Inspector General
Guam Field Pacific Office
415 Chalan San Antonio
Baltej Pavilion, Suite 306
Agana, Guam 96911

(671) 647-6060

HOTLINE

U.S. Department of the Interior
Office of Inspector General
1849 C Street, NW
Mail Stop 5341- MIB
Washington, D.C. 20240-0001

Toll Free Number
1-800-424-5081

Commercial Numbers
(202) 208-5300
TDD (202) 208-2420

