

This is the executive summary of the report is from the independent external audit on EDTL by Deloitte, delivered to the Prime Minister and Parliament in May 2011. La'ó Hamutuk scanned the Portuguese original document and translated it to English, and we may have accidentally introduced some errors. For the complete document in English and Portuguese, and for more information on the national electricity project, see www.laohamutuk.org/Oil/Power/10PowerPlant.htm .

Government of the Democratic Republic of Timor-Leste

Review of Electricity of Timor-Leste (EDTL)

April 2011

Executive Summary and Recommendations

(The complete report is at <http://www.laohamutuk.org/Oil/Power/2011/DeloitteEDTLApril2011En.pdf>.)

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Executive Summary

1.1 Historical Context

The electricity sector in Timor-Leste was seriously damaged in 1999. Since then, successive governments and international organizations have made significant efforts to improve and expand the supply of electricity to consumers. Despite such efforts, interruptions in electrical supply and other problems related to the provision in Timor-Leste continue to occur regularly.

The conducted review was aimed at obtaining an understanding of the electricity sector in Timor-Leste and the general examination of key processes and procedures of the Electricity of Timor-Leste (EDTL). EDTL is the supplier for the national electricity system in Timor-Leste and is supervised by the Secretary of State for Electricity, Water and Urbanization, in the Ministry of Infrastructure (“the Ministry”).

1.2 Scope and objectives

The Ministry of Finance asked us to:

- Develop an understanding of the issues that contribute to the interruption of electricity supply, including examination of relevant documents, in particular contracts with major suppliers
- Generally we examine the key internal controls and accounting procedures
- We examine high value transactions, as disclosed in the statement of receipts and payments for the 21-month period ended September 30, 2010
- Proceed to review the commercial register and the shareholding structure of a sample of goods suppliers
- Prepare a report on situations detected a report and recommendations

Our approach in this study consisted mainly of interviews with key stakeholders, in order to obtain their perspectives on the challenges of efficiency and financial process, and inspection of documents. A summary of the terms of reference of the work is presented in Annex O.

1.3 Brief summary of the electricity sector

1.3.1 Electricity sector in Timor-Leste

The electricity sector in Timor-Leste is a set of non-integrated power generation and distribution networks spread across the country. Currently, electricity is not connected through a transmission infrastructure.

1.3.2 Construction of a national transmission system and power generators

With a view to building a national transmission system and new power generators, the Government has signed contracts with China Nuclear Industry 22nd Construction Company Ltd and Puri Akraya Engineering Limited, respectively.

Additionally, the Government contracted with the consultants Electroconsult & Bonifica SpA to manage the construction processes mentioned above. They are also employed to obtain advice on the proposed improvements to the electricity sector.

Section 2 provides more detailed information about the EDTL and electricity sector in Timor-Leste.

1.4 Key factors that contribute to disruptions in electricity supply

There are several factors that contribute to disruptions in electricity supply. Such factors include:

- Power plants and obsolete equipment
- Inefficient procurement processes
- Failure to implement the Utilities Board
- Ineffective contract with the contractor to manage the operation of EDTL (hereinafter referred to simply as “the management contractor”)
- Funding difficulties

- Poor recovery of amounts owed by customers
- Ineffective supply chain of fuel to the districts and sub districts
- Insufficient supply of strategic spare parts
- Restrictions on the level of human resources

Section 3 describes in detail the situations encountered and the recommendations relating to the factors that contribute to energy supply interruptions in the electricity sector in Timor-Leste.

1.5 Detected situations related to internal controls and accounting procedures

1.5.1 Supply

1.5.1.1 Decentralization

During 2010, the Government undertook decentralization of supply to provide greater autonomy to line ministries at this level. As part of this process, it was expected that the Supply Technical Secretariat (STA) would supervise and arrange guidance on major purchases. However, there were significant delays in the time that the STA was slow to approve projects, which demonstrates that the STA has not worked as planned, either before or after the resignation of Deputy Prime Minister.

1.5.1.2 Major investment projects - Changes to the terms of the national transmission system

The China Nuclear Industry 22nd Construction Company (CNI22) was contracted by the Ministry of Infrastructure to build national transmission network. The corresponding contract included the construction of power plants. The Ministry of Infrastructure has commissioned and was responsible for the acquisition of the national transmission grid has been given authorization to its construction. After signing the contract with CNI22, the Government decided, contrary to what had been agreed, to acquire power plants via the entity Puri Akraya Engineering Limited (Puri Akraya). The contract with CNI22 is currently being revised to reflect these changes.

1.5.1.3 Major investment projects - Purchase of electricity generators

The entity Puri Akraya Engineering Limited was contracted to build new generating electricity through direct award. The total amount of the contract amounted to \$352,569,123 USD.

Recommendation

The amendments to the contract with the entity Puri Akraya Engineering Limited must be formalized in accordance with the terms and conditions of contract.

1.5.1.4 Procedures for procurement of goods addressed to only one supplier

There have been several acquisitions, including contracts related to electricity distribution, whose associated process developed by the Ministry of Infrastructure has involved consultation with just one supplier. In many cases, the purchase of their property and their request was not initiated by EDTL.

Recommendations

- EDTL must have a procurement process that is independent of the Ministry of Infrastructure, being, however, in accordance with all aspects foreseen in decree-laws relating to procurement.
- The Ministry would maintain oversight through its role of governing EDTL, but not be involved, however, in day-to-day operations of this entity.
- While single-supplier procurement processes, can provide rapid and high quality solutions, allow access to known suppliers and promote local businesses, other processes that involve consultation with various vendors, as specified by applicable law, can create less expensive solutions.

1.5.1.5 Goods ordered and approved but not paid

In some cases, payments were not made to suppliers on receipt of invoice and supply of property. In the case of a supplier, for example, payment was processed with almost a year late, since the request for payment (CPV) was not authorized by the Ministry of Infrastructure, holding up release of funds.

Recommendation

- EDTL must have a procurement process that is independent of the Ministry of Infrastructure, being, however, in accordance with all aspects foreseen in ordinances relating to the supply.

- Provisionally, because of the critical importance of electricity supply in Timor-Leste, so that purchase orders are approved by EDTL, the corresponding process of acquisition should be immediately operated in the Ministry of Infrastructure. If the Ministry of Infrastructure cannot approve such purchase orders, EDTL management and supplier shall be notified promptly of the reasons for such impossibility.

1.5.1.6 Suppliers of high value transactions

The Terms of Reference for this work include:

- The examination of transactions for large amounts, as disclosed in the statement of receipts and payments for the period of 21 months ended September 30, 2010
- Review of business registration and ownership structure of suppliers of high value transactions

Annex L contains a list with details of the ownership structure of the main suppliers.

1.5.2 Receipts

1.5.2.1 Revenue collection and bad debts

EDTL has a billing system that operates only for customers located in Dili. Customers with credit risk still represent a problem, since many customers do not pay their bills. Only about 40% of commercial and governmental customers located in Dili pay their bills.

Additionally, there are important customers with unpaid bills from the years 2009 and 2010. Talks with EDTL Management revealed that the electricity supply was not cut off for customers with outstanding balances over 90 days old, once the program that allows for the interruption of electricity supply is not yet operating.

Recommendation

The Management of EDTL should give priority to the implementation of the program that allows cutting off the electricity supply. A program of cutting electricity supply to customers with unpaid bills, applied consistently, will encourage the adoption of a culture of "those who use should pay."

1.5.3 Fixed assets

1.5.3.1 Incomplete registration of fixed assets

The recent decentralization of fixed asset management requires that each ministry or agency be responsible to register, update and manage their fixed assets. The register of fixed assets of EDTL on December 31, 2009, is not sufficiently detailed. For example, it does not include the date of acquisition of the property, as well as its location and its cost. The register of fixed assets does not have enough information for proper registration of the goods and to prevent misappropriation of the same.

Recommendation

EDTL should include all the essential information of the assets in its fixed asset register, including:

- description of the property,
- acquisition date,
- category,
- type of asset,
- cost of the asset,
- location of the goods

1.5.3.2 Purchases of fixed assets not reconciled with the Freebalance

Purchases of fixed assets recorded in Freebalance not been reconciled with the additions of property in the register of fixed assets. As a result, there is the risk that the investments made by EDTL may not be included in FreeBalance and / or the register of fixed assets.

Recommendation

Purchases of fixed assets recorded in FreeBalance should be reconciled monthly with the additions of assets recorded in the register of fixed assets, with correction of any errors/omissions. An official with a leading position must sign and date the reconciliation as evidence of their review.

1.5.3.3 Physical counts of fixed assets

The staff has not made EDTL physical counts of existing fixed assets. Physical counts should be performed periodically to identify any missing or fixed assets in excess, since the goods may be lost, may change in location, to be sold or be misappropriated and remained still registered entries in the assets of EDTL and Government.

Recommendation

A physical count of all periodic fixed assets should be made to identify missing goods, surplus goods or unrecorded disposals/write-offs of fixed assets. Each counted item should be reconciled with the register of fixed assets. The fixed assets register should be updated to reflect the fixed assets held and if there are discrepancies, they should be investigated.

Section 4 details the situations identified and recommendations regarding internal controls and accounting procedures.

1.6 Business logic

The Government of Timor-Leste should consider the activity of EDTL following business logic. This will imply that the EDTL acts as an autonomous entity, with a greater degree of accountability to its stakeholders, including relevant government ministries and, in particular, their clients.

It is likely that EDTL will be subsidized by the Government in the coming years. Consequently, a business logic should assist the Government to implement processes that accurately capture the cost of the electricity sector. This will help the Government to determine appropriate tariffs and subsidies associated with the fund for future State budgets.

Key components of a business logic include:

- Service obligations to customers
- Management autonomy
- Performance management
- Pricing
- Asset Management
- Human resource management
- Capital structure

Recommendation

The Government should consider the activity of EDTL to follow business logic. The adoption of business logic is often a substantial reform initiative, and should be relevant to the requirements of the population and the Government of Timor-Leste.

See section 3.9 for more detail on the situations identified.

1.7 Follow the recommendations

Given the critical importance of the electricity sector for the development of Timor-Leste, a process should be implemented to monitor the adoption of these recommendations by the EDTL and the Ministry of Infrastructure.

The National Directorate of the Autonomous Public Authorities (DNAP) in the Ministry of Finance has implemented a process to monitor the recommendations made from previous reviews of the autonomous agencies. Annex N includes a template from DNAP to document the status of recommendations.

1.8 Recognition

We would like to take this opportunity to thank the management and staff of EDTL, the State Secretariat for Electricity, Water and Urbanization, the Director of Corporate Services of the Ministry of Infrastructure and the Directorate of the Ministry of Finance for their cooperation and assistance in course of this work.

Deloitte Touche Tohmatsu

April 7, 2011

Recommendations (extracted from the full text of the report)

3.1.1 Utilities Board

It is recommended to create a Utilities Board for the direction of the operations of EDTL.

3.1.2 Contract with Manitoba Hydro

- It is recommended to start immediately (in consultation with the Management of EDTL and the management contractor) working towards the formulation of the requirements of the contract management support that will come after the current contract.
- The Government should request a review of the contract, under which future contractual payments to Manitoba would become the key performance indicators (KPI). Listed below are specific opportunities to strengthen the results of the contract. Additional details are provided in Annex B.
 - **Review of key performance indicators:** Most of key performance indicators in the current contract or are too complex or lacking in definition. As a result, they do not add sufficient value in terms of performance measurement. Needs to develop a small number of key performance indicators that are measurable, to allow monitoring of the contract and be used to measure the incentive payments set out therein.
 - **Increase in the number of heads and supervisors:** EDTL this level needs to strengthen its organization, and the current management contract provides only for staff to Director level. Providing managers and supervisors by the appropriate contractor to carry out management will result in much fewer counterparts in the structure of EDTL, with significant benefits for the daily operations and development of competence within the EDTL. We estimate that more than 10 employees are required with the necessary language skills.
 - **Team of engineers:** The inclusion of a small team of engineers (up to 4 people) to carry out design tasks, project management and planning for small jobs, would improve the performance of the contract for EDTL. Currently, the directors of the entity contracted to perform management perform enough work where they are forced to “get their hands on” when that work could be done more efficiently by the appropriate personnel for these tasks.
 - **Procurement team:** If the Utilities Board delegates the functions of supply to the entity contracted to perform management in order to make the process more expedient, it becomes necessary to purchase a small team working together with the purchasing people of EDTL. It would take approximately four additional people. Much of this work will involve the monitoring of procurement processes created in the Ministry of Finance and will support the current global initiative of the Government in this area.
 - **Additional services director for the district and sub-district:** The additional director will be responsible for all aspects related to services provided outside of Dili EDTL (including Baucau). We draw attention to the fact that this application has already been submitted by the management contractor for approval.
 - **Change of scope in the event of privatizing generation:** should be allowed to decrease the scope so as to relieve / reduce the responsibilities of the contractor to carry out management in the event that a privatized generator (IPP) becomes operational.

In accordance with the contract, there shall be a review of the performance of the management contractor. Payments arising from the review should only be made after reviewing the contract between the Government and the contractor to manage.

3.2.1. Budget cuts

Sufficient funding should be provided to enable the achievement of the electrical supply, as established in Decree-Law No. 13/2003.

Additionally, the Secretariat of Electricity, Water and Urbanization should review, in conjunction with the Management of EDTL and the contractor to carry out management, budgets submitted by EDTL. This is because EDTL and the contractor to perform the management are in possession of technical and operational knowledge that formed the basis of the budgets submitted.

3.3. Fuel management

Because the contract to supply fuel currently in force has a short term basis, long term supply contracts should be

negotiated and awarded, in accordance with the procurement laws.

3.3.2. Agreements for fuel storage and delivery

The current fuel management system will change substantially as a result of current construction projects. Consequently, it is suggested the implementation of systems to replace parts of the sector. However, parts of the sector will continue to exist, and for new construction systems should be implemented to ensure that inventories of fuel are stored in secure facilities and that all fuel consumption is recorded based on valid documentation. An accounting process should be implemented that allows the movements and monitor fuel levels, the latter being supported by documentation for authorization of fuel consumption. Additionally, fuel measurements should be performed daily, which will be compared with records of fuel, to ensure that no unauthorized fuel consumption. Policies should be implemented to establish who within the EDTL can use fuel and for what purposes, and what restrictions, if any, existing at the level of such use.

3.3.3. Fuel Inventories

The Government should evaluate the possibility of maintaining its own strategic fuel reserves.

3.4. Electricity generation

It is recommended that EDTL be given authority to establish its own supply system independent of the Secretariat of Electricity, Water and Urbanization. Thus, they can purchase parts and materials efficiently. This system of supply will, in all material respects, conform to the relevant decree-law.

3.4.1. Comoro Power Station

It is recommended to undertake a review of items in Comoro plant to determine:

- The items that can be sold at market prices.
- Alternatively, if unsold, items which can be disabled safely and kept for possible future use, in case they will not be part of the new national electricity system.

3.4.2. Generation of electricity to the district capitals and sub-districts

It is recommended that all power stations of various districts and sub-districts be abandoned and demolished when no longer needed.

3.4.4. Operation and maintenance of the national transmission system

Should be taken into account the hiring, with the builder or other entity qualified to operate and maintain the lines for a period of five years after construction. After this period, EDTL should already have internally developed the skills necessary to perform these functions.

3.4.5. Connections between the new substations and currently existing 20 kV distribution systems

- It is recommended that, at all substations being built, urgent actions are undertaken with a view to planning and development of supply to connect between the nine new substations and 20 kV distribution feeders.
- It is recommended that the number of power circuit breakers will be reviewed on all new substations in order to determine whether they are adequate.

3.4.6. Interconnecting the Comoro power station and the national transmission system

It is recommended that the issue of interconnecting the Comoro power station to the national transmission system is resolved and that depending on the decision, appropriate actions are taken regarding the current proposed increase of 24 MW capacity at Comoro Power Station.

3.4.7. Reserve transformers for the 150/20 kV substations

It is recommended to obtain two reserve transformers 150/20 kV to be installed in new substations that are currently under construction.

3.5.1. The Electricity distribution network

These systems require, generally, attention in the following areas:

- Reviews and extensive repairs.
- Routine maintenance on a permanent basis.
- Continuous monitoring of tree growth, we identified a situation in which a proposed thinning of vegetation, which involved personnel and equipment for 6 months, was cancelled because of the prices asked were higher than the amounts approved / budgeted.
- Increase of transformers and low-voltage lines to improve the quality of electricity. Generally, the voltage fluctuations in networks of low-voltage far exceeds the levels of electrical appliances. This represents an additional burden for customers who thus bear the costs associated with electrical failure caused by low supply voltages and the poor performance of electrical appliances.
- Adding to systems to enable load increases.
- Improvements in high-voltage switchgear and protection mechanisms in most electric power plants.

3.5.2. Private sector involvement in the distribution network

- Suppliers should be appointed by EDTL and work directly under its supervision.
- When contracted local citizens do not meet industry requirements and have the necessary technical expertise, the Government should provide training and assistance in developing the local business community.

3.5.3. Transportation for distribution operations

EDTL must be provided with appropriate vehicles, and equipment that allows them to expand, repair and maintain the distribution lines. Additionally, a program of vehicles repair and maintenance should be implemented.

3.6.2. Measurement of service consumption

- Expanded facilities are associated with the prepayment (the availability of pulsa) to other areas outside of Dili, as well as install meters in the districts and sub-districts.
- It should be a planned policy to implement meters in compounds with multiple units, such as, for example, apartments and hotels.

3.6.3. Illegal connections

There should be an appropriate allocation of funds for the acquisition of concentric cable in order to permit completion of the "Rewiring" program. This program will reduce illegal connections and boost EDTL revenue.

3.6.4. Program for the reinstallation of meters

The current reinstallation of meters in Dili should extend to all districts and sub-districts, beginning with Baucau. The program should be supported by adequate funding and an educational campaign.

3.7.1. Training human resources

EDTL must continue to focus on implementing regular performance and strengthening a culture of performance.

Additionally, the Government must channel to EDTL a reasonable share of the budget related to human resources training. In accordance with Section 3.1.2, the role of contractor to manage the development of human resources training should be reviewed and, if necessary, implemented in accordance with the new contract.

3.7.2. Worker health and safety

EDTL should introduce a comprehensive health and safety policy, at a level corresponding to the minimum standards of the industry.

Additionally, there should be a campaign aimed to alert employees and society to the dangers of electricity.

3.8. Operating Systems

Continue to develop a set of revisions to systems and EDTL operational processes, to ensure that future operations are efficient. Such revisions should allow the identification of opportunities for improvement and, together with Management, the presentation of action plans to address any shortcomings. The following are examples of revisions that could be made:

- Storage, Spare Parts and Registration
- Tools & Test Equipment
- Communication Systems for Operations
- Safety Sites
- Safety Equipment and Clothing
- Health Systems and Safety at Work
- Staff Accommodation

3.9 Business Logic

The Government should explore the option of adopting a business logic for EDTL. The adoption of a business logic and, often, a substantial reform initiative, and should be relevant to the requirements of the population and the Government of Timor-Leste.

4.1.1. Governance: Audit of financial reports

An independent external auditor shall be appointed to audit the EDTL annual financial information.

4.2.1.1. Major Investment Contract for Construction of the national power station and its facilities

Contract

The contract with CNI22 must be renewed and, if necessary, changed as soon as possible to reflect:

- Removing the purchase of power plants on CNI22 and other changed circumstances.
- The inclusion of management services for power plants and the grid by the CNI22 after its construction. Since CNI22 will no longer build power plants, should be taken into account the need to change the terms and conditions of the contract that specify the role of this entity in plant management and network.

The amendments to the contract must be reviewed by the central procurement unit of the Ministry of Finance, in conjunction with engineering consultants Electroconsult & Bonifica S.p.A. (joint venture). This should ensure that there is consistency between the results specified in contracts with the entities Puri Akraya and CNI22.

Feasibility study

The Government should consider carrying out feasibility studies for larger projects. A feasibility study usually includes:

- A study of the systems
- A study of where development will occur
- An environmental study
- A review of strategic and service plans and a study plan
- An analysis of requirements for delivery of services and relationships
- The identification of viable options
- The evaluation of options
- The identification of the full scope of work
- An estimate of the capital cost of the options
- The implications of recurrent costs
- Drawings
- A review of methods of procurement
- Program implementation

4.2.3. Purchases without a public consultation process

- EDTL must have a procurement process that is independent of the Ministry of Infrastructure.
- While procurement processes directed to a single vendor can provide a high quality solution, allowing access to known suppliers and promote local businesses, other processes that involve consultation with various vendors,

as specified by applicable law, may lead to less expensive solutions.

4.2.4. Goods ordered and approved but not paid

- EDTL must have a procurement process that is independent of the Ministry for Infrastructure, which, however, must conform in all material respects, to the decree law related to procurement.
- Tentatively, because of the critical importance of electricity supply in Timor-Leste, so that purchase orders are approved by EDTL, the corresponding process of acquisition should be immediately operated in the Ministry of Infrastructure. If the Ministry of Infrastructure cannot approve such purchase orders, they should promptly notify the EDTL management and the supplier of the reasons for such impossibility.

4.2.5. Investigation of irregularities in procurement and payments

The appropriate authorities of Timor-Leste must decide whether that investigation warrants further investigation.

All documentation relating to each purchase process should be retained and stored securely, is available for inspection by any duly authorized person.

4.2.6. Referendum Package (*Pakote Referendum*)

The Secretariat of Electricity, Water and Urbanization must ensure that all payments are linked to budget lines. When such situations occur, it must ensure that an investigation is conducted and that appropriate actions are taken if there is a specific intent to circumvent the procurement process.

4.3.1. Revenue collection and bad debts

The Management of EDTL should give priority to the implementation of the program that allows them to interrupt the supply of electricity. A program of interruption of electricity supply to customers with unpaid bills, applied consistently, will encourage the adoption of a culture of “those who use should pay.”

4.3.2. Reconciliations of cash receipts

Staff of the EDTL financial department should carry out weekly cash reconciliations. The process should involve all of the cash balances held in branches of EDTL, the amounts in bank accounts and any amounts in transit, such as amounts not yet shown in cash or bank statements sent to processing or not yet registered. The reconciliations should be subject to a review by the top financial management in order to ensure that errors are identified and that the cash balances are regularly monitored.

4.3.3. Segregation of duties in respect of charges

The functions that involve the handling of receipts and updating of customer accounts should be performed by different officials. Additionally, to improve the segregation, the Commercial Directorate should regularly monitor the account balances of clients, thus ensuring that the balances are correct and that the collections process is properly started.

4.4.1. Salaries: People on the payroll without any official function

EDTL must ensure that all employees have a description of their duties, which is put in practice. Should continue to conduct regular reviews of employees who are on the EDTL payroll in order to identify, authenticate and reconcile any additions and deletions that have been made by the Government.

4.4.2. Payslips not issued to employees

A process should be implemented that allows employees to receive their monthly pay stubs detailing the salary and any additional allowances and deductions made.

4.4.3. Verification of time sheets

EDTL should install as soon as possible, the fingerprint machines.

4.5.1. Absence of a formal policy/ manual for fixed assets

A handbook of fixed assets should be prepared with clear guidelines on the registration process and management of fixed assets

4.5.2. Incomplete registration of fixed assets

EDTL must include all essential information about its goods in the registry of fixed assets, namely:

1. description of the property,
2. acquisition date,
3. category,
4. type of asset,
5. cost of the asset,
6. location of the property

4.5.3. Purchases of fixed assets not reconciled with Freebalance

Purchases of fixed assets recorded in Freebalance should be reconciled monthly with the additions of assets recorded in the register of fixed assets, and any errors / omissions corrected. A supervisor must sign and date the reconciliation as evidence of their review.

4.5.4. Physical counts of fixed assets

A periodic physical count of all fixed assets should be made so that unrecorded missing goods, surplus goods or disposals / write-offs of fixed assets can be identified. Each item must be fully reconciled with the register of fixed assets. The fixed assets register should be updated to reflect the fixed assets held and if there are discrepancies, they should be investigated.

4.5.5. Review of records of fixed assets

The register of fixed assets should be regularly reviewed by an independent official with management rank, who must sign and date a copy of the record as evidence of their review.

4.6.1. Financial Reporting: Absence of a reporting structure

The reporting structure for EDTL should be defined with the shortest possible time.