

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

INDEPENDENT AUDITOR'S REPORT
ON INTERNAL ACCOUNTING CONTROL

YEAR ENDED SEPTEMBER 30, 1989

INDEPENDENT AUDITOR'S REPORT ON INTERNAL
ACCOUNTING CONTROL

Honorable Yosiwo George
Governor
State of Kosrae

We have audited the general purpose financial statements of the State of Kosrae as of September 30, 1989, and for the year then ended, and have issued our report thereon dated March 20, 1990. These general purpose financial statements are the responsibility of Kosrae State's management. Our responsibility is to express an opinion on these general purpose financial statements based on our audit.

Except as described in the aforementioned report, we conducted our audit in accordance with generally accepted auditing standards and the standards for financial and compliance audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements and whether management has complied with laws and regulations and has established and maintained a system of internal controls. An audit in accordance with these standards includes examining, on a test basis, evidence supporting the amounts and disclosures in the general purpose financial statements and compliance with laws and regulations. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

For the purpose of this report, we have classified the significant internal accounting controls of the State of Kosrae in the categories of: budgetary cycle, revenue and receipt cycle, purchases and disbursement cycle, payroll and personnel cycle, treasury cycle, and external financial reporting. The purpose of our study and evaluation was to determine the nature, timing and extent of the auditing procedures necessary for expressing an opinion on the financial statements administered by the State of Kosrae. Our study and evaluation was more limited than would be necessary to express an opinion on the system of internal accounting control taken as a whole or any of the categories of controls identified above.

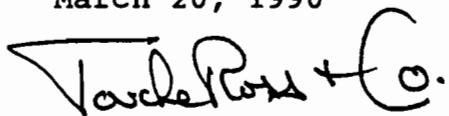
The management of the State of Kosrae is responsible for establishing and maintaining a system of internal accounting control. In fulfilling this responsibility, estimates and judgements by management are required to assess the expected benefits and related costs of control procedures. The objectives of a system are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with statutory authorizations and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any system of internal accounting control, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the degree of compliance with the procedures may deteriorate.

Our study and evaluation made for the limited purpose described in the first three paragraphs would not necessarily disclose all material weaknesses in the system. Accordingly, we do not express an opinion on the system of internal accounting control of the State of Kosrae, taken as a whole or on any of the categories of controls identified in the third paragraph. However, our study and evaluation disclosed conditions set forth in the following pages that we believe result in more than a relatively low risk that errors or irregularities in amounts that would be material in relation to the financial statements of the State of Kosrae, may occur and not be detected within a timely period.

These conditions were considered in determining the nature, timing and extent of the audit tests to be applied in our audit of the 1989 financial statements, and this report does not affect our report on the financial statements dated March 20, 1990.

This report is intended solely for the use of the State of Kosrae, the National Government of the Federated States of Micronesia, and the cognizant audit and other federal agencies and should not be used for any other purpose.

March 20, 1990

A handwritten signature in dark ink, appearing to read "Touche Ross & Co.", written in a cursive, stylized script.

Certified Public Accountants

Prior Year Internal Control Findings

1. CRITERIA: Findings from the Report on Internal Controls for the year ending September 30, 1988, should be adequately resolved by Kosrae State management.

CONDITION: The following findings from the Report on Internal Controls for the year ending September 30, 1988, were found not to be resolved during the audit of the period ending September 30, 1989:

<u>Page No.</u>	<u>Findings No.</u>	<u>Description</u>
4	1	Prior Year Internal Control Findings; September 30, 1987 Report on Internal Controls.
8	4	Journal Vouchers-Authorization
10	6	Procurement
11	7	Cash Reconciliation
13	9	Monitoring Trust Funds
15	11	Insurance Coverage
16	12	Payroll
17	13	Revenue Collection
18	14	Internal Reporting Requirements

CAUSE: Unknown.

EFFECT: The nonresolution of these prior year findings will continue to hinder the effective maintenance of the State's accounting records.

RECOMMENDATION: Kosrae State management should take action to resolve these prior year audit findings.

Expenditure Classification

2. CRITERIA: Expenditures should be classified in the State's accounting records based on the nature of the transaction. This proper accounting classification will allow for effective period to period comparative analysis.

CONDITION: Currently, the following account classification structure is used at both the budgetary and accounting levels:

Personnel
Travel
POL
Equipment
All Others

We found numerous transactions recorded as 'all others' that could have been classified more specifically; especially procurement of capital equipment and contractual services.

CAUSE: Since the budgetary amounts are established based on the above account structure, the recording of expenditures should follow the budget structure.

EFFECT: The effect of utilizing a minimal classification structure distorts period to period comparisons of expenditures by account which may hinder an effective annual budget development process.

RECOMMENDATION: It is recommended that a broader account classification structure be utilized to allow for more detailed period to period analytical comparison.

Travel Advance Balances

3. CRITERIA: Travel advance receivable balances should be reported at their realizable value in each fund.

CONDITION: Year end travel advance balance analysis for the years ending September 30, 1989 and 1988, for selected funds is as follows:

<u>Fund</u>	<u>1989</u>	<u>1988</u>
State Revenue Fund	\$ 76,491	\$ 36,973
221 (b) Compact Special Block Fund	23,546	7,128
U.S. Federal Grants Fund	95,331	57,879

Based on review of the accounting activity in these accounts and subsidiary detail for the State Revenue Fund, there appears to be minimal credit entry activity to these control accounts resulting in inflated ending debit balances.

CAUSE: It appears the automated accounting system is not completely conducive to recording travel advance transactions. The initial entry to record the advance receivable is off-set by a credit to accounts payable. The traveler's advance check is recorded by debiting accounts payable and crediting cash. This initial sequence is required to utilize the check writing process within the CAPPS accounts payable subsystem. Upon return of the traveler, the initial entry to the advance receivable should be liquidated through a reversing entry process but it appears that this entry is not being completed.

EFFECT: An overstatement of travel advance receivable asset balances occurs.

RECOMMENDATION: It is recommended that State management review the travel advance entry process and seek external assistance, if necessary, to ensure that transactions are recorded properly.

Payroll Ceiling

4. CRITERIA: All departments should comply with personnel ceilings established by the comprehensive budget act for the respective fiscal year.

CONDITION: One instance of a department exceeding the statutory ceiling was discovered. The Office of Personnel and Employment Services exceeded its ceiling of five by two employees in pay period 23.

CAUSE: Unknown.

EFFECT: Potential noncompliance with budgetary ceilings occurs.

RECOMMENDATION: It is recommended that departments comply with budgetary ceilings.

Control of Checks

5. CRITERIA: Blank checks should be safely stored in a secure place out of reach of unauthorized personnel.

CONDITION: Blank checks are stored in the computer room which is locked over night. During office hours, the computer room is open and blank checks are not secure.

CAUSE: Unknown.

EFFECT: Possible unauthorized use of funds could occur.

RECOMMENDATION: A separate locked cabinet should be procured to store unused checks.