

POHNPEI STATE GOVERNMENT
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 Resio S. Moses
Governor
State of Pohnpei

We have audited the general purpose financial statements of the State of Pohnpei as of September 30, 1989, and for the year then ended, and have issued our report thereon dated March 16, 1990. These general purpose financial statements are the responsibility of Pohnpei 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.

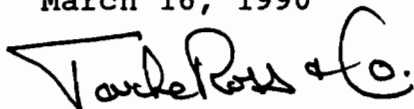
For the purpose of this report, we have classified the significant internal accounting controls of the State of Pohnpei in the categories of: budgetary cycle, revenue and receipt cycle, purchases and disbursement cycle, payroll and personnel cycle, treasury cycle, and external financial reporting. The 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 Pohnpei. 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 Pohnpei, 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 Pohnpei, taken as a whole or on any of the categories of controls identified in the third paragraph. However, our study and evaluation disclosed no condition that we believe to be a material weakness.

This report is intended solely for the use of the State of Pohnpei, 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 16, 1990



Certified Public Accountants

Prior Year Outstanding Findings

1. **CRITERIA:** Findings reported in the report on Internal Control for fiscal year ended September 30, 1988 should be resolved.

CONDITION: The following findings and recommendations remain unresolved as set forth in the Report on Internal Controls for the fiscal year ended September 30, 1988, dated May 5, 1989.

Fiscal Year 1987

<u>Findings No.</u>	<u>Description</u>	<u>Page No.</u>
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Fiscal Year 1988

4	Inventories	6
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CAUSE: Unknown.

EFFECT: The effect is the same impact on the financial statements in fiscal year 1989 as indicated in fiscal year 1988

RECOMMENDATION: Prior year findings should be resolved.

AUDITEE RESPONSE:

FISCAL YEAR 1987

Utilities Division Billings and Sub-Ledger

As of the date of this reply, our Tax & Revenue Division is now implementing both of the above on our main computer system.

Journal Voucher Documentation

The organizational problem largely responsible for this finding has been corrected since January of 1989.

FISCAL YEAR 1988

Travel Advances - The reconciliation of travel advances is one of the few remaining problems in the Department of Treasury and we expect to reconcile this problem during FY90.

Cash Reconciliations

2. CRITERIA: Sound internal controls over cash balances include the timely preparation of monthly bank reconciliations and effecting any required adjustments to the general ledger cash balances.

CONDITION: Although improvement was evident in the preparation of year end bank reconciliations our review of controls over cash noted monthly bank reconciliation adjustments were not made to general ledger cash balances.

CAUSE: Unknown.

EFFECT: The effect is the lack of timely and reliable financial information from which to make sound financial decisions.

RECOMMENDATION: It is recommend that monthly bank reconciliations be prepared on a timely basis and any required adjustments be reflected in the general ledger cash balances of the automated accounting system.

3. CRITERIA: When assets at a department are no longer to be used by that department, the assets should be transferred to a holding area pending ultimate disposition.

CONDITION: Departments informed the Real Personal Property Management Division (RPPM) of unnecessary assets by memorandum. However, RPPM did not take action to remove these assets from the requesting department.

CAUSE: RPPM does not have established guidelines with respect to dealing with such property.

EFFECT: A possible overstatement of fixed assets occurs and assets do not appear to be utilized to the maximum possibility.

RECOMMENDATION: Guidelines should be established concerning disposal procedures for assets no longer required by departments.

AUDITEE RESPONSE: The finding implies that it is the fault of Treasury's RPPM section that unused assets are not removed from offices for sale or disposal. In Pohnpei's Public Contracts and Property Management Regulations, it is clearly stated in Section 179 that this is the responsibility of the respective office.

Contracts

4. CRITERIA: Public Contracts and Property Management Regulation Section 128 states that capital improvement contracts are to be approved by the State Contract Review Board.

CONDITION: Based on a sample of ten contracts, selected for audit testing one contract, number C90044 Power Improvement Upgrade, lacked evidence of approval by the State Contract Review Board. Based on audit interpretation of the nature of transactions performed under this contract it was interpreted as a Capital Improvement Contract and therefore should be subject to scrutiny and approval by the State Contract Review Board.

CAUSE: The State interpreted the contract to be a service contract. Under Section 128, service contracts do not require review by the State Contract Review Board.

EFFECT: The effect is possible non-compliance with public contracts and property management regulations.

RECOMMENDATION: Adherence should occur with contract regulations.

AUDITEE RESPONSE: Treasury agrees that the contract in question (C90044) should have been reviewed by the Contract Review Board, which was bypassed in this case. We refer this finding to the Department of Public Works for comments.

5. CRITERIA: The State's Financial Management Regulations dictate that disbursements exceeding the amount of \$5,000 be competitively bid or have this requirement waived by the governor pursuant to Section 22 of the public contracts and property management regulations.

CONDITION: Based on our audit procedures performed it appears that the following transactions were not appropriately bid or no evidence of the governor's waiver was available:

<u>Description</u>	<u>APV/Check/Contract #'s.</u>
1. Procurement of Medical Supplies from various vendors	APV's - 908837, 908589, 911062, 90638, 90572, 90613, and 902069
2. Procurement of copier for Department of Education	APV - 901201
3. Procurement of educational supplies by the Department of Education	APV - 907993 Check - 37792
4. Procurement of supplies and materials	APV's - 907439 and 910194

CAUSE: Unknown.

EFFECT: The effect of this condition is potential non-compliance with competitive bidding requirements under the State's Financial Management Act.

RECOMMENDATION: It is recommended that compliance with adopted financial management regulations be maintained. It is also recommended that the State Public Auditor examine further the current procurement procedures.

AUDITEE RESPONSE:

1. Obtaining comparative pricing for medicine; purchases is a chronic problem, we refer this to the Department of HSS for reply.

2. The Department of Education has represented attached to the requisitions that the machine to be purchased was chosen by their own comparative prices. We therefore ask that the Department provide the documentation.

Cash Receipts - Economic Development Authority

6. CRITERIA: Timely deposit of receipted funds should occur.

CONDITION: A deposit occurring on February 23, 1989 included receipts issued on February 10, 1989.

CAUSE: Cash receipts were not timely deposited.

EFFECT: Cash receipts were not timely deposited.

RECOMMENDATION: All receipts should be banked on a timely basis.

Cash Disbursement - Economic Development Authority

7. CRITERIA: The purchase of fish for resale must be recorded in EDA's books as purchases rather than as advances receivable.

CONDITION: Purchases of fish for resale are being recorded as an advance receivable from employees.

CAUSE: The accountant was not aware of the correct manner of recording these transactions.

EFFECT: Overstatement of the advance receivable and understatement of the purchase account occurs.

RECOMMENDATION: All purchases of fish for resale should be recorded as purchases.

Cash Receipts - Economic Development Authority

8. CRITERIA: The numerical sequence of receipts is to remain intact which ensures proper allocation and receipting of funds.

CONDITION: The numerical sequence of receipts was not continuous. Missing receipts occurred on January 25, 1989, February 23, 1989, April 26, 1989, May 17, 1989, and September 18, 1989.

CAUSE: Unknown.

EFFECT: It is possible that these receipts were unrecorded. Therefore, a possible misstatement of the financial statements may have occurred.

RECOMMENDATION: Numerical sequences of receipts should remain intact to ensure that all receipts are adequately accounted for .

Interest Assessment - Pohnpei State Housing Authority (PSHA)

9. CRITERIA: Interest should be calculated on the outstanding loan balance rather than on an amount that has not yet been disbursed to the borrower.

CONDITION: Loan repayment commences 30 days after the execution of the loan agreement. Interest however is assessed on the loan amount granted rather than on the amount the borrower has actually borrowed (which is the sum of actual purchases of housing material and labor as of any given date).

CAUSE: This has been the procedure at the Housing Authority.

EFFECT: This practice has caused interest income to be overstated on the Authority's books. However, interest recorded as of September 30, 1989 has an immaterial effect on the financial statements as a whole.

RECOMMENDATION: We strongly recommend that PSHA cease such practice and follow acceptable methods of calculating interest earned on loans.

Postings to Loan Subsidiary Ledgers - Pohnpei State Housing Authority

10. CRITERIA: A visible audit trail should be provided with respect to posting cash collections to respective loan accounts.

CONDITION: We were not able to trace the detail of collections of allotments from State Finance to the respective loan receivable ledgers.

CAUSE: No cash summary or cash collection recap form is used.

EFFECT: Misposting of loan repayments to the loan receivable sub-ledger accounts can occur.

RECOMMENDATION: We recommend that PSHA utilize daily cash recap forms so a visible audit trail can be provided with respect to verification of loan repayment postings to sub-ledger accounts.

Timely Deposits of Cash - Pohnpei State Housing Authority

11. CRITERIA: A functioning internal control system requires cash collections be deposited in a timely manner.

CONDITION: Daily cash collections were not deposited on a timely manner on two separate occasions.

CAUSE: Cash receipts were not timely deposited.

EFFECT: Non-deposit of cash can lead to lost interest income and makes it difficult to ensure that all cash is actually deposited.

RECOMMENDATION: We strongly recommend that daily cash collections be deposited in a timely manner.

Pohnpei State Housing Authority

12. CRITERIA: Cash collections should be tracable to the deposit made in the applicable bank account.

CONDITION: We were not able to trace cash collections per the cash receipts to the applicable bank deposits.

CAUSE: Because of the numerous bank accounts utilized by the Authority, cash collections under the Pohnpei State Legislature Loan Fund appear to be erroneously deposited in a different loan fund bank account. In addition, cash receipts issued are not in numerical sequence to allow amounts of cash receipts to be agreed to applicable deposits.

EFFECT: An understatement of the cash in bank per the Pohnpei State Legislature Fund bank account occurred. However, this was offset by an over statement in another bank account.

RECOMMENDATION: Since all current bank accounts are mainly for loan purposes, it appears that only one bank account is necessary. The use of one cash account will also alleviate current concerns relative to the need to reconcile numerous bank accounts.