CUSTOMS & TAX AUDIT
FISCAL YEAR 2005
AUDIT NO. 2006-02

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National Public Auditor
EXECUTIVE SUMMARY

ABOUT THE ADMINISTRATION OF CUSTOMS & TAX
The Division of Customs & Tax Administration (CTA), within FSM Department of Finance and Administration (DoF&A), was created pursuant to Title 54 of the FSM Code. Its primary responsibilities are to maximize tax collections; ensure compliance with all national tax laws; and offer recommendations for amendments to such laws, when appropriate. The FSM DoF&A’s Division of National Treasury (the Treasury) is responsible for the recording and distribution of customs and tax revenue shares to the State and National Governments. The Secretary of the DoF&A is required to comply with the Customs Act of 1996, the Financial Management Act of 1979, and the DoF&A’s Finance Office Procedures in managing, collecting, recording, and distributing customs and tax revenues to the National and State Governments.

FINDINGS

❖ Customs and tax cash collections are not consistently deposited to the bank in a timely manner by the CTA Field Offices. In addition, the CTA Field Offices’ collections are not consistently receipted, recorded, and deposited to the bank by the Treasury in a timely manner.

❖ There is a lack of proper monitoring and oversight of the CTA collections by the Treasury; thereby, causing discrepancies between the CTA collections and the Treasury’s General Ledger records. As a result, remittances of state revenue shares are not made in a timely manner.

RECOMMENDATIONS

✔ All collections of customs and tax revenues should be promptly deposited to the bank or the Treasury. In addition, clear policies and procedures should be put in place to ensure that collections are deposited in tact and that they are timely. These policies and procedures should indicate the oversight responsibilities with respect to the timely depositing of cash collections.

✔ The Divisions of CTA and Treasury should perform frequent reconciliations of CTA collections with Treasury’s records in the General Ledger. In addition, clear policies and procedures should be put in place to ensure that all collections are receipted and recorded immediately upon receipt of the information from the CTA Field Offices. These policies and procedures should indicate the oversight responsibilities with respect to timely receipts, accounting, and reconciliation of customs and tax collections.
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INTRODUCTION

BACKGROUND

The Division of Customs & Tax Administration (CTA), within FSM DoF&A, was created pursuant to Title 54 of the FSM Code. Its primary responsibilities are to maximize tax collections; ensure compliance with all national tax laws; and offer recommendations for amendments to such laws, when appropriate.

The Secretary of the DoF&A has the ultimate accountability of the customs and tax functions with respect to collections, compliance, accounting, and revenue shares to the Governments. The Assistant Secretary for CTA, who is the head of the Division, is responsible for the oversight and general operations of the Division. Reporting to the Assistant Secretary are the Manager of the Compliance Branch, the Manager of the Document Processing Branch, and four Deputy Assistant Secretaries located at each State CTA Field Office. Support staff includes nine personnel at the CTA Central Office in Palikir and thirty at the four Field Offices as of fiscal year 2005.

The CTA Division has two main functions of Customs and Tax both of which share the same Field Offices in Chuuk, Kosrae, Pohnpei, and Yap. Each field office is headed by a Deputy Assistant Secretary, tasked with the management of the daily activities. The Deputy Assistant Secretaries report to the Assistant Secretary.

1. **Tax Administration** is comprised of the Compliance, Document Processing, and Collection Branches. The Compliance and Document Processing Branches are located at the CTA Central Office in Palikir and each area is headed by a Branch Manager. The Collection Branch is located within the CTA Field Offices in each of the States.

   A. **The Compliance Branch** is responsible for planning and conducting annual audits of taxpayers’ records for compliance with appropriate laws and determining the accuracy and completeness of taxpayers’ tax returns.

   B. **The Document Processing Branch** receives daily and monthly cash collection reports from the Field Offices and reviews tax returns for accuracy and completeness. The Branch also processes income tax refunds, maintains taxpayers' returns, relevant documentation, and files.

   C. **The Collection Branch** monitors the filing of tax returns and payments; processes tax returns from delinquent taxpayers; updates tax rolls (taxpayer list) periodically; solicits tax returns from late filers; collects tax payments and deposits all collections to the banks/Treasury; and prepares daily/monthly activity reports for transmittal to the CTA Central Office and the Treasury.
2. **Customs Administration** includes a Customs Specialist and a Customs Analyst. Eighteen other support staff, consisting of Customs Inspectors and Customs Officers, are employed at the Field Offices. Its general responsibilities include:

   A. Inspection at ports of entry, assessment, and collection of taxes on goods and merchandise imported into the FSM by sea or air; and

   B. Prevention of prohibited goods of merchandise imported into the FSM.

In addition to the customs and tax responsibilities at the CTA, the Treasury has the responsibility of receipting, recording, and distributing revenue shares to all the State Governments. Upon receipt of revenues from the CTA Field Offices, the Treasury applies the applicable revenue share formulae, based on revenue type classifications and applicable rules, regulations, and laws and are reflected in the General Ledger. The Treasury is required to remit the States’ revenue shares on a monthly basis.
AUDIT SCOPE AND OBJECTIVES

A. SCOPE

Our audit scope covered fiscal year 2005 from October 1, 2004 to September 30, 2005. However, gathering of relevant information may include previous and subsequent years for analytical purposes. The audit was conducted pursuant to Title 55 FSMC Chapter 5, which states in part:

The Public Auditor shall inspect and audit transactions, accounts, books, and other financial records of every branch, department, office, and agency, board, of the National Government and of other public legal entities, including, but not limited to, States, subdivisions thereof, and nonprofit organizations receiving public funds from the National Government.

We performed this audit in accordance with Generally Accepted Government Auditing Standards issued by the Comptroller General of the United States and included tests of records, transactions, and other auditing procedures that we considered necessary under the circumstances.

The audit evaluated the Divisions of Customs & Tax Administration and the Treasury’s compliance relative to the Customs Act of 1996\(^1\) and the Financial Management Act of 1979\(^2\) as amended regarding the ongoing management of customs and tax revenue collections, reporting, and distribution of States revenue shares for the fiscal year 2005. The audit fieldwork was conducted at the CTA Central Office in Palikir, the Division of Treasury, and at the CTA Field Offices in Chuuk, Kosrae, Pohnpei, and Yap. The audit was conducted pursuant to Title 55 FSMC Chapter 5 of the FSM Code.

The Secretary of the DoF&A is responsible for the overall management of customs and tax revenue collections, reporting, and distribution of the States’ revenue shares in accordance with the standards and procedures outlined in the Customs Act of 1996 as amended; Financial Management Act of 1979 as amended; the Financial Management Regulations; and the FSM Finance Operating Procedures.

B. AUDIT OBJECTIVES

The objectives of the audit are to determine that:

a. Customs and tax revenue collections are reported and accounted for in a timely manner;

b. Customs and tax revenue distributions to the Governments (four State Governments and the National Government) are accurate and timely; and

c. Year-end accruals of customs and tax revenue and payables to the State Governments are accurate.

\(^1\) The CTA Standard Operating Procedures (SOP) and DoF&A Finance Office Procedures are the related policies and procedures.

\(^2\) The Financial Management Regulations (FMR) are the related regulations.
C. METHODOLOGY

We obtained documents and reports related to the CTA cash collections such as bank deposits, Treasury receipt and accounting of the cash collections, tax refunds, remittance of States revenue shares, customs and tax year-end accruals, and receipt books from the CTA Central Office, CTA Field Offices, and the Treasury. We also interviewed and gathered data to accomplish related analysis in order to achieve our objectives.

Additionally, we conducted fieldwork based on random sample selections at the CTA Field Offices, CTA Central, and the Treasury to validate our analysis.

Finally, we summarized the results of our audit procedures as completed.

D. PRIOR AUDIT COVERAGE

The Office of the National Public Auditor (ONPA) performed a prior audit of the CTA in 2005, which covered the period from October 1, 2003 to September 30, 2004. The Audit Report (#2005-05) was issued on March 10, 2006. Management concurred with our findings and recommendations and due to the short time since the issuance of the FY2004 audit, management did not have time to adequately implement the recommendations included in the report. Unresolved findings are reiterated in this report.

E. CONCLUSION

Based on our audit, we concluded that:

- Customs and tax revenue collections are not reported and accounted for in a timely manner; and
- Distributions of customs and tax revenue shares to the Governments are untimely.
- Year-end accruals of customs and tax revenue and payables to the State Governments are accurate.

We have offered recommendations in order to address each of the specific findings included in the following pages.
FINDINGS & RECOMMENDATIONS

FINDING #1 - Discrepancies Between CTA and Treasury Records
(Division of the National Treasury and Customs & Tax Administration)

Criteria: All customs and tax collections should be promptly and accurately receipted and recorded in the General Ledger maintained by the Treasury.

Condition: Our analysis of the CTA cash collections and the Treasury General Ledger receipts indicated a variance of approximately $548,995. For example, during our review of the cash collections receipted at the Treasury, we found that a tax settlement for $458,572 that was receipted and recorded in the General Ledger was not reflected in the CTA records. This finding of discrepancies was identified in a prior ONPA audit.

Cause: Cash collections received, receipted and recorded in the General Ledger at Treasury are not adjusted in the CTA records.

Effect: As a result, the Customs and Tax collection records as reflected in the General ledger at the Treasury and the CTA records cannot be reconciled. Inaccurate customs and tax information could be provided to and relied upon by the National and State Governments.

Recommendation:
The Secretary of Finance and Administration or his designee should ensure that:

(A) The Divisions of CTA and Treasury perform frequent reconciliations of the CTA collections with the Treasury’s records in the General Ledger. This should be a collaborative effort between the Divisions of the CTA and the Treasury.

(B) Clear policies and procedures are put in place to ensure that collections are receipted and recorded immediately and the same receipts be adjusted in the CTA records in a timely manner. These policies and procedures should indicate the oversight responsibilities with respect to the timely receipt, accounting and reconciliation of customs and tax collections.

Auditee’s Response:

We acknowledge and note this finding. As indicated in our response to the CTA audit of fiscal year 2004, the procedures introduced on November 1, 200[5], quickly identified if there is a delay in receipting at the National Treasury in Palikir. Appropriate measures have been instituted to identify and follow up on delays and any failures in submitting reports in a timely manner. National Treasury performs monthly reconciliation of General Ledger with
CTA records for monthly collections and we will continue to expand on existing procedures to account for tax collection data for both in CTA records and the Treasury General Ledger.
FINDING #2 - Untimely Remittance of Revenue Shares to the State Governments

(Division of the National Treasury and Customs & Tax Administration)

Criteria: Customs and tax revenue distributions to the State Governments should be accurate and timely (Procedure 9 of the Finance Office Procedures).

Condition: The state government’s revenue shares were remitted past the anticipated fifth day of the subsequent month by an average of eight (8) business days. The table below indicates the overall significant delays from the time the customs and tax revenues were collected at the CTA Field Offices to the time the revenue shares are remitted to the state governments by the Treasury.

<table>
<thead>
<tr>
<th>Percentage of Remitted Amounts Late</th>
<th>Minimum Late Days</th>
<th>Maximum Late Days</th>
<th>Average Late Days</th>
</tr>
</thead>
<tbody>
<tr>
<td>68 %</td>
<td>1</td>
<td>86</td>
<td>8</td>
</tr>
</tbody>
</table>

This finding of untimely remittances was identified in a prior ONPA audit.

Cause: There is an absence of clearly established procedures or guidelines by the Secretary of Finance and Administration for the remittance of revenue shares to the State Governments. Additionally, the untimely receipt and accounting of customs and tax collections by Treasury contributes to the late remittances.

Effect: As a result, there are delays in the remittances of $7,623,555.57 or 68% of customs and tax revenue to the respective State Governments.

Recommendation:
The Secretary of Finance and Administration or his designee should ensure that:

(A) Clear policies and procedures are put in place to ensure that collections are receipted and recorded immediately upon receipt of the information from the CTA Field Offices. These policies and procedures should indicate the oversight responsibilities with respect to the timely receipt and accounting of customs and tax collections.

The Divisions of CTA and Treasury perform frequent reconciliations of the CTA collections with the Treasury’s records in the General Ledger. This should be a collaborative effort between the Divisions of the CTA and the Treasury.

Auditee’s Response:
The procedures in place since November 1, 2005, make the reconciliation of Treasury records with CTA reports easier and quicker thus enabling in a more timely distribution of the revenue sharing with the States. It is to be noted that experience at Kosrae, where
General Ledger data is submitted to Palikir monthly, has shown that to achieve the fifth day distribution deadline, it is necessary for the data to be forwarded to Palikir about two days before the month ends. This leads to reconciliation problems. With the imminent move of Yap and Chuuk to a similar reporting arrangement as Kosrae, this problem will escalate. Accordingly, the procedures relating to the revenue sharing distribution may need to be amended to require revenue sharing distribution by the tenth working day of the month following the month of collection.
FINDING #3 - Untimely Deposit of CTA Collections to the Bank or the Treasury
(Customs & Tax Administration)

Criteria: All CTA cash collections should be deposited to the bank by the end of the next business day (FMR 1.6).

Condition: Based on the sample we reviewed, we found that cash collections for three (3) days or 8.8% in Chuuk, four (4) days or 11.8% in Yap, and eleven (11) days or 29.7% in Pohnpei were not deposited to the bank or the Treasury in a timely manner. This finding of untimely deposits was identified in a prior ONPA audit.

Cause: The Field Offices did not consistently comply with the cash deposit requirements. As for Pohnpei CTA, the current requirement to transport and deposit the physical cash collections from their office in Kolonia to the Treasury at Palikir partially contributed to this condition.

Effect: The untimely deposit of cash collections causes late receipt, accounting, and the eventual remittance of customs and tax revenues to the Governments. The untimely deposit of cash collections could potentially expose physical cash to theft, misuse, or fraud. Based on our sample, customs and tax collections totaling $22,693.86 for Chuuk, $4,525.75 for Yap, and $367,002.43 for Pohnpei were not deposited to the bank or the Treasury in a timely manner.

Recommendation:
The Secretary of Finance and Administration or his designee should ensure that:

(A) All collections of customs and tax are deposited to the bank or the Treasury pursuant to applicable policies and procedures.

(B) Clear policies and procedures should be put in place and consistently enforced to ensure that collections are deposited in tact and that they are timely. These policies and procedures should indicate oversight responsibilities with respect to the timely deposit of cash collections.

Auditee’s Response:

This finding is noted. CTA Central Office will closely monitor its field offices to ensure that daily collections are accounted for and collection reports transmitted to the National Treasury field offices in Kosrae, Chuuk and Yap in a timely manner for verification and deposit in the

\(^3\) Unlike the Chuuk, Kosrae, and Yap CTA Field Offices that are required to deposit their cash collections to the bank by the next business day, the Pohnpei CTA Field Office is required to deposits their cash collections to the Treasury by the end of each business day.
bank pursuant to “Collected Cash and Checks Accounting and Daily Deposit Procedures” in effect as of November 1, 2005. The Assistant Secretary for CTA is currently reviewing the effectiveness and practicality of the existing procedure for Pohnpei field office, in which it physically transports to and deposit daily cash collections at Treasury in Palikir.
FINDING #4 – Collections Received by Treasury Are Not Deposited to the Bank in a Timely Manner

(Division of the National Treasury)

Criteria: All cash collections by the Treasury shall be deposited to the National Government bank accounts by the end of the next business day (FMR 1.6).

Condition: Based on the sample we reviewed, we found that thirty-one (31) or 51.7% of the Pohnpei CTA collections deposited at the Treasury were not deposited promptly to the bank by the Treasury. This finding of untimely deposits to the bank was identified in a prior ONPA audit.

Cause: There is a lack of high-level oversight of Treasury receipts to ensure that all collections are deposited promptly to the bank.

Effect: The untimely deposits of cash collections results in delays in the accounting and ultimate remittance of customs and tax revenue to the State Governments. The untimely deposit of cash collections could potentially expose physical cash to theft, misuse, or fraud. Based on our sample, approximately $1,919,266.78 of customs and tax collections by the Pohnpei Field Office were not timely deposited to the bank.

Recommendation:
The Secretary of Finance and Administration or his designee should ensure that:

(A) All collections of customs and tax revenues are promptly deposited to the bank.

(B) Clear policies and procedures are put in place to require that collections are deposited in tact and are timely. These policies and procedures should indicate oversight responsibilities with respect to the timely deposits of cash collections.

Auditee’s Response:

Staff at the National Treasury remained at work until the Pohnpei field office lodge daily collections at Palikir. Treasury staff deposits collections on the same day or the next working day. This practice is in line with the provisions of the FSM National Government Financial Management Regulations.
FINDING #5 - Untimely Receipt and Accounting of CTA Revenue by the Treasury
(Divisions of the CTA and National Treasury)

Criteria: All CTA collections deposit slips and related support documentation must be promptly submitted to the Treasury where all collections shall be receipted, accounted for, and reflected in the General Ledger in a timely manner.

Condition: CTA Field Offices’ cash collections that are deposited to the bank are not receipted by the Treasury in a timely manner. The table below indicates the overall significant delays from the time these cash collections are deposited to the bank by the Chuuk, Kosrae, and Yap CTA Field Offices to the time they are receipted and accounted for by the Treasury:

<table>
<thead>
<tr>
<th>CTA Field Office</th>
<th>Percentage of Sample</th>
<th>Minimum Late Days</th>
<th>Maximum Late Days</th>
<th>Average Late Days</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chuuk</td>
<td>75%</td>
<td>1</td>
<td>12</td>
<td>5</td>
</tr>
<tr>
<td>Kosrae</td>
<td>68%</td>
<td>1</td>
<td>97</td>
<td>13</td>
</tr>
<tr>
<td>Yap</td>
<td>75%</td>
<td>1</td>
<td>107</td>
<td>19</td>
</tr>
</tbody>
</table>

This finding of untimely receipt and accounting of CTA revenue by the Treasury was identified in a prior ONPA audit.

Cause: The FSM Treasurer does not receipt and account for CTA collections immediately upon receipt of the information from the CTA Field Offices. Several days’ collections are instead combined and reflected in one National Treasury Cash Receipt.

There is a lack of high-level review of Treasury receipts to ensure that all collections are promptly receipted and accounted for in the General Ledger. Proper procedures were not in place for the reconciliation of CTA daily collections and customs and tax records reflected in the General Ledger.

The requirement to mail the CTA collections documentation (bank deposit slips, Daily Revenue Collection Summaries, related customs and tax receipts, etc.) partially contributes to the late receipt and accounting of the collections by the Treasury. The nature of the flight schedules from the CTA Field Offices of Chuuk, Kosrae, and Yap to Pohnpei makes it difficult for the collections documentation to be received by the Treasury promptly after the deposit date of the collections.

Effect: The untimely receipt and accounting of cash collections results in delays in remittance of customs and tax revenue to the State Governments.
Recommendation:
The Secretary of Finance and Administration or his designee should ensure that:

(A) Clear policies and procedures are put in place to ensure that collections are receipted and recorded immediately by the Treasurer upon receipt of the information from the CTA Field Offices. These policies and procedures should indicate the oversight responsibilities with respect to the timely receipt and accounting of customs and tax collections.

(B) The Divisions of CTA and Treasury perform frequent reconciliations of the CTA collections with the Treasury’s records that are reflected in the General Ledger.

(C) A system is put in place to enhance the timeliness of the receipt of the cash collections information from the Field Offices to the FSM Treasury.

Auditee’s Response:

The procedures implemented on November 1, 2005, require a copy of the Treasury Field Office receipt, a summary of the day’s collections, and the banking deposit slip to be faxed daily to Treasury Central in Palikir. Treasury receipting is performed from this information. Therefore, there should no longer be a delay in receipting of collections.

Monthly reconciliations of General Ledger and CTA collection records are now performed. Procedures provide for a prompt follow up and resolution of any missing advice from the Field Offices.
NATIONAL PUBLIC AUDITOR'S COMMENTS

In addition to providing copies of this report to the President and Members of the Congress, we also sent copies to the Secretary of the Department of Finance & Administration, the Assistant Secretary for Customs & Tax Administration, the Assistant Secretary for the Treasury Division, and the Deputy Assistant Secretaries for the Customs & Tax Administration Field Offices in the States of Chuuk, Kosrae, Pohnpei, and Yap. Furthermore, we will make copies available to other interested parties upon request.

If there are any questions or concerns regarding this report, please do not hesitate in contacting the office. Contact information for the Office can be found on the last page of this report, along with the National Public Auditor (ONPA) and staff who made major contributions to this report.

Haser H. Hainrick
National Public Auditor

June 23, 2006
ONPA CONTACT AND STAFF ACKNOWLEDGEMENTS

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| ACKNOWLEDGEMENTS | In addition to the contact named above, the following staff made key contributions to this report:  
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