

OFFICE OF THE NATIONAL PUBLIC AUDITOR
FEDERATED STATES OF MICRONESIA

**CUSTOMS & TAX AUDIT
FISCAL YEAR 2006**

AUDIT REPORT NO. 2007-04



**Haser H. Hainrick
National Public Auditor**



FEDERATED STATES OF MICRONESIA

Office of The National Public Auditor

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May 29, 2007

Honorable Members of the FSM Congress
His Excellency Manny Mori, President
Federated States of Micronesia
Palikir, Pohnpei FM 96941

EXECUTIVE SUMMARY

RE: Audit of Customs & Tax, FY 2006

We have completed our audit of the Division of Customs & Tax Administration (CTA), within the FSM Department of Finance and Administration (DoF&A), for fiscal year 2006. CTA's 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 DoF&A's Division of National Treasury (Treasury) is responsible for recording and distributing 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 State and National Governments.

The objectives of the audit were to determine that: 1) customs and tax revenue collections are reported and accounted for in an accurate and timely manner; 2) customs and tax revenue distributions to the Governments (four State Governments and the National Government) are accurate and timely; and 3) year-end accruals of customs and tax revenue and payables to the State Governments are accurate.

We found that Treasury and CTA have accurately accounted for customs and tax revenue collections, revenue distributions to the Governments and year-end accruals of revenue and payables to the State Governments. However, we also found that the Treasury did not consistently remit revenue shares to the State Governments in a timely manner and that CTA Field Offices did not consistently deposit customs and tax cash collections to the Treasury in a timely manner. Although we reported these two findings in the fiscal year 2004 and 2005 CTA audit reports, management has not taken corrective action to resolve the situation. Before a clean audit report for CTA can be realized, the Secretary of DoF&A needs to relay to his staff the importance of resolving these findings. We recommended actions that the Secretary of DoF&A should take to ensure that the remittances and deposits are done in a timely manner. The findings and recommendations are described in detail in the attachment to this letter.

Respectfully yours,

A handwritten signature in black ink, appearing to read 'H. Hainrick', written in a cursive style.

Haser Hainrick
National Public Auditor

xc: Secretary, Department of Finance & Administration
Assistant Secretary, Division of National Treasury
Assistant Secretary, Division of Customs & Tax Administration

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BACKGROUND

The Division of Customs & Tax Administration (CTA), within the 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 Secretary of DoF&A has the ultimate accountability of customs and tax functions with respect to collections, compliance and accounting within the Department as well as the responsibility to distribute revenue shares to the State Governments. The Assistant Secretary for CTA is responsible for 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 eight personnel at the CTA Central Office in Palikir and 32 at the four Field Offices as of fiscal year 2006.

The CTA Division has two main functions, *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 Division of National Treasury (Treasury), and prepares daily/monthly activity reports for transmittal to the CTA Central Office and Treasury.
2. ***Customs Administration*** includes a Customs Specialist and a Customs Analyst. Twenty-one other support staff, consisting of Customs Inspectors and Customs Officers, are employed at the Field Offices. Its general responsibilities include:

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- 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 or merchandise from being 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 formula, (based on revenue type classifications and applicable rules, regulations, and laws) and reflects the shares in the General Ledger. The Treasury is required to remit the States' revenue shares on a monthly basis.

The following table shows the total in customs and tax revenue collected and reported by CTA in fiscal year 2006 (by state and fiscal quarter):

Fiscal Quarter	State				Total
	Chuuk	Kosrae	Pohnpei	Yap	
First Qtr	\$1,296,543	\$ 509,182	\$ 2,688,495	\$1,168,478	\$5,662,698
Second Qtr	1,642,802	482,905	2,756,004	1,187,467	\$6,069,178
Third Qtr	1,409,954	476,498	2,296,029	1,063,408	\$5,245,889
Fourth Qtr	1,810,393	498,520	2,485,870	1,073,065	\$5,867,848
Total	\$6,159,692	\$1,967,105	\$10,226,398	\$4,492,418	\$22,845,613

SCOPE

Our audit scope covered fiscal year 2006 from October 1, 2005 to September 30, 2006. However, gathering of relevant information may include previous and subsequent years for analytical purposes. The audit was conducted pursuant to Title 55 FSM Code 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, agency, board, commission, bureau, and statutory authority 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.

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The audit evaluated the CTA's and Treasury's compliance relative to the Customs Act of 1996¹ and the Financial Management Act of 1979² as amended regarding the ongoing management of customs and tax revenue collections, reporting, and distribution of States revenue shares for the fiscal year 2006. The audit fieldwork was conducted at the CTA Central Office in Palikir, the Division of National Treasury, and at the CTA Field Offices in Chuuk, Kosrae, Pohnpei, and Yap.

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.

AUDIT OBJECTIVES

The objectives of the audit are to determine that:

- a. Customs and tax revenue collections are reported and accounted for in an accurate and 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;

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 Office and the National Treasury to validate our analysis.

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

PRIOR AUDIT COVERAGE

This audit represents the third audit undertaken by the Office of the National Public Auditor (ONPA). The two previous audits covered fiscal years 2004 and 2005. The Audit Report for fiscal year 2004 (#2005-05) was issued on March 10, 2006. The Audit Report for fiscal year

¹ The CTA Standard Operating Procedures (SOP), CTA & Treasury Daily Deposit Procedures and DoF&A Finance Office Procedures are the related policies and procedures.

² The Financial Management Regulations (FMR) are the related regulations.

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2005 (#2006-02) was issued on June 10, 2006. Management concurred with our findings in both audits. Unresolved findings are reiterated in this report.

CONCLUSION

Based on our audit, we concluded that:

- ❖ Customs and tax revenue collections are reported and accounted for in an accurate manner, but not in a timely manner;
- ❖ Customs and tax revenue distributions to the Governments (four State Governments and the National Government) are accurate, but not timely, and;
- ❖ Year-end accruals of customs and tax revenue and payables to the State Governments are accurate.

We offer the following recommendations to address each of the specific findings disclosed below and the following pages.

FINDINGS & RECOMMENDATIONS

FINDING #1 - Untimely Remittance of Revenue Shares to the State Governments

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

Criteria: The Treasury should remit revenue shares to the State Governments on the first working day after the fifth of the subsequent month. (Procedure 9 of the Finance Office Procedures).

Condition: The Treasury remitted the revenue shares to State Governments after the required date in 27 of the 61 remittances reviewed or 44 percent of the sampled remittances. On average, the remittances were issued twelve (12) business days after the required date. The longest delay of remittance to State Governments was 37 days. The following table breaks down the untimely remittances by state government:

State Government	Number of Late Remittances	Percentage of State Share	Minimum Late Days	Maximum Late Days	Average Late Days
Chuuk	7	37%	1	32	14
Kosrae	12	63%	1	37	10
Pohnpei	4	27%	2	35	24
Yap	4	33%	1	6	3

This is a repeat finding disclosed in prior ONPA audits of customs & tax administration covering fiscal year 2004 and 2005.

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Cause: Management has not implemented appropriate measures to ensure prior audit recommendations were implemented. There is an absence of clearly established procedures or guidelines by the Secretary of DoF&A for the remittance of revenue shares to the State Governments. According to Treasury staff, the untimely receipt and accounting of customs and tax collections by wire transfers and direct deposits contributes to the late remittances.

Effect: As a result, there are delays in the remittances of \$3,140,489 or 27% of customs and tax revenue to the respective State Governments.

State Government	Amount Late
Chuuk	\$688,149
Kosrae	\$667,526
Pohnpei	\$1,095,393
Yap	\$689,421
Total	\$3,140,489

Recommendation: The Secretary of DoF&A should ensure that:

- (A) Clear policies and procedures are put in place to ensure that revenue shares to the State Governments are remitted in a timely manner and that these policies and procedures are consistently enforced.
- (B) Clear policies and procedures are put in place to ensure collections by wire transfers and direct deposits are receipted and recorded in a timely manner. These policies and procedures should indicate the oversight responsibilities with respect to the timely receipt and accounting of customs and tax collections.

FINDING #2 - Untimely Deposit of CTA Collections to Treasury

(Division of Customs & Tax Administration)

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

Condition: Based on the sample we reviewed, we found that cash collections were not deposited to Treasury in a timely manner.

CTA Field Office	Number of Late Deposits	Percentage of Sample	Minimum Late Days	Maximum Late Days	Average Late Days
Chuuk	2	6%	1	1	1
Kosrae	8	25%	1	3	2
Pohnpei	26	76%	1	16	3
Yap	2	6%	8	13	6

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This is a repeat finding that was disclosed in prior ONPA audits of customs & tax covering fiscal year 2004 and 2005.

Cause: The Field Offices did not consistently comply with the cash deposit requirements.

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 \$25,465 for Chuuk, \$28,651 for Kosrae, \$464,466 for Pohnpei, and \$26,699 for Yap were not deposited to Treasury in a timely manner.

Recommendation: The Secretary of DoF&A or his designee should ensure that policies and procedures are consistently enforced to ensure that customs & tax collections are deposited in a timely manner.

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AUDITEE RESPONSE



Secretary of Finance
&
Administration

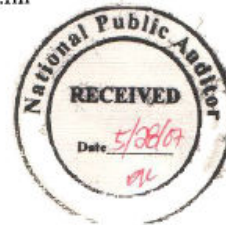
May 28, 2007

Mr. Haser Hainrick
National Public Auditor
Office of the National Public Auditor
Federated States of Micronesia
Palikir Pohnpei FM 96941

**GOVERNMENT OF THE
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*Haser
5.28.2007*



Re: Response to Customs & Tax Administration Audit for FY2006

Dear Mr. Hainrick:

Thank you for giving us the opportunity to respond to the recently concluded Customs and Tax Administration Audit for Fiscal Year 2006 (Audit 2007-04). Following is our response:

1. Untimely remittance of Revenue Shares to the States Governments.

We agree with this finding with reservations due to the following reasons:

1. Chuuk State Government
 - a. 4 out of 12 months, National Treasury remitted the revenue share **before** the due date.
 - b. 4 out of 12 months, National Treasury remitted the revenue share **on** due date.
 - c. 1 out of 12 months, National Treasury remitted the revenue share **1 day after** the due date.
 - d. 3 out of 12 months, National Treasury remitted **partially** the revenue share **2 to 3 days after** the due date.
 - e. 3 out of 12 months, National Treasury remitted in **full** the revenue share **7 to 32 days after** the due date.

2. Pohnpei State Government
 - a. 5 out of 12 months, National Treasury remitted the revenue share 1 to 3 days **before** the due date.

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- b. 5 out of 12 months, National Treasury remitted the revenue share **on** due date.
- c. 1 out of 12 months, National Treasury remitted partially the revenue share **2 days after** the due date.
- d. 1 out of 12 months, National Treasury remitted **partially** the revenue share **before** the due date.
- e. 2 out of 12 months, National Treasury remitted in **full** their revenue share **27 to 35 days after** the due date.

3. Yap State Government

- a. 3 out of 12 months, National Treasury remitted the revenue share **before** the due date
- b. 6 out of 12 months, National Treasury remitted the revenue share **on** due date
- c. 3 out of 12 months, National Treasury remitted the revenue share **2 to 6 days after** the due date

4. Kosrae State Government

- a. 2 out of 12 months, National Treasury remitted the revenue share **before** the due date.
- b. 1 out of 12 months, National Treasury remitted **partially** the revenue share **before** the due date.
- c. 1 out of 12 months, National Treasury remitted **partially** the revenue share **on** due date.
- d. 1 out of 12 months, National Treasury remitted the revenue share **on** due date.
- e. 7 out of 12 months, National Treasury remitted in **full** the revenue share **2 to 37 days after** the due date.

2. Untimely deposit of CTA collections to Treasury

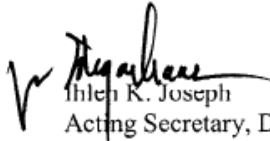
We agree with this finding.

The untimely deposit of CTA collections to Treasury office was due to the unbalanced daily collections from the field offices between cash receipt and cash collection. Information and documentation of collection transmitted through wire transfer (Mobil) sometimes do not get to field offices in time to issue cash receipts. Properly certified documentation are necessary to provide evidence that fund have indeed been transferred before cash receipts are issued. The recommendation is fully noted and the Department will work on corrective measures to adequately address this finding.

The Department of Finance and Administration will work toward ensuring that policies and procedures are consistently enforced.

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Sincerely,



Helen K. Joseph
Acting Secretary, Department of Finance and Administration

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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 the Division of Customs & Tax Administration, the Assistant Secretary for the Division of National Treasury, 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

May 29, 2007

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ONPA CONTACT AND STAFF ACKNOWLEDGEMENTS

ONPA CONTACT

Haser H. Hainrick, National Public Auditor
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ACKNOWLEDGEMENTS

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

Ann Walker, Audit Supervisor
Michael Henry, Auditor-In-Charge
Moses Russel, Staff Auditor
Yolanda Leben, Staff Auditor
Aisi Mori, Staff Auditor
Erwihne David, Staff Auditor
Ivan Alafanso, Staff Auditor

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