

OFFICE OF THE NATIONAL PUBLIC AUDITOR
FEDERATED STATES OF MICRONESIA

**REVIEW OF CUSTOMS & TAX ADMINISTRATION
FISCAL YEAR 2007**

REPORT NO. 2008-05



Haser H. Hainrick
National Public Auditor



FEDERATED STATES OF MICRONESIA

Office of The National Public Auditor

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July 9, 2008

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

RE: Review of Customs & Tax Administration for FY 2007

We have completed a review of the customs & tax revenue collected in Fiscal Year 2007 by the Department of Finance & Administration (DFA). The review was conducted pursuant to Title 55, Chapter 5 of the FSM Code, and in accordance with the "*Generally Accepted Government Auditing Standards*" issued by the Comptroller General of the United States. The objectives of the review were to determine that: 1) customs & tax revenue collections were reported and accounted for in an accurate and timely manner, 2) customs & tax revenue shares payable to the State governments were remitted accurately and timely, and 3) year-end accruals of customs & tax revenue and payables to the State Governments were accurate.

As a result of our review, we concluded that customs & tax revenue collections were not reported and accounted for in a timely manner and revenue shares were distributed to the State governments past the required timeframe. However, we also concluded that customs & tax revenue collections, revenue shares payable to the State governments, and year-end accruals were accurately accounted for. Lastly, there is a significant variance between the Division of Customs & Tax Administration (CTA) and Division of National Treasury (DNT) records of customs & tax revenue collections. We recommend the Secretary of the DFA strengthen current policies and procedures and urge him to direct the CTA and DNT to collaborate in ensuring that all customs & tax revenue collections are collected, receipted, deposited, and distributed in accordance with relevant FSM laws, regulations, policies and procedures. Additionally, the Secretary should issue a directive to require CTA and DNT to reconcile their records of customs & tax revenue collections on a monthly basis. 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 "Haser Hainrick".

Haser Hainrick
National Public Auditor

cc: Finley Perman, Secretary of the DFA
John Uwas, Assistant Secretary of the CTA
Juliet Jimmy, Assistant Secretary of the DNT

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INTRODUCTION

Background

The Division of Customs and Tax Administration (CTA), within the Department of Finance and Administration (DFA), was created pursuant to Title 2 and 54 of the FSM Code to administer customs and tax. The CTA is headed by an Assistant Secretary who is designated by the Secretary of DFA to administer customs and tax and manage the division's general operations. Reporting to the Assistant Secretary are the Compliance Branch Manager, Document Processing Branch Manager, and four Deputy Assistant Secretaries in charge of each of the field offices. Support staff includes seven personnel at the Central Office in Palikir and 32 at the field offices as of fiscal year 2007.

CTA 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 (DNT), and prepares daily/monthly activity reports for transmittal to the CTA Central Office and DNT.
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:
 - A. Inspection at ports of entry, assessment, and collection of taxes on goods and merchandise imported into the FSM by sea or air; and

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B. Prevention of prohibited goods or merchandise from being imported into the FSM.

In addition to the responsibilities delegated to CTA, the DNT is responsible for receipting, recording, and distributing revenue shares of the customs and tax collections to all the State Governments. Upon receipt of revenues from the CTA Field Offices, the DNT applies the applicable revenue share formula, (based on revenue type classifications and applicable rules, laws and regulations) 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 collected and reported by CTA in fiscal year 2007 (by state and fiscal quarter):

Fiscal Quarter	State				Total
	Chuuk	Kosrae	Pohnpei	Yap	
First Qtr	\$1,376,395	\$471,615	\$3,305,188	\$1,120,315	\$6,273,513
Second Qtr	1,392,221	469,582	2,182,188	975,097	5,019,088
Third Qtr	1,165,275	489,752	2,413,492	1,161,680	5,230,199
Fourth Qtr	1,146,230	542,997	2,609,835	848,125	5,147,187
Total	\$5,080,121	\$1,973,946	\$10,510,703	\$4,105,217	\$21,669,987

Note: rounded off to the nearest dollar

Objective, Scope, and Methodology

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. Treasury Receipts are reported and accounted for in a accurate and timely manner;
- c. Customs and tax revenue distributions to the Governments (four State Governments and the National Government) are accurate and timely, and;
- d. Year-end accruals of customs and tax revenue and payables to the State Governments are accurate;

Scope

Our audit scope covered fiscal year 2007 from October 1, 2006 to September 30, 2007. 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,

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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.

The review evaluated CTA's and DNT'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 2007. 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 DFA 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.

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 DNT. We also interviewed and gathered data to accomplish related analysis in order to achieve our objectives.

Additionally, we conducted fieldwork based on random sample selections³ at the CTA field offices, CTA Central Office and DNT to validate our analysis. A generally accepted materiality or tolerance level of five percent was used.

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

PRIOR AUDIT COVERAGE

This audit is the fourth audit undertaken by the Office of the National Public Auditor (ONPA). The most recent audits covered fiscal years 2005 and 2006. The Audit Reports for fiscal year 2005 (2006-02) and 2006 (2007-04) were issued on June 23, 2006 and May 29,

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

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

³ Confidence level = 90% ; Margin of error = 10%

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2007 respectively. The management concurred with our findings in both audits and 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;
- Treasury receipts are reported and accounted for in an accurate and timely manner;
- Year-end accruals of customs and tax revenue and payables to the State Governments are accurate.

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FINDINGS & RECOMMENDATIONS

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

Criteria: The DNT 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 DNT incurred delays in remitting revenue shares payable to the State governments. This was noted in 30 percent (20 of 67) of the sampled remittances. On average, the remittances were delayed thirty-five (35) business days. The delay ranged from 1 to 144 from the required date of remittance. 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	6	30%	1	11	5
Kosrae	5	25%	1	10	4
Pohnpei	4	27%	3	144	87
Yap	5	31%	1	43	15
Total	20				

This is a repeat finding disclosed in prior ONPA audits of customs & tax covering fiscal year 2005 and 2006.

Cause: Management has not implemented appropriate measures to ensure prior audit recommendations were implemented. There is an absence of clearly established policies and procedures for remittance of revenue shares to the State Governments. According to DNT staff, the untimely receipt and accounting of customs and tax collections contributed to the late remittances.

Effect: As a result, there are delays in the remittance of \$2,437,583.31 or 23% of the sampled remittances of customs and tax collections reviewed.

State Government	Amount Late	Total Sampled Remittances	Percentage Late
Chuuk	\$865,263.59	\$2,306,804.16	38%
Kosrae	394,212.37	908,660.50	43%
Pohnpei	506,157.49	5,333,078.01	9%
Yap	671,949.86	2,027,041.01	33%
Total	2,437,583.31	10,575,583.68	23%

Recommendation: We recommend that the Secretary of the DFA should clearly:

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- (A) Establish specific policies and procedures 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) Establish specific policies and procedures to address untimely receipt and accounting of customs and tax collections resulting from, but not limited to, unbalanced collections, wire transfers, or direct deposits.

FINDING 2 - Untimely Deposit of CTA Collections to Treasury

Criteria All customs and tax collections should be deposited to DNT by the end of the business day (FMR 1.6).

Condition: We found that 14 percent (12 of 83) of the sample of cash collections reviewed were not deposited to DNT in a timely manner.

CTA Field Office	Number of Late Deposits	Percentage of Sample	Minimum Late Days	Maximum Late Days	Average Late Days
Chuuk	6	27%	1	2	1
Kosrae	3	14%	1	1	1
Pohnpei	3	14%	1	1	1
Total	12				

This is a repeat finding that was disclosed in prior ONPA audits of customs and tax covering fiscal year 2005 and 2006.

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

Effect: The untimely deposit of cash collections causes late receipt, accounting, and the eventual remittance of customs and tax collections to the Governments. The untimely deposit of cash collections could potentially expose physical cash to fraud, waste and mismanagement. Based on the sample reviewed, customs and tax collections totaling approximately \$90,017 (\$55,193.31 for Chuuk, \$2,173.33 for Kosrae and \$32,650.39 for Pohnpei) were not deposited to DNT in a timely manner.

Recommendation: We recommend that the Assistant Secretary of CTA should consistently enforce the requirement to promptly deposit collections to DNT.

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FINDING 3 – Discrepancies Between CTA and Treasury Records

Criteria Ultimately, all customs and tax collections should be reflected on the General Ledger (GL) maintained by Treasury (FMR 1.6 and DFA daily deposit procedures).

Condition: Review of the GL and CTA records of customs and tax collections indicated a variance of \$474,599. The GL indicates a total of \$22,144,585 was receipted or recorded at DNT in fiscal year 2007. On the contrary, CTA records indicate only a total of \$21,669,986 was collected in fiscal year 2007.

A similar finding was disclosed in a prior ONPA audit of customs & tax covering fiscal year 2004.

Cause: A system is not in place to periodically reconcile the customs and tax collections. Additionally, both CTA and DNT personnel do not periodically compare their records to ensure that all collections are reported, receipted, or accounted for on the records of both divisions.

Effect: As a result, approximately \$474,599 in customs and tax collections paid directly to DNT were not receipted or reflected on CTA records. Ultimately, CTA is underreporting the total amount of collections made in fiscal year 2007.

Recommendation: We recommend that the Secretary of the DFA should:

- (A) Direct the Assistant Secretaries of CTA and DNT to designate appropriate personnel to reconcile CTA and DNT records of customs & tax collections. This should be a collaborative effort between the Divisions.
- (B) Clearly establish specific policies and procedures which will require the monthly reconciliation of customs and tax collections records at CTA and DNT to ensure that all collections are ultimately reported, receipted and accounted.

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APPENDIX I – Response from the Secretary of the DFA to the Draft Report



Secretary of Finance
&
Administration

**GOVERNMENT OF THE
FEDERATED STATES OF MICRONESIA
Department of Finance and Administration**

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July 02, 2008

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

Re: Response to Customs & Tax Administration covering Fiscal Year 2007

Dear Mr. Hainrick:

Thank you for your letter of June 3, 2008 giving us the opportunity to respond to the recently concluded Customs and Tax Administration Audit for Fiscal Year 2007 (Audit Report 2008-05). Herein is our response to the audit report.

Finding No. 1 - Untimely remittance of Revenue Shares to the States Governments.

We agree on the finding but subject to qualification that are limited as follows:

- National Treasury was late in remitting the revenue share to the following:

State Government	Number of Late	No of days late	Amount
Pohnpei State	2	2 to 4 days	<u>676,214.00</u>

As reflected above, during the year, Division of National Treasury was late in remitting the revenue share for Pohnpei State twice in FY07 while remittances for Yap, Chuuk and Korea States were remitted on or before the due date on the first working day after the fifth of the subsequent month.

During the year, there were instances of subsequent remittances after Division of National Treasury remitted the monthly revenue share to the states due to untimely deposit of CTA collections to Treasury and or late posting of cash receipts in the accounting system. The subsequent remittances are stated below:

- National Treasury subsequent remittances were late to the following:

See Note 1 in Appendix II

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State Government	Number of Subsequent Remittances	No of days late	Amount
Chuck State	5	2 to 17 days	775,684.36
Pohnpei State	3	9 to 279 days	503,086.98
Yap State	5	2 to 19 days	670,805.41
Korea State	5	2 to 17 days	394,212.37
Total			<u>2,343,789.12</u>

We will review the Procedure 9 of the Finance Office Procedure to establish a more specific policies and procedures to ensure that revenue shares to the State Governments are remitted in a timely manner.

Finding No. 2 - Untimely deposit of CTA Collections to Treasury.

We agree and noted the finding. As discussed in our exit conference, there is significant improvement in handling the collections and deposits in the field offices as compared to previous audit reports. However, as this is still a repeated finding, the central office of CTA will continue to make improvement in collaboration with its field offices in monitoring collections and enforce the requirement to promptly deposit collections to the Division of National Treasury (DNT) by the end of the business day.


Finding No. 3 – Discrepancies Between CTA and Treasury Records.

We agree with this finding but subject to the qualification that the untimely deposit was limited and does not materially affect the cash position of the government and or remittance of revenue share to the State Governments.

We will make amendment to our procedure to include a system that periodically reconcile the customs and tax collections and compare records at CTA and DNT to ensure that all collections are reported, receipted and accounted for on the records of both divisions.

Again, thank you for the opportunity to comment on the report.

Sincerely,



Finley S. Perman
Secretary

See Note 2 in Appendix II

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APPENDIX II – ONPA’s Response to DFA Comments

Note 1 – *The Secretary stated that he agreed with finding no. 1 on untimely remittance of revenue shares to the State Governments. However, his agreement is limited because there were instances of subsequent remittances after the DNT had already remitted the monthly revenue shares to the State Governments. This was caused by untimely deposit of collections to DNT and/or late posting of cash receipts into the accounting system.*

ONPA’s Response – The Department plans to address these concerns by strengthening current policies and procedures as recommended in this report and pointed out on Page 2 of the Secretary’s comments. This issue was brought up during the exit conference and subsequently reviewed and analyzed. The Department and the two relevant Divisions have to realize that the untimely deposit of collections to DNT or late posting of cash receipts into the accounting system could lead to delays in the remittance of revenue shares (to the State Government) depending on the degree of untimeliness. Management should consider streamlining current policies and procedures to ensure that collections reported, receipted, and distributed are accurate and timely as prescribed and adverse risks are mitigated.

Note 2 – *The Secretary stated that he agreed with finding no. 3 on discrepancies between CTA and DNT records to the extent that the variance does not materially affect the cash position of the government and/or remittance of revenue shares to the State Governments.*

ONPA’s Response – Although the current variance might not materially affect the cash position of the government and/or remittance of revenue shares to the State Governments, the fact that both Divisions did not perform monthly or even fiscal year-end reconciliations of their records and were not required to do so, could adversely and/or materially affect revenue shares if permitted to continue.

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NATIONAL PUBLIC AUDITOR'S COMMENTS:

We wish to thank the staff at the CTA and DNT within the DFA for their assistance and cooperation throughout the course of the review.

The ONPA will perform a follow-up review within the next 9 months to ensure that the Department have addressed the recommendations contained in this report.

In conformity with our standards, we presented a copy of the draft report to the Secretary of the DFA, Assistant Secretary of CTA, and Assistant Secretary for DNT. Their written comments to the draft report are attached to this report.

We have provided copies of this report to the President and Members of the Congress for their use and information. 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 our Office. Contact information for the Office can be found on the last page of this report, along with the ONPA and staff who made major contributions to this report.



Haser H. Hainrick
National Public Auditor

July 9, 2008

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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:

Michael Henry, Supervisor (Team Leader)
Yolanda Leben, Auditor-In-Charge
Christina Elnei, Staff Auditor
Lover Haimin, Staff Auditor

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