

KWAJALEIN ATOLL LOCAL GOVERNMENT

**INDEPENDENT AUDITORS' REPORT
ON INTERNAL CONTROL AND ON COMPLIANCE**

YEAR ENDED SEPTEMBER 30, 2015

**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

The Honorable Mayor Hirata Kabua
Kwajalein Atoll Local Government:

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Kwajalein Atoll Local Government (KALGOV) as of September 30, 2015, and have issued our report thereon dated December 27, 2018. Our report included a qualification due to the omission of certain capital assets and the lack of recording a liability for compensated absences in governmental activities and stated that the scope of our work was not sufficient to enable us to express, and we did not express, an opinion on the respective financial statements of the governmental activities and the general fund for the year ended September 30, 2015.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered KALGOV's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of KALGOV's internal control. Accordingly, we do not express an opinion on the effectiveness of KALGOV's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. However, as described in the accompanying schedule of findings and responses, we did identify certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying Schedule of Findings and Responses as items 2015-001, 2015-002, 2015-004 and 2015-010 to be material weaknesses.

A significant deficiency is a deficiency, or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying Schedule of Findings and Responses as items 2015-003, 2015-007 and 2015-009 to be significant deficiencies.

Compliance and Other Matters

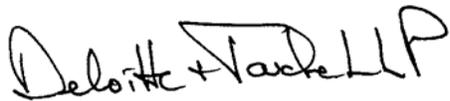
As part of obtaining reasonable assurance about whether KALGOV's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Findings and Responses as items 2015-005, 2015-006, 2015-008 and 2015-011.

KALGOV's Omission of Response to Findings

KALGOV has opted to omit responses and corrective actions to the findings identified in our audit and are described in the accompanying Schedule of Findings and Responses. Such missing information is considered to be an essential part of the Schedule of Findings and Responses. However, KALGOV's responses, if any, are not subjected to the auditing procedures applied in our audit of the financial statements and, accordingly, we express no opinion on them.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

A handwritten signature in black ink that reads "Deloitte + Tatchell LLP". The signature is written in a cursive, stylized font.

December 27, 2018

KWAJALEIN ATOLL LOCAL GOVERNMENT

Schedule of Findings and Responses
Year Ended September 30, 2015

Finding No.: 2015-001
Area: Capital Assets

Criteria: Effective internal control necessitates that capital assets be recorded in the fixed asset register, properly tagged with asset identification number, and with complete description and location.

Condition: As of September 30, 2015, a capital asset register was not available to support the underlying cost and accumulated depreciation recorded in the general ledger. Furthermore, the following exceptions over capital assets were noted:

1. Due to unavailability of a capital asset register, location and condition of capital assets were undeterminable.
2. No established policies and process for capital asset disposals.
3. No established capitalization policy in place to determine capitalizable assets.

Cause: The cause of the above condition is the lack of internal control policies and procedures governing proper monitoring, capitalization, maintenance, and disposal of capital assets.

Effect: The effect of the above condition is potential misstatement in capital asset balances and scope limitation in the audit process.

Recommendation: We recommend that management maintain a fixed asset register, perform inventory of capital assets, establish capitalization policy and establish capital asset retirement policy.

Prior Year Status: The lack of established policies and procedures over capital assets was reported as a finding in the audit of KALGOV for fiscal years 2012 through 2014.

Auditee Response and Corrective Action:

Auditee did not provide a formal response to this finding.

KWAJALEIN ATOLL LOCAL GOVERNMENT
Schedule of Findings, Continued
Year Ended September 30, 2012

Finding No.: 2015-002
Area: Compensated Absences

Criteria: Per Rule XVII - *Leave Privileges* of the policy adopted by KALGOV Civil Service Commission (CSC):

- a. Section 1(a) states that the maximum amount of leave that can be accumulated at the end of the leave year December 31 is 240 hours. Thereafter, any excess shall be forfeited unless taken before the end of the calendar year in which such excess was accumulated.
- b. Section 1(f) states that vacations will be scheduled in an orderly manner so that adequate manpower is available for the work to be done.
- c. Section 1(j) states that unused vacation leave will be paid to the employee subject to maximum amount described in Section 1 (a).
- d. Section 3(b) states that the appointing officer may require medical documentation as evidence of the employee's illness or injury that prevented attendance at work.
- e. Section 3(f) states that upon normal retirement, medical retirement or death the employee or beneficiary shall be paid 50% of the sick leave accumulated. Maximum accumulated sick leave is 960 hours.

Condition: During the year ended September 30, 2015, KALGOV asserted that it follows RepMar's Public Service Commission policy regarding compensated absences. However, no written documentation was available on file to support this assertion. Furthermore, the following exceptions were noted regarding compensated absences:

1. A supporting schedule of compensated absences payable as at September 30, 2015 was not available.
2. The sick leave liability at September 30, 2015 reported a debit balance of \$20,861 due to encashment of sick leave pay without corresponding accrual.
3. Accumulated amount of \$814 unused sick leave was paid to employees still in service without appropriate approved sick leave application and certificate from qualified medical officer.
4. During the year ended September 30, 2015, management encashed a total of \$10,074 for unused annual leave. Recipients include KALGOV employees still in service.
5. A \$2,878 cash advance covering 320 annual leave hours was requested by the Finance Director; however, examination of the underlying payroll register indicated 720 annual leave hours were applied totaling \$7,322.

Cause: The cause of the above condition is the lack of internal control policies facilitating complete monitoring, accurate reporting of compensated absences, and compliance with KALGOV CSC policies.

Effect: The effect of the above condition is potential misstatement in compensated absences payable, noncompliance with KALGOV CSC policies, and scope limitation in the audit process.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Schedule of Findings and Responses
Year Ended September 30, 2015

Finding No.: 2015-002, Continued
Area: Compensated Absences

Recommendation: We recommend that management maintain updated compensated absences schedule and adhere to KALGOV CSC policies.

Prior Year Status: The lack of established policies and procedures over compensated absences was reported as a finding in the audit of KALGOV for fiscal years 2012 through 2014.

Auditee Response and Corrective Action:

Auditee did not provide a formal response to this finding.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Schedule of Findings and Responses
Year Ended September 30, 2015

Finding No.: 2015-003
Area: Accounts Receivables

Criteria: Effective internal control necessitates that employee advances and other receivables be collected in a timely manner to facilitate efficient governmental operations and minimize possible losses through noncollection.

Condition: As of September 30, 2015, KALGOV reported the following employee advances and other receivables:

	<u>Amount</u>	<u>Allowance</u>
Due from Employees	\$27,203	\$(21,768)
AR Others	28,093	(27,577)
Tax Due	76,699	(43,457)

Due from employees included cash advances for one current employee (\$27,000) and one former employee (\$12,200) without payroll deduction. The \$27,000 cash advance was subsequently liquidated in March 2015 upon the death of the employee.

Furthermore, documentation that management performs allowance assessment on a periodic basis was not available.

Cause: The cause of the above condition is the lack of adequate internal control governing proper approval of employee advances and enforcement of timely collection of receivables.

Effect: The effect of the above conditions potentially impacts KALGOV's ability to facilitate efficient government operations and potential loss of government funds.

Recommendation: We recommend that management implement collection procedures over outstanding employee advances and other receivables. Furthermore, we recommend that management establish formal policies approved by the Executive Council over employee advances.

Prior Year Status: The lack of established policies and procedures over accounts receivable was reported as a finding in the audit of KALGOV for fiscal years 2013 and 2014.

Auditee Response and Corrective Action:

Auditee did not provide a formal response to this finding.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Schedule of Findings and Responses
Year Ended September 30, 2015

Finding No.: 2015-004
Area: Journal Entries

Criteria: Effective internal control necessitates that journal entries be adequately supported and independently reviewed.

Condition: Our testing of journal entries noted the following exceptions:

1. The journal voucher system is not utilized and there is no evidence to support independent review of recorded journal entries.
2. Journal entry # 15-09005 for \$108,000 to record tax revenues paid directly to MISSA lacked supporting documentation supporting the revenue amount and application of payment.
3. Journal entry #s 15-09006 and 15-09008 for \$377,784 and \$173,339, respectively, to record tax revenues paid directly to MISSA and RepMar lacked supporting documentation supporting the revenue amount and application of payment.
4. Journal entry # GLFY15-MKABUA for \$1,032 to record a land lease expenditure lacked supporting lease agreement as basis for recordation.

Cause: The cause of the above condition is the lack of internal control policies and procedures requiring correctness of journal entries and independent review prior to recording to the general ledger.

Effect: The effect of the above condition is a potential for unauthorized journal entries.

Recommendation: We recommend that management adopt policies and procedures to evidence review and approval of journal entries. Furthermore, management may consider utilizing the journal voucher system.

Prior Year Status: The lack of internal control policies and procedures over journal entries was reported as a finding in the audit of KALGOV for fiscal years 2012 through 2014.

Auditee Response and Corrective Action:

Auditee did not provide a formal response to this finding.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Schedule of Findings and Responses Year Ended September 30, 2015

Finding No.: 2015-005
Area: Local Noncompliance - Social Security Taxes

Criteria: Sections 131 and 215 of the RepMar Social Security Act of 1990 and the Social Security Health Fund Act of 1991, respectively, state that no later than the tenth day after the end of each quarter, every employer shall submit to the Social Security Administrator a report of the wages and salaries paid by the employer, and the contributions due from the employer, under Sections 129 and 130, 213 and 214, respectively, and pay into the Fund the contributions due.

Condition: KALGOV filed and paid social security contributions for the year ended September 30, 2015 in a manner inconsistent with the criteria. As of September 30, 2015, KALGOV was liable for social security contributions in the amount of \$5,952,654, inclusive of penalties and interest relating to delinquent and unremitted contributions.

Cause: The cause of the above condition is the lack of policies and procedures to monitor timely filing of returns and payment of social security taxes.

Effect: The effect of the above condition is noncompliance with the Social Security Act of 1990 and the Social Security Health Fund Act of 1991.

Recommendation: We recommend that management comply with the Social Security Act of 1990 and the Social Security Health Fund Act of 1991.

Prior Year Status: The lack of compliance with the Social Security Act of 1990 and the Social Security Health Fund Act of 1991 was reported as a finding in the audit of KALGOV for fiscal years 2012 through 2014.

Auditee Response and Corrective Action:

Auditee did not provide a formal response to this finding.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Schedule of Findings and Responses
Year Ended September 30, 2015

Finding No.: 2015-006
Area: Local Noncompliance - RepMar Withholding Taxes

Criteria: 48 MIRC Chapter 1, Income Tax Act of 1989, Section 105, states that the employer shall once every four (4) weeks or thirteen times per year, pay taxes withheld under Section 104 under Chapter 1. The employer shall, along with the taxes, within two (2) weeks following the preceding four (4) week period make a full, true and correct return showing all wages and salaries paid by the employer to the employees during the preceding four (4) week period and showing the tax due and withheld thereon as provided in Section 104 of the Chapter.

Condition: KALGOV filed and paid income taxes withheld for the year ended September 30, 2015 in a manner inconsistent with the criteria. As of September 30, 2015, KALGOV was liable for income taxes withheld in the amount of \$4,138,217, which included unremitted income taxes withheld from prior years.

Cause: The cause of the above condition is the lack of policies and procedures to monitor timely filing of returns and payment of withheld income taxes.

Effect: The effect of the above condition is noncompliance with the RepMar Income Tax Act of 1989, as amended.

Recommendation: We recommend that management establish policies and procedures to comply with the RepMar Income Tax Act of 1989, as amended.

Prior Year Status: The lack of compliance with the RepMar Income Tax Act of 1989, as amended, was reported as a finding in the audit of KALGOV for fiscal years 2012 through 2014.

Auditee Response and Corrective Action Plan:

Auditee did not provide a formal response to this finding.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Schedule of Findings and Responses Year Ended September 30, 2015

Finding No.: 2015-007
Area: Payroll

Criteria: Effective internal control necessitates that personnel files should be maintained to support personnel related expenditures and disbursements.

Condition: Personnel action forms (PAF) for KALGOV employees were not available for examination to facilitate verification and agreement with hourly rate per payroll register. Furthermore, we tested 27 payroll items and noted the following exceptions:

1. One item where employee RIJR for PPE December 20, 2014 was underpaid \$8.
2. A \$113 variance existed between payroll register and general ledger details for PPE August 1, 2015.
3. Timesheets for Public Safety Department employees for PPE April 25, 2015 lacked signature of department head to support independent review of time charges.

Cause: The cause of the above condition is the lack of internal control policies and procedure governing proper maintenance of employee permanent files.

Effect: The effect of the above condition is a potential misstatement in salaries and wages.

Recommendation: We recommend that management properly maintain employee permanent files and perform independent review of timesheets to support employee related expenditures.

Prior Year Status: The lack of internal control policies and procedures over the maintenance of employee permanent files and timesheets was reported as a finding in the audit of KALGOV for fiscal years 2012 through 2014.

Auditee Response and Corrective Action:

Auditee did not provide a formal response to this finding.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Schedule of Findings and Responses
Year Ended September 30, 2015

Finding No.: 2015-008
Area: Local Noncompliance – RepMar’s Procurement Code

Criteria: Section 106(3) of RepMar’s Procurement Code applies to KALGOV, being a political subdivision of RepMar. The Procurement Code states the following:

- (a) Section 124 - unless otherwise authorized by law, all Government contracts shall be awarded by competitive sealed bidding.
- (b) Section 127 - procurement of goods and services not exceeding \$25,000 may be made in accordance with small purchase procedures promulgated by RepMar's Policy Office. Small purchase procedures are those relatively simple and informal methods for securing services, supplies, or other property that do not cost more than \$25,000. RepMar’s Ministry of Finance has previously declared that if small purchase procedures are used, price or rate quotations shall be obtained from an adequate number of qualified sources.
- (c) Section 128 - a contract may be awarded for a supply, service, or construction item without competition when it is determined in writing that there is only one source for the required supply, service, or construction item.

Condition: For the following items, supporting documentation was inadequate to evidence the procurement process:

- 1. Check # 131 and 7296 for \$7,392 and \$1,450, respectively, for fuel purchase; and
- 2. Check # 7609 for \$24,527 for vehicle purchase.
- 3. Check # 103 for \$3,550 for purchase of four laptop computers.

Cause: The cause of the above condition is the lack of internal control policies and procedures to facilitate compliance with procurement requirements.

Effect: The effect of the above condition is potential noncompliance of RepMar Procurement Code.

Recommendation: We recommend that management adhere to Repmar Procurement Code.

Prior Year Status: The lack of internal control policies and procedures to facilitate compliance with RepMar procurement requirements was reported as a finding in the audit of KALGOV for fiscal years 2012 through 2014.

Auditee Response and Corrective Action:

Auditee did not provide a formal response to this finding.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Schedule of Findings and Responses
Year Ended September 30, 2015

Finding No.: 2015-009
Area: Travel Expenditures

Criteria: Effective internal control necessitates that travel expenditures be supported by itineraries, boarding passes, and invoices to support liquidation process.

Condition: For the following items, travel advances were not provided with an ordinance supporting existing rates used for per diem, lodging, car rental and representation allowances. Furthermore, no itinerary or boarding passes were on file for the following items:

1. Check #s 221, 7651 and 8011 for \$535, \$5,200 and \$3,975, respectively, were drawn for travel advances of the City Manager. Furthermore, the travel advances drawn on check #s 221 and 7651 did not adequately disclose the purpose of travel;
2. Check #s 7688 and 8013 for \$1,103 and \$4,500, respectively, were drawn for travel advances of the Finance Director. Furthermore, the travel advance drawn on check # 7688 did not adequately disclose the purpose of travel;
3. Check # 8183 for \$1,828 was drawn for airfare of the Finance Director that was not supported by an underlying travel authorization;
4. Check # 7875 for \$2,750 was drawn for travel advance of the Mayor;
5. Check # 7652 for \$5,501 was drawn for travel advance of the Legal Clerk;
6. Check # 7903 for \$3,000 was drawn for travel advance of KALGOV employee;
7. Check #s 7689 and 7849 for \$1,321 and \$2,751, respectively, were drawn for travel expenditures that included per diem of \$300 and \$675, respectively; and
8. Check # 220 for \$225 was drawn for car rental allowance of KALGOV employee attending EPA Board meeting.

Cause: The cause of the above condition is the lack of established internal control policies and procedures administering the liquidation of travel advances.

Effect: The effect of the above condition is potential unauthorized and misstatement of travel expenditures.

Recommendation: We recommend that management establish appropriate internal control policies and procedures governing authorization and liquidation of travel advances.

Prior Year Status: The lack of established internal control policies and procedures administering the authorization and liquidation of travel advances was reported as a finding in the audit of KALGOV for fiscal years 2012 through 2014.

Auditee Response and Corrective Action:

Auditee did not provide a formal response to this finding.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Schedule of Findings and Responses
Year Ended September 30, 2015

Finding No.: 2015-010
Area: Revenues and Cash Receipts Journal

Criteria: Fines, taxes and fees assessed should be supported by necessary documentation including tickets, tax assessments, invoices, applications, ordinances or their equivalent. Furthermore, cash collected should be deposited in a timely manner and related cash collection reports should evidence review and approval.

Condition: Of fifty-seven cash receipts tested, we noted the following exceptions:

1. Cash collection reports were not certified by Finance Director evidencing that independent review occurred.
2. Tax assessment forms with related invoices and bills of lading were not provided for the following cash receipts:

<u>CR/OR no.</u>	<u>CR/OR Date</u>	<u>Amount</u>
6348	12/01/14	\$ 16,128
6824	08/12/15	12,672
6203	10/07/14	9,302
6707	04/01/15	8,114
6897	07/13/15	<u>6,617</u>
		\$ <u>52,833</u>

3. General journal, cash receipt invoices, property tax assessments forms - payment receipts, deposit slips, bills of lading and related vendor's invoices were not provided for the following:

<u>Reference</u>	<u>GL Account</u>	<u>Date</u>	<u>Amount</u>
15-04006	Excise – soda	04/30/15	\$ 2,400
1016TJ	Excise – wine	09/30/15	23,616
121914	Excise - property tax	12/18/14	1,026
12-1205	Excise - property tax	12/31/14	1,181
15-09005	Excise – soda	09/30/15	8,415
15-09005	Excise - property tax	09/30/15	<u>101,102</u>
			\$ <u>137,740</u>

4. Certain excise property tax on the initial sale assessment indicated that taxes levied was fully paid when only partial payment were received. Payments subsequently received were as follows:

<u>Cash Receipt no.</u>	<u>Cash Receipt Date</u>	<u>Unpaid Tax Due</u>	<u>Settlement Date</u>
6201	10/10/14	\$ 8,064	11/13/14
6348	12/01/14	8,064	01/02/15
6598	01/30/15	8,064	02/27/15
6325	11/13/14	<u>7,210</u>	04/10/15
		\$ <u>31,402</u>	

KWAJALEIN ATOLL LOCAL GOVERNMENT

Schedule of Findings and Responses
Year Ended September 30, 2015

Finding No.: 2015-010, Continued

Area: Revenues and Cash Receipts Journal, Continued

- 5. KALGOV charges an alcohol tax of \$0.40 per can of beer in accordance with ordinance no. 2004-05 with an effective date of 07/19/2004. However, copy of said ordinance supporting the rate was not on file during examination.
- 6. Series of Official Receipts (OR) or Cash Receipts (CR) were insequentially issued or missing. As a result, we were unable to ascertain the completeness of cash collections.
- 7. Property tax assessment forms - payment receipts, bills of lading and supplier's invoices to support tax collected were not provided for the following:

<u>Cash Receipt no.</u>	<u>Date</u>	<u>Tax Due</u>
7032	10/20/15	\$ 20,582
DD110615	11/06/15	45,000
7184	12/30/15	<u>19,920</u>
		\$ <u>85,502</u>

Cause: The cause of the above condition is the lack of established internal control policies and procedures over the filing and maintenance revenue recordation and collection process.

Effect: The effect of the above condition is a potential understatement of revenues, unauthorized rates used, and misappropriation of cash.

Recommendation: We recommend that management develop and maintain procedures to ensure that revenue collections are supported, properly recorded, pursue collection of unpaid taxes due, approval of rates used are maintained, timely deposit of collections, and collection reports are independently reviewed.

Prior Year Status: The lack of established internal control policies and procedures over the filing and maintenance of revenue recordation and collection process was reported as a finding in the audit of KALGOV for fiscal years 2012 through 2014.

Auditee Response and Corrective Action:

Auditee did not provide a formal response to this finding.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Schedule of Findings and Responses Year Ended September 30, 2015

Finding No.: 2015-011
Area: Local Noncompliance - Public Services Fund

Criteria: Section 4A of the Memorandum of Agreement (MOA) between KALGOV and RepMar requires the creation and separate accounting for the KALGOV Public Services Fund.

Condition: During the year ended September 30, 2015, KALGOV received \$240,560 from RepMar in accordance with the MOA; however, all related transactions associated with this grant were recorded in the General Fund.

Cause: The cause of the above condition is the lack of adequate controls governing compliance with the MOA.

Effect: The effect of the above condition is noncompliance with terms and conditions of the MOA.

Recommendation: We recommend that management separately establish and account for transactions of the Public Services Fund.

Prior Year Status: The lack of internal control policies and procedures over the creation and separate accounting for the KALGOV Public Services Fund was reported as a finding in the audit of KALGOV for fiscal years 2012 through 2014.

Auditee Response and Corrective Action Plan:

Auditee did not provide a formal response to this finding.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Schedule of Prior Audit Findings
Year Ended September 30, 2015

The status of unresolved prior year internal control findings is disclosed within the Schedule of Findings and Responses section of this report.