

KWAJALEIN ATOLL LOCAL GOVERNMENT

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

YEAR ENDED SEPTEMBER 30, 2012

**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 the financial statements of the Kwajalein Atoll Local Government (KALGOV) as of September 30, 2012, 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, 2012. We conducted our audit 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.

Internal Control Over Financial Reporting

Management of KALGOV is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered KALGOV's internal control over financial reporting as a basis for designing our auditing procedures 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 over financial reporting. Accordingly, we do not express an opinion on the effectiveness of KALGOV's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed in the accompanying schedule of findings and responses, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that we consider to be 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 2012-001 through 2012-004, 2012-009 and 2012-012 to be material weaknesses.

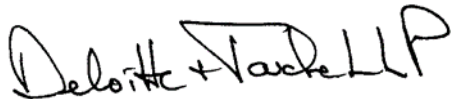
A *significant deficiency* is a deficiency, or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying Schedule of Findings and Responses as items 2012-008 and 2012-011 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 2012-005 through 2012-007, 2012-010 and 2012-013.

KALGOV's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Responses. We did not audit KALGOV's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of management, the Honorable Council members, and others within the entity and is not intended to be and should not be used by anyone other than these specified parties.



December 27, 2018

KWAJALEIN ATOLL LOCAL GOVERNMENT

Schedule of Findings and Responses Year Ended September 30, 2012

Finding No.: 2012-001
Area: Business License Fees Revenues

Criteria: Effective internal control necessitates that business license revenues be timely collected and charged in accordance with approved Council ordinance.

Condition: Examination of business license revenues for the year ended September 30, 2012 noted the following exceptions:

1. KALGOV levied business license fees for three items inconsistent with Council-approved rates as mandated by Ordinance No. 2006-04.
2. Business license fees of \$8,000 collected on January 5, 2012 were not deposited until January 10, 2012.
3. Daily cash collection reports lacked supervisor's signature to support that independent review took place.

Cause: The cause of the above condition is the lack of internal control policies and procedures requiring that fees be charged in accordance with Council-approved rates and collections be timely reviewed and deposited.

Effect: The effect of the above condition is potential understatement in revenues.

Recommendation: We recommend that management scrutinize revenue collections to facilitate timely identification of potential revenue collection deficiencies.

Auditee Response and Corrective Action:

Auditee did not provide a formal response to this finding.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Schedule of Findings and Responses, Continued
Year Ended September 30, 2012

Finding No.: 2012-002
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, 2012, 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.

Auditee Response and Corrective Action:

Auditee did not provide a formal response to this finding.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Schedule of Findings and Responses, Continued
Year Ended September 30, 2012

Finding No.: 2012-003
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, 2012, 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, 2012 was not available.
- 2. The sick leave liability at September 30, 2012 reported a debit balance of \$15,676 due to encashment of sick leave pay without corresponding accrual.
- 3. Accumulated amount of \$8,609 unused sick leave was paid to employees still in service without appropriate approved sick leave application and certificate from qualified medical officer.
- 4. Subsequent to September 30, 2012, management encashed a total of \$20,516 for unused annual leave. Recipients include KALGOV employees still in service.

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, Continued
Year Ended September 30, 2012

Finding No.: 2012-003, Continued
Area: Compensated Absences

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

Auditee Response and Corrective Action:

Auditee did not provide a formal response to this finding.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Schedule of Findings and Responses, Continued
Year Ended September 30, 2012

Finding No.: 2012-004
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. Journal entry completeness tests indicated the understatement of property tax revenues and related receivable accounts of \$2,781. As this amount was not considered material to the financial statements, no adjustment was proposed.
2. The journal voucher system is not utilized and there is no evidence to support independent review of recorded journal entries.
3. Journal entry # 12-09012 for \$137,490 to record a liability for RMI withholding taxes lacked supporting calculation and statement of account to ascertain the amount recorded. Furthermore, documentation supporting independent review of journal entry was not available.

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.

Auditee Response and Corrective Action:

Auditee did not provide a formal response to this finding.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Schedule of Findings and Responses, Continued
Year Ended September 30, 2012

Finding No.: 2012-005
Area: Local Noncompliance - Procurement / Legal Services

Criteria: Section 118 (2) of 44 MIRC Chapter 1 of the RMI Procurement Code states that no contract for the services of legal counsel may be awarded without the approval of the Attorney-General.

Condition: During the year ended September 30, 2012, KALGOV incurred \$41,000 in professional services for independent legal counsel. No approval was provided by KALGOV to indicate that these services were approved by the Attorney-General. Furthermore, a \$3,000 disbursement (check # 23397) was paid for legal services that was not supported by underlying invoice detailing services provided.

Cause: The cause of the above condition is the lack of adequate controls over the procurement of legal services in accordance with the RMI Procurement Code.

Effect: The effect of the above condition is potential noncompliance with the RMI Procurement Code regarding authority to contract for certain services.

Recommendation: We recommend that management comply with the RMI Procurement Code and obtain written approval of the Attorney-General for contracts for the services of independent legal counsel.

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, Continued
Year Ended September 30, 2012

Finding No.: 2012-006
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, 2012 in a manner inconsistent with the criteria. As of September 30, 2012, KALGOV was liable for social security contributions in the amount of \$6,533,074, 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.

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, Continued
Year Ended September 30, 2012

Finding No.: 2012-007
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, 2012 in a manner inconsistent with the criteria. As of September 30, 2012, KALGOV was liable for income taxes withheld in the amount of \$3,397,703, 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.

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, Continued
Year Ended September 30, 2012

Finding No.: 2012-008
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 one exception where the timesheet for employee no. 218480 for PPE June 9, 2012 was not available for examination.

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.

Auditee Response and Corrective Action:

Auditee did not provide a formal response to this finding.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Schedule of Findings and Responses, Continued
Year Ended September 30, 2012

Finding No.: 2012-009
Area: Account Reconciliations

Criteria: Effective internal control necessitates that account balances are properly and timely reconciled.

Condition: During the year ended September 30, 2012, KALGOV's General Fund recorded an interfund receivable of \$1,911,154. No corresponding interfund payable was recorded. In the prior year, the corresponding interfund payable was recorded in a special revenue fund that was subsequently combined with the General Fund. An adjustment was proposed during the audit process to reduce the interfund receivable and correct beginning fund balance.

Cause: The cause of the above condition is the lack of timely and complete reconciliations.

Effect: The effect of the above condition is a misstatement in account balances.

Recommendation: We recommend that management perform timely reconciliation of GL accounts and independent review.

Auditee Response and Corrective Action:

Auditee did not provide a formal response to this finding.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Schedule of Findings and Responses, Continued
Year Ended September 30, 2012

Finding No.: 2012-010
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 # 23129 for \$25,450 for the purchase of a new vehicle;
- 2. Check # 24202 for \$5,000 for partial payment on a \$15,000 vehicle purchased from a private individual;
- 3. Check #s 23223, 23361, 23396, 24440 and 24620 for \$16,995, \$1,560, \$3,928, \$3,300 and \$2,798, respectively, for various operational purchases; and
- 4. Check # 23383 for \$400 for the purchase of two digital cameras.

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.

Auditee Response and Corrective Action:

Auditee did not provide a formal response to this finding.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Schedule of Findings and Responses, Continued
Year Ended September 30, 2012

Finding No.: 2012-011
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 #7107 for \$2,145 was drawn for travel advance comprising of airfare, per diem, lodging, and car rental.
2. Check #23184 for \$1,137 was drawn for travel advance comprising of airfare, per diem, lodging, and car rental.
3. Check # 24438 for \$1,359 was drawn for travel advance comprising of airfare, per diem, lodging, and car rental.

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.

Auditee Response and Corrective Action:

Auditee did not provide a formal response to this finding.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Schedule of Findings and Responses, Continued
Year Ended September 30, 2012

Finding No.: 2012-012
Area: Revenues and Cash Receipts

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 forty-seven revenue items tested, we noted the following exceptions:

1. Cash collection reports were not certified by the Finance Director evidencing independent review.
2. Cash collection reports, tax assessment forms with related vendor invoices and bills of lading for a \$11,434 property tax item (Ref # 12-09008) were not provided.
3. Bills of lading and related vendor invoices for a \$7,200 cigarette tax item (CR # 3328) were not provided.
4. Recordation and issuance of cash receipts were inconsistent with date of deposit to bank for the following:

<u>CR/OR no.</u>	<u>CR/OR date</u>	<u>Date deposited</u>
3323	03/15/2012	02/14/2012
10842	11/30/2011	11/29/2011
10899	01/05/2011	12/30/2011
3323	03/15/2012	02/14/2012
3319	03/15/2012	02/23/2012
3327	03/15/2012	02/27/2012
3383	04/11/2012	04/05/2011

5. A deposit slip for a \$14,888 collection (CR # 3571) was not provided.
6. A cash receipt invoice supporting a \$7,797 tax assessment and deposit was not provided.
7. A \$7,860 property tax item (CR # 3429) was supported by a tax assessment form with an assessed amount of \$8,343. The difference of \$483 remains unpaid; however, such was tagged as fully paid per property tax assessment payment receipt. No related receivable was recorded.
8. Eight items included importation of diesel fuel that were not subjected to fuel excise tax. In addition, supporting vendor invoices did not indicate the number of gallons as basis for taxation. Details are presented as follow:

KWAJALEIN ATOLL LOCAL GOVERNMENT

Schedule of Findings and Responses, Continued
Year Ended September 30, 2012

Finding No.: 2012-012, Continued
Area: Revenues and Cash Receipts

<u>CR no.</u>	<u>Invoice amount (Per tax assessment form)</u>
3477	\$ 23,464
10933	21,784
3343	22,904
3401	22,094
3513	23,464
3618	22,288
3847	23,184
3321	<u>22,344</u>
	<u>\$181,526</u>

Ordinance no. 1987-25 states that, fuel excise tax including oil for vehicles and outboard/inboard, are subjected to \$.06/gallon of import FOB price.

Furthermore, registered companies engaged in importation and selling of fuel and diesel in Ebeye exist. However, no collections were recorded relating to taxes on importation of fuel during the year ended September 30, 2012.

- 9. Vendor invoices for eleven items totaling \$51,703 were not provided.
- 10. KALGOV charges an alcohol tax of \$0.40 per can of beer and cigarette/tobacco tax of \$4 per carton in accordance with Ordinance no. 2004-05 with an effective date of July 19, 2004. However, copy of the said ordinance supporting the rates were not on file during examination.
- 11. Our tests of cash receipts subsequent to September 30, 2012 revealed the following:
 - a. Examination of cash receipt journal revealed cash receipt no. 3880 was the last issued in September 2012 and cash receipt no. 3890 was the first issued in October 2012. Cash receipt nos. from 3881 to 3889 were missing and unrecorded.
 - b. Property tax assessment - payment receipt, bill of lading and the related invoices for cash receipt no. 3971 amounting to \$15,030 were not on file.

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

Effect: The effect of the above condition is the possibility of understated revenue, unauthorized rates used, and misappropriation of cash.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Schedule of Findings and Responses, Continued
Year Ended September 30, 2012

Finding No.: 2012-012, Continued
Area: Revenues and Cash Receipts

Recommendation: We recommend that management develop and maintain procedures requiring that collections be supported and recorded; that unpaid taxes be collected; maintenance of ordinances supporting rates used; timely deposits; and review of collection reports.

Auditee Response and Corrective Action:

Auditee did not provide a formal response to this finding.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Schedule of Findings and Responses, Continued
Year Ended September 30, 2012

Finding No.: 2012-013

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, 2012, KALGOV received \$248,000 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.

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, 2012

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