

Follow Up Audit on Kosrae Industrial Development Corporation (KIDCO)

A Report to the
Governor
and the
Legislature of
the State of Kosrae



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December 16, 2016

The Honorable Governor, Lyndon H. Jackson
The Honorable Speaker, Tulensa Palik
The Honorable Members, 11th Kosrae State Legislature
Kosrae State Government
Kosrae State Federated States of Micronesia 96944

Re: Follow up audit on Kosrae Industrial Development Corporation (KIDCo)

EXECUTIVE SUMMARY

We respectfully submit this Follow-up Audit No. 01-2016 to further review performance audit on Kosrae Industrial Development Corporation issued on November 22, 2010. This review was conducted as per resolution No. 11-131. The Objectives of the follow up audit are to:

The objectives of the audit were to (1) Identify audit report findings that require immediate management attention and any other findings for which follow up is considered necessary at this time, and inform the public about the follow up review on those findings. (2) Identify and provide status information for each recommendation reviewed. The status of each recommendation reviewed will be one of the following:

Implemented: Auditee fully implemented the recommendation, either as described in the report or in a manner that resolved the underlying issue.

In Progress: Auditee has specific plan to begin, or has begun, to implement and intends to fully implement the recommendation.

Partially Implemented: Auditee implemented the recommendation in part, but is not making efforts to fully implement.

Not Implemented: Auditee has not implemented the recommendation and indicates that it will not do so.

The audit was performed in accordance with auditing standards generally acceptable in the United States of America and the standards applicable to the performance audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. The audit was also conducted pursuant to Title 10 Chapter 4 of the Kosrae State Code and other, KIDCo Manual of Operation and other regulations promulgated thereafter.

With reference to the specific objectives, we noted the following (1) Management and oversight system did not provide adequate assurance that operational goals and objectives are achieved. (2) Financial reporting system did not provide reliable and accurate information. (3) Controls over cash receipts and disbursements were inadequate. (4) Contract with President/CEO of the Joint Venture Company needs to be reviewed and updated.

Based on the foregoing findings we recommend (1) that the management with the assistance of the Board of Directors to establish a strategic plan for the Joint Venture Company (JVC). (2) The board and management cooperatively set up broad policies over its accounting and budgeting functions, human resources, marketing and purchasing functions. (3) Board of Directors of the JVC to revisit the level of proficiency of the JVC's key personnel. (4) the JVC to establish and implement policies requiring the use of pre-numbered disbursement voucher to accommodate all the disbursements regardless whether the source of funds are from checking or savings account. (5) That management should exhaust all other possibilities to collect the amounts due if still cost beneficial. (6) That a person knowledgeable with the QuickBooks system and familiar with fixed asset accounting adjusts the amounts to reflect the proper book values of the asset. (7) That the CEO should not be allowed to be the sole signatory on JVC bank accounts and approve payments due to the conflicting responsibilities. (8) JVC to use Impress Fund System accounting for petty cash. (9) The management to submit a duly notarized contract for the JVC CEO with details on the benefits and responsibility of the employee (see annex 1).

Details of our examination are discussed in the findings and recommendations section of this report.

The Office of the Public Auditor provided draft copies of this report to the President/CEO of KIDCo and Board of Directors for their review and comment November 18, 2016. Copies of the Strategic Plan and Management Response for KIDCO were attached as annex 1 and 2.

Respectfully submitted,


Stoney S. Yaslung
Public Auditor

TABLE OF CONTENTS

EXECUTIVE SUMMARY.....1
INTRODUCTION.....4
BACKGROUND.....4

AUDIT OBJECTIVE AND SCOPE.....4
 Objective.....4
 Scope.....4
METHODOLOGY.....5
PRIOR YEAR AUDIT/REVIEW.....6
CONCLUSION.....6

Follow Up Report on Prior Audit Findings Status of Findings.....6

FINDING NO. 1. Management and oversight system did not provide adequate assurance that operational goals and objectives are achieved.....6
 Finding No. 1.1 Absence of a strategic plan contributed to JVC’s inability to achieve its purpose.....6
 Finding No. 1.2 The board did not exercise adequate oversight over JVC’s management.....7

FINDING NO. 2. Financial reporting system did not provide reliable and accurate information.....8
 Finding No. 2.1 It cannot be verified whether cash disbursements of \$908,204 was used for company purposes due to unavailable source documentation.....10
 Finding No. 2.2 Probable loss of \$270,037 arising from delinquent accounts receivables.....10
 Finding No. 2.3 Absence of fixed assets supporting documents and depreciation was not consistently applied overtime.....11

FINDING NO.3 Controls over cash receipts and disbursements were inadequate.....13
 Finding No. 3.1 Absence of segregation of duties over cash disbursements.....13
 Finding No. 3.2 Controls did not ensure that all collections are deposited.....14
 Finding No. 3.3 Controls over petty cash disbursements are inadequate.....15

FINDING NO. 4 Contract with the President/CEO of the JVC needs to be reviewed and updated.....16

ANNEX I: KIDCO STRATEGIC PLAN.....18
ANNEX II: MANAGEMENT RESPONSE.....19
PUBLIC AUDITOR’S COMMENT.....21
ACKNOWLEDGEMENT AND OPA CONTACT.....22

INTRODUCTION

Pursuant to the Legislative Resolution No. 11-132 of the 11th Kosrae Legislature, regulating the Office of the Public Auditor to conduct a special examination related to the operation of the Kosrae Industrial Development Company (KIDCO) previously known as the Semo-Micronesia Inc. For this purpose, the Public Auditor decided to conduct a follow up on the previous audit performed covering the period of FY 2004-2010.

Background

We have conducted a follow-up work on certain audit report findings contained in Report No. PA 03-10 for Semo-Micronesia Inc./Kosrae Industrial Development Co/ The Joint Venture Corporation, issued on November 22, 2010. The objectives of the follow up audit are to:

1. Identify audit report findings that require immediate management attention and any other findings for which follow up is considered necessary at this time, and inform the government about the follow-up review on those findings.
2. Identify and provide status information for each recommendation reviewed. The status of each recommendation reviewed will be one of the following:
 - **Implemented:** Auditee fully implemented the recommendation, either as described in the report or in a manner that resolved the underlying issue.
 - **In Progress:** Auditee has specific plans to begin, or has begun, to implement and intends to fully implement the recommendation.
 - **Partially Implemented:** Auditee implemented the recommendation in part, but is not making efforts to fully implement it.
 - **Not Implemented:** Auditee has not implemented the recommendation and indicates that it will not do so.

Scope

Our Follow up audit covered the result and findings in the Report No. PA 03-10 on Semo-Micronesia Inc./Kosrae Industrial Development Co/ The Joint Venture Corporation, issued on November 22, 2010. We also covered the gathering, reviewing and testing of relevant information and documentations including previous and subsequent period for analytical purposes. We conducted the inspections pursuant to Kosrae State Code Title 10, section 4 which stated in part:

“(a) The Public Auditor shall inspect and audit personally, or by his duly authorized assistants, all account, books, and other financial records of the State Government, to include but not be limited to, every branch, department, office, political subdivision, board, commission, agency, other public legal entity (owned, or partially owned by the state), whether they receive public funds or not, and nonprofit organizations that received public funds from the State Government;

- (b) Inspect and audit personally, or by his duly authorized assistants, the fiscal books, records and accounts of all allottees and other custodians of public funds, making independent verification of all assets, liabilities, revenues, expenditures and obligations of the State Government, entities owned in whole or part by the State Government, and agencies of the State Government;
- (c) Inspect and audit personally, or by his duly authorized assistant, the fiscal books, records, and other financial records associated with any project, program and activity receiving funding in whole or in part from public funds of the State Government, including the records of any contractor performing public work on a cost-reimbursement-type contract in order to verify the cost charged to the public contractor;
- (d) Inspect and audit personally or by his duly authorized assistants, the books, records, accounts, and other financial records associated with business sales that may be used for sales assessment for tax collection purposes”

AUDIT METHODOLOGY

The audit was conducted in accordance with generally accepted government auditing standard (GAGAS). Those standards requires that we plan and perform the audit to obtain, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

In planning our examination, we obtained sufficient understanding of the internal controls that is material to the audit objectives to plan the engagement and design the audit procedures. Based on this assessment, we reviewed documents and records relevant to the Project.

We considered compliance to state laws and regulations to be able to render an opinion to our audit objectives. Our procedures were also designed to identify weaknesses on internal controls that are material to the expression of an opinion to our audit objectives.

Audit procedures included, but were not limited to, interviews of KIDCO employees and stakeholders. We also review of transaction process and documentation. In addition we perform assessment on the implementation of previous audit. The audit criteria used to develop the required audit tests were based on (1) the Financial Management Regulation (2) Kosrae Code; and (3) previous audit report issued.

PRIOR YEAR AUDIT/REVIEW

This is the second time that a separate audit/examination was conducted with the Kosrae Industrial Development Corporation.

Conclusion

We concluded that based on the audit objectives:

- (1) Most of the recommendation and commitment on the previous audit were not properly implemented.

Follow-Up Report on Prior Audit Findings Status of Findings

FINDINGS AND RECOMMENDATIONS

FINDING NO. 1. Management and Oversight System did not Provide Adequate Assurance that Operational Goals and Objectives are achieved.

1.1. The Absence of a Strategic Plan Contributed to JVC's Inability to Achieve its Purposes

A corporate strategic plan is a document that describes the steps necessary for an organization to grow and become more profitable. The benefits of strategic planning include making sure all members of an organization are working toward common objectives, and that the corporation's resources financial and human are allocated as efficiently as possible.

The Joint Venture Company's (JVC) controls over its governance are inadequate. There were no strategic plans to set out the mission, vision and objectives of the company, no documented strategies developed on how to achieve the JVC's objectives, and standards for performance were not in place to evaluate actual performance against the standards.

Recommendation:

We recommend that the Management with the assistance of the Board Directors establish a strategic plan for the JVC. A plan to include a mission statement which explains why the company is in business, and what value it intends to provide its customers, its employees, its stakeholders and even the society; an analysis to where the company currently stands; company's vision statement-imagining how the company could look in three to five years in the future, goals and objectives – such as revenue growth in three to five years, and its strategic activities and tactics on how to realize its goals and objectives.

The board directors of the JVC should revisit the level of proficiency of the JVC's key personnel. The board of directors must ensure that the key personnel possess the necessary skills to business planning, implementation and monitoring to meet its business goals and objectives. We further recommend that the shareholders set an acceptable standard as to the income they are expecting from their investment or the limit of the amount of loss acceptable to them.

Status: Not Implemented

The management submitted a document labeled as KIDCO STRATEGIC PLAN which indicates sales projection for 2016 to 2019 however the said document does not define the strategic activities and tactics on how to realize its goal. The previous audit recommendation had clearly stated that a Strategic Plan should include the company's vision statement on three to five years goals and objectives as well as the action plan to achieve the set goals and objectives. (see: annex 1) Further review indicates that there was no evaluation made by the board of directors for the proficiency of the JVC's key personnel consequently no capacity building was initiated to meet the necessary skills on planning, implementations and monitoring the business goals and objectives. In addition, there was no document provided to the auditor on the investment gain and loss acceptability level.

Management Response:

The management developed and submitted what was believed to be a strategic plan suitable for the type and size of undertaking that KIDCO is involved in. It provides direction and target goals to be achieved over a specific period of time. Furthermore the Board and Management had sought the assistance of the State Government in the training of its key staff in financial management aspect of the corporations operation. However, although the State had provided much needed assistance in improving our financial management capability the training aspect was not fully met. The Board and Management believe that they did implement the recommendation of the audit as best as it could only did not achieve the desired level of accomplishment. (see attached: annex II)

1.2. The Board did not Exercise Adequate Oversight over JVC's Management

Typical duties of board of directors include (a) governing the organization by establishing broad policies and objectives; (b) selecting, appointing, supporting and reviewing the performance of the chief executive; (c) ensuring the availability of adequate financial resources; (d) approving annual budgets; and (d) accounting to the stakeholders for the organization's performance.

The Board's functional responsibilities were not adequately exercised. There we no corporate policies and objectives set out for the organization other than what is stated in the Joint Venture Agreement. There were no broad policies over basic corporate functions as accounting and budgeting, human resources, marketing and purchasing functions. We only noted a draft manual of administration covering human resources functions. The Joint Venture Agreement only included policies that salaries and benefits of directors and employees shall be reviewed annually; that the President of the JVC shall procure financial statements annually to the Board; and that annual financial statements of the JVC will be subject to annual audit by independent public accountants.

Recommendations:

We recommend that the Board and management cooperatively set up broad policies over its accounting and budgeting functions, human resources, marketing and purchasing functions. These broad policies will serve as a guide to the management to set up detailed policies and procedures to operate these vital corporate functions. It is important that Shareholders review the performance of the Board and the Board to conduct annual review of the CEO's performance. There is also a need to review the contract of its CEO and the benefits he authorized himself which appeared to be inconsistent with the provisions of the existing contract. The Board must require management to prepare and require approval of annual budgets. Interim budgets and Variance Analysis should be presented in every board meetings as their tool for decision making to pursue a course of action. Decisions and course of actions taken during the board meetings must be documented in the minutes of meetings.

Status: Partially Implemented

As the board reviewed the performance of the CEO as part of the employment contract, there is no documentation on board of meeting to support the evaluation process. It is also confirmed by the board and the staff that there is no existing operation manual that covers broad policies over its accounting and budgeting functions, human resources, marketing and purchasing functions. Likewise, the management fails to provide the auditor the approved annual budget, interim budgets and variance analysis as presented during their board meeting. However it is worth mentioning that filing of documents has greatly improved.

Management Response:

Even though budgets were prepared by Management and reviewed and approved by the Board we concur that such approval had not been recorded by way of either a record in the minutes of Board meeting or by way of Board Resolution.

FINDING NO. 2 Financial Reporting System did not Provide Reliable and Accurate Information

Reliability refers to the completeness of the information provided. For example, data may be technically accurate, but if it is provided out of context or without supporting information, it may not yield a reliable picture of the company's true financial position. Accuracy means that information provided to investors represents a true picture of performance. Article 11 of the Joint Venture Agreement: "11.1 The books and records of the JVC shall be maintained in accordance with the generally accepted accounting principles of FSM. Source documents to evidence the propriety of JVC's financial transactions were not maintained on file and are not available in the JVC office.

- (1) Ninety-five percent (95%) or \$722,110 of JVC disbursements made from their checking account did not have supporting documentation on file.
- (2) Withdrawals from savings account in the amount of \$184,173 did not have supporting documentation;
- (3) Detailed schedule of fixed asset beginning balances and its source documents were not available. Amounts presented on the financial statements and subsidiary listings showed a discrepancy of about \$800,000.
- (4) Documents to support disbursements and replenishments of the JVC's petty cash funds were not available; and
- (5) Documents to support that JVC recorded obligations as accounts payable to its CEO in the amount of about \$600,000 were inadequate;

The amounts reported for the JVC's accounts receivables and net book values of its fixed assets and equipment did not reflect what it purport to represent.

- (1) Most of the accounts comprising the balance of \$237,037 have exceeded the statute of limitation for legal action. It is necessary to reassess its probability of collection and provide valuation allowance for financial statement presentation purposes;
- (2) Provisions of depreciation to fixed assets and equipment were not consistently applied overtime; and
- (3) Retained earnings year ending and opening balances did not agree from year to year.

As a result, accurate and reliable financial information was not made available to the Board and Shareholders of the JVC. Information necessary to monitor the performance of the JVC and make timely corrective course of actions were not available.

Recommendation:

We recommend to the board of directors of the JVC to revisit the level of proficiency of the JVC's key personnel. The management and the board directors must ensure that the key personnel possess the necessary skills of financial accounting and ability to maintain accurate and reliable financial information. Reliability of financial information can also be achieved by establishing and implementing additional policies and procedures. Reliability can be enhanced by a policy to mandatory file source documents for every financial transactions and its retention period. Further, requiring Board approval before the release to other parties will enhance the integrity of the financial information.

Status: Not Implemented

As mention on the status of Recommendation regarding finding no. 1.2 for the noticeable improvement of filing of documents and supporting papers, however the financial reporting system has not improved. Issues on the account balances are not resolved as well as the book value of fixed assets are still not determined. As a result, the management is still using inaccurate financial data. The previous audit recommendation on the proficiency of the JVC's key personnel has not been addressed and no clear financial policy has been issued by the management.

Management Response

We concur with the findings but wish to reiterate that it was not through a lack of effort but that the attempt on the part of the Management and Board to seek assistance from the State had been unsuccessful. Because we believe that the current staff has the capacity to be trained to handle the job proficiently, we are not seeking a new hire but instead are continuing our efforts to train our current staff.

2.1. It cannot be Verified Whether Cash Disbursements of \$908,248 was Used for Company Purposes due to Unavailable Source Documentation.

Article 6 (1) Financial Administration (a) Standard for Financial Management Systems (2) (vi) “Source Documentation. Accounting records shall be supported by such source documentation as canceled checks, paid bills, payrolls, time and attendance records, Contract and Sub-Grant award documents, and other financial data.”

The audit revealed that there has been minimal effort on the part of management being unable to maintain disbursement supporting documents such as receipts, invoices, delivery receipts, certification for services rendered for services contracted and documentation of the purposes of disbursements.

Recommendation:

We recommend that JVC establish and implement policies requiring the use of pre-numbered disbursement voucher to accommodate all disbursements regardless whether the source of funds are from checking or savings account. Checks used and/or copies of withdrawal slips must be filed along with the disbursement voucher to include receipts from vendors, delivery reports, payroll sheet computations and other documents necessary to support disbursements. Policies to include filing of bank documents such as bank statements, passbooks, copies of withdrawal and deposit slips and the retention period which disbursements needed to be filed should be implemented.

Status: Partially Implemented

Adequate supporting documents for JVC’s financial transactions were in place and the usage of pre-numbered disbursement voucher and was implemented however not all disbursement were vouchered. Also, used checks or withdrawal slips were not filed along with the disbursement vouchers. Nevertheless, all vouchers have supporting documents such as vendor’s receipts, delivery report and payroll sheet computation. No policy from the management has been issued to cover the financial transaction process.

Management Response

Once again we concur with the findings of the audit and wish to reconfirm our commitment to continue to work towards improving these shortcomings.

2.2. Probable Loss of \$270,037 Arising from Delinquent Accounts Receivables

FSMC, Title 19 Chapter 13: Administrative and Legal Procedures:

“The Supreme Court shall have jurisdiction in rem over all vessels irrespective of their flag and all maritime claims whenever arising with respect to: (14) claims for the construction, repair, alteration or equipping of a vessel; which claims must be commenced within three years of the date on which the (right of action accrues) incident giving rise to the claim occurred”.

Accounts receivables should be revalued to reflect its estimated amount collectible. A valuation allowance should be provided for financial statement presentation if chances of collection are doubtful.

Recommendation:

We recommend that management should exhaust all other possibilities to collect the amounts due if still cost beneficial. For financial statements presentation, we recommend that a valuation allowance for the full amount be provided. We also recommend that future amounts in the QuickBooks system must be regularly reconciled to the subsidiary listings and source documents.

Status: In progress

The auditors meeting with the management of JVC confirmed that they are in the process of recovering collectibles from delinquent clients. They have actually received units equipment amounted to US\$ 78,038.00 as partial payment of an overdue account. This however was not recognized in the books of account to reflect the net recoverable amount of the account receivable, hence, all equipment were listed in their fixed asset schedule.

Management Response:

We concur with the findings of the audit and wish to point out for the records, that these recommendations have already been implemented, in fact immediately after they were pointed out to the board.

2.3. Absence of Fixed Assets Supporting Documents and Depreciation was not Consistently Applied Overtime.

Fixed asset accounts in the general ledger should agree with the subsidiary listings and source documents. Provision for depreciation for depreciable assets should be consistently applied over the life of the asset.

Recommendation:

We recommend that a person knowledgeable with the QuickBooks system and familiar with fixed asset accounting adjust the amounts to reflect the proper book values of the asset. We further recommend that the JVC establish and implement an asset capitalization policy which will set criteria applicable to JVC which purchases need to be capitalized. The policy should include life of an asset, salvage values if applicable and the method of depreciation used. Generally, all assets purchased which are not intended for sale and will have a useful life of more than one year need to be capitalized, however for purposes of convenience, a dollar amount for the capitalization threshold maybe established. For purposes of major repairs or improvements to buildings and equipment, cost of repairs of improvement may be capitalized if they will extend the useful life of the asset or increase its productivity.

Status: Not Implemented

Review of financial transaction reveals that fixed assets depreciation was not consistently recognized. Hence, the financial report does not reflect the fair market value of the existing assets. The management claims that valuation cannot be made because they do not have financial capacity to hire an expert on valuation to do so. In addition, the user of the QuickBooks system does not have enough knowledge to use the system and recognize non-cash financial transactions.

Management Response

We concur with the finding and wish to point out however that the Management maintains a computer file that records and updates the assets of the corporation with adjusted book value. This file is kept updated and need only to be inputted into the Quick books accounting system. Our finance and accounting staff needs to be trained properly to make such entries into Quick books and the Board is seeing to it that it is done. The management will make sure that the information will be incorporated to the financial statement manually.

FINDING NO. 3 Controls Over Cash Receipts and Disbursements were Inadequate

3.1. Absence of Segregation of Duties Over Cash Disbursements

Segregation of duties is critical to effective internal control; it reduces the risk of both erroneous and inappropriate actions. In general, the approval function, the accounting/reconciling function, and the asset custody function should be separated among employees. When these functions cannot be

separated, due to small department size, a detailed supervisory review of related activities is required as a compensating control activity. Segregation of duties is a deterrent to fraud because it requires collusion with another person to perpetrate a fraudulent act.

During our review of the JVC disbursement procedures, we noted there is no segregation of duties on custody, authorization and recording functions. The CEO of the JVC is the one who authorizes and approves payments. He keeps the JVC's checking account check books and savings account passbooks and he is the sole authorized signature to withdraw from these accounts. He has also access to the JVC's computerized accounting system which he can record, alter and post transactions.

Recommendation:

We recommend that the CEO should not be allowed to be the sole signatory on JVC bank accounts and approve payments due to the conflicting responsibilities. JVC should require two check signatories, the CEO and any member of the board representing the Government of Kosrae.

Should the above recommendation is not practicable; the Board should require mandatory review of the disbursements authorized by the CEO on a monthly basis. This review should be evidenced by the Board's signature on the CEO's report of disbursement and filed accordingly.

Status: Not Implemented

Based on interview and inquiries with the management and key staff of JVC they find that having more than one signatory is not practicable for them. But then they also confirm that there was no regular mandatory reviews of disbursement have been made.

Management Response

We concur with the findings of the audit. The reason for not implementing this recommendation as stated in the audit comment is that it is impractical for the level and type of activities being pursued by the corporation. We have opted based on the advice from the staff to require management to provide monthly cash transaction reports to the Board by email and to keep a file on these reports for further review during Board meetings.

3.2. Controls did not Ensure that All Collections are Deposited

Standard internal control procedure requires that issuance of pre numbered official receipts must be made in every collection. Official receipts are accountable forms which must be issued chronologically, filed and reviewed to ensure that all collections have been deposited. Un-deposited collections and unused official receipts must be kept secured. Independent review procedure reduces the risk that a person in a position to both perpetrates and conceals errors in the normal course of duty.

Use of receipts & review procedures to ensure that all collections are deposited were not in place. The review noted that the JVC is not using a pre-numbered official receipt to accommodate collection from

customers. Instead, the CEO only indicates in the invoice a handwriting “paid”, his signature and date paid to show that the JVC’s invoice has been already paid. We summarized invoices that have been marked paid and traced payments to the JVC bank accounts and further noted that several collections were not deposited to their bank account as indicated “Reimburse to Jung”, and used in petty cash but charged as expense.

“Reimburse to Jung” – instead of depositing collections to their bank accounts, collections were used as reimbursement to Mr. Jung. In the absence of documents to support reimbursement, it cannot be determined whether the funds spent due for reimbursement have been used for JVC’s purposes. For the period audited we identified 12 instances that collections were directly used for reimbursement in the amount of \$1,971.

Funds collected are more vulnerable to misappropriation. The management cannot ensure that all funds collected were recorded and deposited in their bank account. Without the use of pre-numbered official receipts, it is easy for the person responsible to conceal collections (cash or checks payable to cash) by cancelling the invoice being paid or not marking the invoice as

Recommendation:

It is necessary for management to establish and implement a policy over collection of funds. A policy to include the mandatory use of pre-numbered official receipts in every collection made. Procedures on how to prepare a schedule of collections showing the receipt numbers used in every deposit made, frequency of deposits and/or minimum amount to be deposited and an independent review to ensure that deposits are complete by checking the schedule of receipts used against the validated deposit slips. The policy must include mandatory filing of copies of approved withdrawal slips and validated deposit slips especially for fund transfers from savings to checking account.

Status: Partially Implemented

Auditors’ review of documents for collections reveals that previous recommendation to establish a policy on collection procedure was not implemented. JVC started using pre-numbered office receipts however, not all collections were receipted. Nevertheless, no cash collection was used to directly payoff their expenses.

Management Response

We concur with the findings and have already implemented the recommendations offered by the Public Auditor’s Staff concerning filing of receipt even when our customers do not require receipts.

3.3. Controls Over Petty Cash Disbursements are Inadequate

Petty cash replenishments should be supported by receipts, accounted as regular disbursements and properly classified to appropriate accounts. We noted that petty cash expenditures were not supported by receipts. There were no pre-numbered petty cash forms being used by the JVC nor a regular review being conducted on the petty cash transactions. Proper accounts codes were not utilized to classify disbursements as to its nature, e.g.

Based on the petty cash journal extracted from the QuickBooks system of the JVC, from January 2004 to August 2009 we noted huge amount entries for “Total Receipts (Food stuff-Materials)” account amounting to \$3,000 to \$4,000. It appeared that foods and materials other than food were lumped in the same account which should have been classified to appropriate accounts.

There was no established policy on petty cash procedures as to when it needs to be replenished. As a result petty cash expenses already amounted to about \$48,000 before gets reimbursed by the JVC. Based on our interview with the JVC staff, the CEO of the JVC used his own money to cover expenses for petty cash. It cannot be determined whether the disbursements were made for company purposes due to absence of petty cash disbursement source documents.

Recommendation:

We recommend that the JVC use the Imprest Fund System accounting for petty cash. The Imprest System has a fixed amount of petty cash including the cash equivalent of the supporting disbursement documents at any given time. The JVC must determine the reasonable amount of petty cash and must establish and implement policies and procedures to include requiring actual receipts in the replenishment of the fund, the pre-numbered petty cash replenishment forms, the balance when the fund gets replenished and the proper classification of disbursements based on the JVC chart of accounts.

In addition, these policies and procedures should include a detailed statement as to the type of expenditures which can be made from the petty cash account as well as the documentation required for reimbursement. The policies and procedures should be formally communicated to all administrative and accounting personnel and monitored for compliance on a regular basis.

Status: Not Implemented

The company did not adopt Imprest Fund System as recommended.

Management Response

KIDCO manual of administration requires that all financial transaction of the corporation should be made by way of corporate checks. We no longer require the use of a petty cash fund.

FINDING NO. 4 Contract with the President / CEO of the JVC Needs to be Reviewed and Updated

Article 9. of the Joint Venture Agreement - Basic Corporate and Operating Policies “9.2 *The general policies of the JVC regarding the salaries, bonuses and other emoluments of directors and employees of the JVC shall be reviewed annually by the parties in consultation with the directors of the JVC and general practice current in FSM shall be taken into consideration.*”

The employment contract of the CEO for the period of 1 year was already expired last January 19, 2004. No amendments or additional agreements were made to renew the said document. The salaries and benefits of the CEO have not been reviewed for about 6 years to date. Based on the current salary of the CEO, he is still receiving the same salary provided in the expired employment contract.

During 2004-2009, benefits provided to the CEO were not included in the 2003 employment contract provisions. With the available documents in the JVC’s office, we noted receipts and records showing that several expenses such as dependents airfare, food, groceries, yard materials and etc. that was charged and receipted in JVC’s name. Items identified in the receipts are baking supplies, bathing supplies, beer, bleach, Budweiser, burger, Clorox, coconut, cucumber, dining, eggs, fan, fish, fishing tools, food, groceries, ice cream, kitchen ware, lime, local produce, rice, shoes, soap, soda, soft drinks, sour soup, take out, tangerines, tuna, wine and yard materials (sewing). These items are not included in the employment contract provisions and appeared to be irrelevant with regular operations of the company. This type of expenses amounted to \$7,463.21 or 17% of total disbursements based on available receipts the company have on file.

To name a few:

On September 11, 2010, JVC checks amounted to \$81.25 were used to pay pork and beef. On August 2, 2010, a check was issued for \$32.55 for tuna and crabs. Two petty cash disbursements on September 22 and August 21, 2010 were made for fish, lime, flour and cola for \$12.25 and \$9.75 respectively. As per our interviews with the JVC’s employees, these purchases were not for the employee’s meal.

On June 17, 2010, Check No. 11363 in the amount of \$813.38 was issued to Continental Airlines used to pay for Mrs. Song airfare. On April 4, 2007 a withdrawal from the savings account in the amount of \$1,000 identified by management as “petty cash for living expenses” was made. Arising from this condition, funds were misappropriated if expenses were not legitimate.

Recommendation:

It is also recommended that the board directors and shareholders review and update the existing contract of the CEO of the JVC to consider its financial position and to reflect the standard practices in FSM and US corporations.

Status: Implemented

Management Response

We concur with the findings regarding the review and update of CEO's contract.

The management submitted a duly notarized contract for JVC CEO with details on the benefits and responsibilities of the employee and employer (see: annex). Board approval of monthly budget is necessary. The Board must require that budgets are definitive as to the nature of expenses and scrutinize details before approval. Approved budgets will then be compared to the actual expenses for variance analysis. The CEO should be made accountable for expenses he authorized beyond the approved budget. Expenses which do not have any legal basis as JVC legitimate expenses should not be allowed. The Board and Shareholders can consider issuing direct orders to the accounting and administrative staffs of the JVC to identify these type of payments and retribute repayments as appropriate. This will be a step in making the management accountable for its actions on Finding No. 1 – Management and Oversight System did not Provide Adequate Assurance that Operational Goals and Objective are achieved.

Status: Not implemented

No approved budget and variance analysis were shown to the auditors.

Management Response

Board and Management will ensure that its approval of budget will be reflected in the form of either a Board Resolution or notation in the relevant Board Meetings on budget matters.



Kosrae Industrial Development Corporation

P.O. BOX 940, TOFOL, KOSRAE, FSM 96944
TEL: (691) 370-2813/5750

December 14, 2016

DRAFT RESPONSE TO THE FOLLOW-UP AUDIT OF KIDCO

Office of the State Public Auditor
Kosrae State Government
Tofol, Kosrae Fm 96944

Attn: Mr. Stoney Taulung

Dear Mr. Taulung:

On behalf of the Management and Board of Directors of Kosrae Industrial Development Corporation (KIDCO) we wish to thank you and your staff for the opportunity provided to meet on Wednesday December 7, 2016 to clarify some of the findings of the recently concluded follow up audit of KIDCO as well as the opportunity to formally submit these written comments on the results.

As mentioned to your staff during our discussions, it is the Board's wish and intent to cause KIDCO to be in compliance with all of the requirements necessary to make it a successful Public Corporation for the benefit of the State. As such it is our intent to comply with all recommendations of the audit as far as practicable and where we find it impractical to work with your office in identifying appropriate alternatives to keep the corporation on the path to success.

With that in mind we offer the following comments as discussed with your staff:

Finding No. 1 – Not implemented - In response to the previous audit the Board and Management developed and submitted what was believed to be a strategic plan suitable for the type and size of undertaking that KIDCO is involved in. It provides direction and target goals to be achieved over a specified period of time.

Furthermore the Board and Management had sought the assistance of the State Government in the training of its key staff in the financial management aspect of the corporations operation; however although the State had provided much needed assistance in improving our financial management capability the training aspect was not fully met. We believe that the current staff possessed sufficient knowledge and experience which could be developed fully through minor tutoring in the use of computerized accounting software.

We believe that based on the foregoing efforts, the Management and Board did implement the recommendation of the audit as best as it could only did not achieve the desired level of accomplishments envisioned by the audit. Nevertheless it is the Management's and Board's intent to continue pursuing the successful implementation of these recommendations.

Finding No. 1.2 – Partially Implemented – Even though budgets were prepared by Management and reviewed and approved by the Board we concur that such approval had not been recorded by way of either a record in the minutes of Board meetings or by way of a Board Resolution. With your assistance and comments on our Manual of Administration which we provided for your review we intent to implement the necessary corrective measures to cure the problems.

Finding No. 2 – Not Implemented – We concur with the finding but wish to reiterate that it was not through a lack of effort but that the attempt on the part of the Management and Board to seek assistance from the State had been unsuccessful. Because we believe that the current staff has the capacity to be trained to handle the job proficiently, we are not seeking a new hire but instead are continuing our efforts to train our current staff.

Finding No. 2.1 Partially Implemented – Once again we concur with the findings of the audit and wish to reconfirm our commitment to continue to work towards improving these shortcomings.

Finding No. 2.2 In Progress - We concur with the findings of the audit and wish to point out for the records, that these recommendations have already been implemented, in fact immediately after they were pointed out to the Board.

Finding No. 2.3 Not Implemented – We concur with the finding and wish to point out however that Management maintains a computer file that records and updates the assets of the corporation with adjusted book value. This file is kept updated and need only to be inputted into the Quickbooks accounting system. Our finance and accounting staff needs to be trained properly to make such entries into Quick books and the Board is seeing to it that it is done. It should also be pointed out that the information could be manually incorporated into the financial statement at anytime if needed.

Finding No. 3.1 Not Implemented – We concur with the finding of the audit. The reason for not implementing this recommendation as stated in the audit comment is that it is impractical for the level and type of activities being pursued by the corporation. We have opted based on advice from your staff to require Management to provide monthly cash transaction reports to the Board by email and to keep a file on these reports for further review during Board meetings.

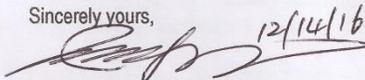
Finding No. 3.2 Partially Implemented - We concur with the finding and have already implementing the recommendations offered by the Public Auditor's Staff concerning filing of receipts even when our customers do not require receipts.

Finding No. 3.3 Not Implemented – We concur with finding and wish to point out that following the previous audit the corporation had put into effect a Manual of Administration which requires that all financial transactions of the corporation should be made by way of corporate checks. We no longer require the use of a petty cash or impress fund system.

Finding No. 4 Implemented – We concur with this finding regarding the review and update of the CEO's contract and as for the Non Implementation of an approved budget the Board will ensure that its approval of budget will be reflected in the form of either a Board Resolution or notation in the relevant Board Meetings on budget matters.

In conclusion, we once again thank you and your staff for your efforts in trying to keep KIDCO on the right track for improvement and success.

Sincerely yours,


Jung In Ho, President/CEO


Harry A. Seymour, Chairman

12/14/16

Received 12/14/16
afanah

Public Auditor's Comments

We would like to extend our appreciation to the Kosrae Industrial Development Corporation and Board of Directors for their cooperation and assistance throughout the course of our audit.

In compliance with the Generally Accepted Government Auditing Standards, a copy of the draft report was shared with the Kosrae Industrial Development Corporation a response. The response is attached (as annex 2) in which agreed on most of the findings and recommendations.

In addition to provide a copy to the President/CEO of JVC, we also extend copies to the following officials and agencies:

- 1 Governor, Kosrae State Government
- 2 Speaker, 11th KSL and all members
- 3 Chief of Clerk, Kosrae State Court
- 4 V6AJ Radio

If there is any question or concern regarding this report, please feel free to contact the Office of the Public Auditor.


Stoney S. Taulung
Public Auditor

ACKNOWLEDGEMENT AND OPA CONTACT

A Follow Up Audit of the Kosrae Industrial Development Corporation Report No. FA 01-2016

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ACKNOWLEDGEMENT	Emma Belagot, CPA, Audit Manger Alice S. George Auditor III Elizabeth Jonah, Auditor II
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