

Audit on Cash Handling of New Production Development Fund- Department of Resources and Economic Affairs

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



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October 17, 2017

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

Re: Performance Audit on Cash Handling of New Production Development Loan Fund

EXECUTIVE SUMMARY

We respectfully submit this Performance Audit PA 02-2017 as a result for our review on the cash handling of New Production Development Loan Fund for the covering period of FY 2014-2015.

The objective of the audit was to determine whether (1) Cash receipts are complete, accurate, properly recorded and timely deposited; (2) NPDLF has adequate controls in place to safeguard its assets and carry out its mandate effectively and efficiently.

The audit was performed in accordance with auditing standards generally acceptable in the United States of America and the standards applicable to 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. Furthermore, Kosrae Financial Management Regulations and other laws and regulation provided for the operation of NPDLF were use as criteria for compliance.

With reference to the specific objectives we noted the following:

- (1) The Internal control for collection is weak resulted to incomplete issuance of official receipt and posting of transaction for Production Development Loan unit and possibility of incomplete deposit is high.



- (2) There is no Manual of Operation for NPDLF resulted to an unadequate control to safeguard its assets.

Based on the foregoing findings, we recommend (1) that a report of deposit showing the receipt numbers of the receipts issued must be prepared to match with the amount in the validated deposit slip or receipts issued for the deposited amount should be filed along with the validated deposit slip. This schedule will be used for review of an independent individual doing the deposit function to ensure that all funds collected were properly and timely deposited. (2) Compliance with PDLF Regulations, Title 2, Section 2.4. We recommend establishment of written manual on policies and procedures which will serve as a guide to every employee working in the collection and recording.

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 with the administration of New Production Development Loan Fund on October 17, 2017. The contents were discussed with Administration of NPDLF and were given 10 working days to respond. Management response was received on November 01, 2017 attached as appendix 1 of this report.

Respectfully submitted,


Stoney S. Taulung
Public Auditor



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INTRODUCTION:

The Kosrae State Office of the Public Auditor (OPA) received the Legislative Resolution No. 10-274 to conduct a special audit on New Production Development Fund (NPDF). It is also in relation to the concern raised by the Department of Administration and Finance with regards to the accuracy of the amount transmitted to them. Accordingly, we performed cash count however there was no collection at the time of the cash count. Initial review of documents submitted to the Office of the Public Auditor by the administrator of the 3 sections under the NPDF displayed sound purpose to conduct performance audit on handling of collection.

BACKGROUND

The New Production Development Fund (NPDF)¹ created thru State Law 9-106 that repeals state law 1-25, 3-99 and 4-8 to merge and consolidate the existing Kosrae Farmer's Exchange Fund, Production Development Loan Fund, Fisheries Revolving Fund and Marketing Support Fund into single revolving fund to carry out the functions of the current four funds.

1. **Production Development Loan Fund**² (PDLF), a revolving fund established by State Law No. 3-99 in order to make available low interest loans to private individuals engaged in the business for profit of producing goods for sale and consumption in the State of Kosrae which can be substituted for goods that are presently imported, or any goods for export and sale outside Kosrae. This State Law was enacted pursuant to the provisions of Kosrae State Code Section 2.402. The main objective of this fund is to be able to provide funds on a loan basis to local residents who are engaged and are intending to engage in the production of consumer goods which will promote import substitution or which can be exported for sale outside the State of Kosrae. Also, to share technical know-how on local residents who engaged in the production of consumer goods.
2. **Kosrae Farmers Exchange Revolving Fund**³ was established by Kosrae State Law 1-25 on June 10, 1977 for the purpose of buying agricultural supplies and selling the goods to farmers at a price not more than 10% higher than the purchase price plus cost of freight and insurance. Proceeds from sales shall be used to make further bulk purchases. State Law 1-25 specifically provides that agricultural supplies in bulks to be purchased are seeds, fertilizers, insecticides, hog and chicken feed, and small hand tools.

¹ State Law 9-106

² State Law 3-99

³ State Law 1-25



3. **Fisherman’s Revolving Fund⁴** was established thru **State Law 4-8**. The fund would be self-starting as Marine Resources currently has various fishing supplies which were provided without cost as part of the Japanese Goods and Services agreement. As such, the Marine Resources Division is in need of a method to allocate these materials. The fund shall sell fishing supplies and the money received from sales would finance additional purchases of fishing supplies on a non-profit basis.

Likewise, state law 9-106 repeals amend title 10.1025 (1)(a)⁵ to specifically to assign the administration of fund to the Director of the Department of Resources and Economic Affairs (DREA) but all funds shall be received, held, disbursed and accounted by the Director of the Department of Administration and Finance (DOAF) or his designee.

Kosrae State Financial Management Regulation

These regulations are promulgated by the Director of the Department of Administration and Finance pursuant to Sections 10.202 and 2.402 of the Kosrae State Code. These regulations shall have the force and effect of law.

“The purposes of these regulations are to implement and establish a Financial Management System, setting forth guidelines, procedures, requirement, and standards to provide fiscal control and accountability over public funds and other funds for which the government is a trustee, a fiduciary, or is any other way responsible.”

(1) The Revenue Fund contains all monies received by the Government pursuant to a law imposing a tax, duty or tariff, and all other revenues and reimbursements from a fine, fee, license, interest, rent, or Government service, and other Government collection or collections by a government for the Government’s benefit except as otherwise required by law. A person who receives monies pursuant to this section transmits the monies within seven days of receipt to the Division of Finance and Budget for deposit in the Revenue Fund. Exemptions of which include but not limited to the Department of Resources and Economic Affairs(KSC 10.205- (1)(a) which states: Likewise, this provision was comprised in FMR VI (6.3)⁶ Fund Accounts.

⁴ State Law 4-8

⁵ Amended Kosrae Code 10.205 (1)

⁶ KFMR 6.3



AUDIT OBJECTIVES AND SCOPE

Objectives

The purpose of this audit is to assess New Production Development Fund Cash Handling Procedure. Specific objective includes the following:

1. Cash Receipts are complete, accurate, properly recorded and timely deposited.
2. NPDLF has adequate controls in place to safeguard its assets and carry out its mandate effectively and efficiently.

Scope

Our performance audit covered the New Production Development Fund's (NPDLF) transaction for the Fiscal year 2014-2015. However, the gathering, reviewing and testing of relevant information and documentations included 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 New Production Development Fund collection management.

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. Details of our findings and recommendations are explained in the schedule of Findings and Recommendation of this report.

PRIOR YEAR AUDITS/REVIEWS

This is the first time that a separate audit / examination was conducted on Cash Handling Procedure of the New Production Development Fund. However, there was previous audit for Production Development Loan Fund and Kosrae Farmers Exchange Revolving Fund as separate entities.

CONCLUSION

Based on our examinations and audit objectives, we conclude that the following:

1. Controls over collection are weak.
2. NPDLF has no adequate controls in place to safeguard its assets and carry out its mandate effectively and efficiently.

The findings and recommendations are discussed in detail in the following pages.



Findings and Recommendations

Finding No. 1 : Weak Internal Control for Collection

‘Condition: We noted that PDLF does not prepare schedule of deposit showing cash receipt numbers in every deposit transaction nor maintains an audit trail to enable review whether all funds collected have been timely and properly deposited. We also found out that not all collections were receipted and cash receipts are not issued chronologically. Hence, interview with the Program Analyst confirmed that he is not sure if all the collections were remitted to him.

1.1 Possible Incomplete issuance of Official Receipts and posting of transaction.

To establish accountability for the reception of cash and completion of deposits/remittance, PDLF cashier is required to prepare an accurate daily transaction summary and deposit/remittance slip.

1.2 Possibility of Incomplete Deposit.

Examination of Official Receipt from Department of Finance and Administration on the total deposit/ remittance of NPDLF show that it was based on the total official receipts issued by the cashier. Review of official receipts issued does not tally with the remittance slip in finance. Thus, the auditor believes that there is a high possibility that some of collections were not deposited.

Criteria: There should be working controls to ensure that all collections were properly recorded and timely deposited.

Cause: Failure of the management to implement prudent procedures to ensure that all loans repayment collections have been deposited.

Effect: The auditors cannot ascertain whether all funds collected from collections were properly and timely deposited due to absence of formal receipts books and formal receipting procedures. Fund misappropriation exists should collections arising from loan payments were not deposited.

Recommendation: We recommend that a report of deposit showing the receipt numbers of the receipts issued must be prepared to match with the amount in the validated deposit slip or receipts issued for the deposited amount should be filed along with the validated deposit slip. This schedule will be used for review of an independent individual doing the deposit function to ensure that all funds collected were properly and timely deposited.



Finding No. 2 – No Operation Manual: Policies and Procedure, no adequate control to safeguard its assets.

Condition: NPDLF procedures are not documented in a written manual. Although employees are familiar with the procedures, a manual would serve to supplement their knowledge. This is particularly critical for the organization since a single person performs substantially all accounting functions and should that person leave the organization, the transition to new personnel could be very difficult. As of now, NPDLF is using the regulation of the previous Production Development Fund. Interview with the Project analysis that handles NPDLF reveals that the merging of 3 units namely Production Development Loan Fund, Kosrae Farmers Exchange Revolving Fund and Fisherman’s Revolving Fund was mandated by the state law however there was no clear regulation issued for its operation as one unit.

Criteria: PDLF Regulations Title 2, Section 2.4 requires that “the Manager establishes and maintains an accounting system to ensure accountability of all funds and all other records of PDLF.”

Cause: Management failed to realize the importance of written operating manual to enable them to prepare correct financial statements.

Effect: Non-compliance with PDLF regulations. Inability to ensure proper monitoring of cash transactions.

Recommendation: Compliance with PDLF Regulations, Title 2, Section 2.4. We recommend establishment of written manual on policies and procedures which will serve as a guide to every employee working in the accounting section to include the following:

1. A list of standard books of accounts and ledgers to be maintained;
2. Policies and procedures of usage of standard forms used in the organization
3. Appropriate descriptions of all financial policies and accounting procedures and routines regarding, but not necessarily limited to the following:
 - a. Monthly review of internally generated reports, which may vary in complexity from a simple scan of transactions to detailed analysis or reconciliation work;
 - b. Policies related to cash transactions, receipts, and procedures regarding the investment of excess cash on hand; and
 - c. Doubtful accounts and related bad debt policies.



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October 17, 2017

Stoney Taulung
Public Auditor
Kosrae State Public Auditor's Office
Kosrae State



Thru: Lyndon Cornelius
Director, DREA

RE: Management Response to Audit Findings for PDF

Dear Mr. Stoney:

I write you this letter to respond to the audit findings highlighted in the working paper dated October 17, 2017 and further discussed in detail during the exit conference. As we stated during the exit conference, our gratitude to you and your staff for the audit conducted. We welcome such exercise as we cannot see our own shortfalls. Thank you!

Finding:

We noted the PDLF does not prepare schedule of deposit showing cash receipt numbers in every deposit transaction nor maintains an audit trail to enable review whether all funds collected have been timely and properly deposited. We also found out that not all collections were receipted and cash receipts are not issued chronologically. Hence, interview with the Program [Project] Analyst confirmed that he is not sure if all the collections were remitted to him.

Recommendation:

We recommend that a report of deposit showing the receipt numbers of the receipts issued must be prepared to match with the amount in the validated deposit slip or receipts issued for the deposited amount should be filed along with the validated deposited slip. This schedule will be used for review of an independent individual doing the deposit function to ensure that all funds collected were properly and timely deposited.



Management Response:

Management Response:

Division of Trade & Investment is now utilizing pre numbered receipts since 2015 as recommended by your office. The department is also implementing other best practices i.e. Project Analyst/AO issues receipts upon receiving of each deposit to acknowledge receipt of that deposit with the amount received. This receipt is then attached to each respective deposit report and file.

The pre numbered receipt being utilized comes in triplicate: white copy (original) for payee, yellow copy is attached with the deposit report, and pink copy is kept in a binder for our copy.

Finding:

NPDLF procedures are not documented in a written manual. Although employees are familiar with the procedures, a manual would serve to supplement their knowledge. This is practically critical for the organization since a single person performs substantially all accounting functions and should that person leave the organization, the transition to new personnel could be very difficult. As of now, NPDLF is using the regulation of the previous Production Development Fund. Interview with the Project Analysis [Analyst]

Recommendation:

Compliance with PDLF Regulations, Title 2, Section 2.4. We recommend establishment of written manual on policies and procedures which will serve as a guide to every employee working in the accounting section to include the following:

1. A list of standard books of accounts and ledgers to be maintained;
2. Policies and procedures of usage of standard forms used in the organization
3. Appropriation descriptions of all financial policies and accounting procedures and routines regarding, but not necessarily limited to, the following:
 - a. Monthly review of internally generated reports, which may vary in complexity from a simple scan of transactions to detailed analysis or reconciliation work
 - b. Policies related to cash transactions, receipts, and procedures regarding the investment of excess cash on hand; and
 - c. Doubtful accounts and related bad debt policies



Management Response:

The management concurs to the finding that PDF does not have manual of operation to guide implementation of the fund. PDF management will develop a new manual of operation to ensure effective implementation and operation of the loan program.

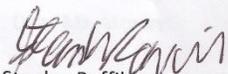
On the contrary, it is important to note that accounting of the fund and any reporting shall be done by the Director of the Department of Administration and Finance pursuant to SL No.9-106, Section 3(iii) and subsection (1)(2). Therefore, PDF management tasks will be limited to collection of payments and maintenance of each individual client file.

We are hopeful that at least a draft copy of the manual will be available for your review and comment during the follow up audit.

Once again our gratitude for the inspection and I hope such inspection/audit be conducted more often in the future to keep us accountable.

Let me know if you have any questions or need further information.

Sincerely,


Stanley Raffilman
Trade & Investment Division

cc: Project Analyst/AO
Division Administrators
PDF

Recommendation:

We recommend that a record of deposit slip sequence/serial numbers of the receipts issued must be prepared in respect with the amount in the validated deposit slip or receipts issued for the deposited amount should be filed along with the validated deposited slip. This schedule will be used for review of an independent work-up regarding the deposit function to ensure that all funds collected were properly and timely deposited.



Public Auditor's Comments

We would like to extend our appreciation to the Department of Resource and Economic Affairs and staff for their cooperation and assistance throughout the course of our audit.

In compliance with Generally Accepted Government Auditing Standards, a copy for the draft report was shared with the Department of Resource and Economic Affairs with a management response. The response is attached which agreed on most of the findings and recommendations.

In addition, to provide a copy to the Department of Resource and Economic Affairs, we also extend copies to the following officials and agencies:

1. Governor, Kosrae State Government
2. Speaker, 11th KSL and all members
3. Chief Clerk, Kosrae State Court
4. Attorney General, Kosrae State
5. V6AJ Radio

If there are any questions or concerns regarding this report, please feel free to contact the Office of the Public Auditor.


Stoney S. Taulung
Public Auditor



ACKNOWLEDGEMENT AND OPA CONTACT

Audit of Department of Resource and Economic Affairs New Production Development Fund
on Cash Handling
Report No. PA 02-2017

OPA Contact Stoney S. Taulung, Public Auditor
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the report Elizabeth M. Jonah, Auditor II
 Reed J. Floyd, Auditor I

OPA MISSION Conduct effective and efficient audits and
Investigation to ensure that Government
resources are properly managed

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