

KAPINGAMARANGI MUNICIPAL GOVERNMENT
FISCAL YEARS ENDED SEPTEMBER 30, 2015 & 2016

AUDIT REPORT NO. 005-18

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POHNPEI STATE GOVERNMENT

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May 23, 2018

The Honorable Marcelo K. Peterson, Governor
The Honorable Fernando Scaliem, Speaker of the 9th Pohnpei State Legislature
The Honorable Members of the 9th Pohnpei State Legislature
The Honorable Caleb Gamule, Chief Magistrate, Kapingamarangi Municipal Government
The Honorable Luther Joseph, Speaker, Kapingamarangi Municipal Council
The Honorable Members of Kapingamarangi Municipal Council

EXECUTIVE SUMMARY

We respectfully submit the audit report of Kapingamarangi Municipal Government for the fiscal years ended September 30, 2015 and 2016. The performance audit was conducted pursuant to Article 11, Section 8 (2) of the Pohnpei State Constitution and Pohnpei State Law No. 1L-10-79, as amended. The audit was also conducted in accordance with the government auditing standards generally accepted in the United States of America contained in the *Government Auditing Standards* issued by the Comptroller General of the United States.

The objectives of our audit were as follows: (1) Were the KMG revenues collected during the audited periods properly documented, deposited at the KMG approved depository account at the designated bank in a timely manner and accounted for in accordance with applicable laws? and, (2) Were the KMG cash disbursements properly approved, recorded, supported, and accounted for in accordance with applicable laws, regulations, policies and procedures or best practice?

Based on our audit, we conclude that there is much room for improvement in the KMG's control related activities over its revenues and in the administration and processing of its disbursements. In line with our audit objectives, we identified two (2) material control weaknesses which are described fully in the Schedule of Findings and Recommendations on pages 4 to 8.

Presented below is a brief summary of the weaknesses along with our recommendations which we believe will help improve the Municipality's operations if implemented.

Summary of Findings

1. *Inadequate Controls over the handling of Revenue Collections; and*
2. *Inadequate Controls over processing of Cash Disbursements.*

Summary of Recommendations

1. *We recommend that KMG give priority consideration to the following:*
 - a) *Develop, implement, and maintain proper internal control policies and procedures in the handling of revenue collections and cash disbursements; and*
 - b) *Enhance employee skills in the proper processing, recording, and reporting of revenue collections and disbursement of cash.*

A copy of the draft report was provided to the Auditee and discussed with them during the exit conference held on April 17, 2018. The Mayor was requested to provide his response to the audit findings that should include the Municipality's corrective action plan in rectifying the weaknesses cited in the report. The Mayor's response becomes part of the report and is presented as Appendix A on pages 10 & 11 of this report.

An addendum to the enabling act that created the Office of the Public Auditor (OPA), SL No.05-08-00, requires that Kapingamarangi Municipal Government should submit to OPA a monthly report indicating its progress in the resolution of the findings cited in the audit report. The resolution of the findings shall not exceed six (6) months.

We extend our sincere appreciation to the Chief Magistrate of Kapingamarangi Municipal Government for his cooperation and assistance during the course of our audit.

Sincerely,

Ihlen K. Joseph
State Public Auditor

Kapingamarangi Municipal Government
Performance Audit of Revenue Collection and Cash Disbursements
For Fiscal Years ended September 30, 2015 and 2016

Audit Report No. 005-18

INTRODUCTION

The audit of the Kapingamarangi Municipal Government (KMG) revenue collection and disbursement activities for fiscal years 2015 and 2016 has been scheduled as part of the Pohnpei Office of the Public Auditor (POPA) audit plan for fiscal year 2017. This report contains the result of our review.

BACKGROUND

The Kapingamarangi Municipal Government (KMG) is one of the eleven municipal governments of Pohnpei State. The KMG is composed of three branches of government, namely:

- 1) **The Executive Branch** - headed by the Chief Magistrate, who is elected by the qualified voters of Kapingamarangi. This branch is responsible for the faithful execution of the provisions of all laws or ordinances and the Constitution of Kapingamarangi.

- 2) **The Legislative Branch** – also known as the Kapingamarangi Municipal Council (KMC) is headed by the Speaker. This branch is the law-making body of the Kapingamarangi Government. The KMC establishes local laws through municipal ordinances for all types of activities, including the fiscal allocation of all resources received annually by the KMG, imposition of local revenues such as business license fees, court fines and other service fees.

- 3) **The Judiciary Branch** – headed by the Chief Justice and has the judicial power of Kapingamarangi. The branch is responsible for interpreting and judging issues, actions, and/or other matters based on the laws and may impose fines and penalties, as applicable.

The Constitution also established a section in the government for Tradition to oversee all matters relating to the Customs and Traditions of Kapingamarangi.

The key management officials of the KMG during the review period were:

1. The Honorable Caleb Gamule - Chief Magistrate
2. Sakius George – Chief Rep.
3. UsastKaipas - Treasurer

SOURCES OF REVENUES

The main sources of revenue for the KMG includes: 1) The Local Government Revenue Sharing Act of 1989, which requires that at least 30% of Pohnpei State Government revenues collected from sources within Pohnpei is allocated to the eleven (11) local governments based on

population; and 2) revenues raised or received from its own locally imposed fees on business licenses, court fines, and other service fees.

Our review disclosed that the total revenues received to support the KMG operations and programs amounted to \$72,461 each year or a total of \$144,922 for the two fiscal years being audited. This amount represents the 30% revenue sharing arrangement required under the Pohnpei Constitution. It does not include monies collected, if any, from the locally imposed business license fees, court fines, and other service fees generated locally.

The KMG legal framework requires that no money shall be disbursed or withdrawn from the KMG funds except by municipal law or ordinance.

AUDIT OBJECTIVES

The objectives of the audit were as follows:

1. Were the KMG revenues collected during the audit periods properly documented, accounted for, and deposited at the KMG approved depository account at the designated bank in a timely manner and in accordance with applicable laws?
2. Were the KMG cash disbursements properly approved, recorded, supported, and accounted for in accordance with applicable laws, regulations, policies and procedures or best practice?

SCOPE AND METHODOLOGY

To achieve our audit objectives, we applied the following audit procedures;

1. Reviewed and verified the availability of Cash Receipt and Cash Disbursement Journal;
2. Reviewed the KMG collection of revenues and disbursement activities for FY-2015 & 2016;
3. Reviewed the KMG Bank Reconciliation activities for the audited period;
4. Conducted interviews with relevant KMG officials; and,
5. Performed other procedures deemed necessary to achieve the audit objectives

Our audit covered two (2) fiscal years, 2015 and 2016.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, 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.

PRIOR AUDIT COVERAGE

We last audited the KMG fifteen (15) years ago. It was a financial related audit and the report identified numerous internal control deficiencies, weaknesses, and non-compliance to the financial management and reporting requirements of the Pohnpei Government.

CONCLUSION

As a result of our audit, we conclude that the KMG still lacks the fundamental controls necessary for the proper accounting, recording, managing and reporting of its financial affairs. We noted slight improvement with respect to the availability of documents. Although, the KMG management requested and was granted ample time to prepare for this review, the documents prepared and presented were not adequate to facilitate a complete review of the KMG financial management and activities for the two fiscal years.

At the outset, we identified two (2) major internal control deficiencies in the KMG financial activities and these include:

1. Lack of proper controls regarding its handling of revenue/cash collection; and
2. Inadequate controls in the processing, recording, and reporting of its cash disbursements.

Refer to the Schedule of Findings and Recommendations for detail on the next five (5) pages.

**Kapingamarangi Municipal Government
Schedule of Findings and Recommendations
For fiscal years ended September 30, 2015 & 2016**

Finding No. 01: KMG Needs to Improve Controls Over Its Revenue Collection

Criteria

The Pohnpei State financial and budgetary legal framework require proper administration and accountability of revenue collection and cash management. This requirement includes the establishment, implementation, and maintenance of proper internal control system to govern and provide assurance that revenue and cash collected are handled and managed properly.

The system should at least include the following:

- a) Issuance of a cash receipt for each revenue and cash transaction received by the government in pre-numbered and numerical order;
- b) correctly recording the cash transaction in the books;
- c) timely depositing of all collections to the approved depository account at the KMG designated bank;
- d) maintaining and safekeeping all related records in an organized manner;
- e) safeguarding the revenues and ensuring they are used for authorized purpose only; and
- f) timely and properly reporting of the government financial affairs to stakeholders.

Condition

Our review disclosed that the Kapingamarangi Municipal Government (KMG) did not have in place a suitable internal control policy or procedure to govern and guide the handling of its revenues and cash collections. We found the following:

1. Revenue/Cash Collections Not Properly Receipted and Reported- While we were able to verify that most of the revenues and cash received by the KMG during the audited period were deposited at the approved depository account at the KMG designated bank, we found that no cash receipts were issued to properly document the collection. As a result, we were not able to confirm or determine the actual revenue/cash collected during the audited period. Revenues

collected from the locally imposed license fees, court fines and other sources were most difficult to determine without supporting cash receipts or related supporting documents.

2. No segregation of Duties – We found that the function of receiving, recording, banking and reporting of KMG revenues were performed by one and same person, with the support and assistance of a related party. There was no evidence of independent or oversight review of the KMG revenue collection activities during the period assessed.

Cause

The KMG did not have a proper internal control policy or procedure in place to govern its revenue collection and cash management activities.

Effect

Without proper accounting and management of its revenues received, the KMG was exposed to high risk of loss, including abuse, misuse and mismanagement of its financial resources.

Recommendations

We recommend:

- The KMG management to give priority consideration to develop, implement, and maintain proper internal control policies and procedures to govern and ensure that its revenue and cash collections are safeguarded from loss, abuse and mismanagement.
- The KMG management to identify and enroll responsible staff in financial and accounting programs available locally, including short-term on-the-job attachment training at the FSM Finance or at Pohnpei DoT&A to enhance skills in government, accounting and related financial management and reporting.
- The KMG management to provide appropriate staff opportunity to learn and be responsible for the financial accounting, management and reporting of the KMG financial matters. The management also
- must continue to provide periodic oversight review to ensure that KMG funds and related resources are safeguarded at all times.

Auditee Response: Cash receipts were not requested by the Auditor-In-Charge. Please refer to Appendix A on pages 9-11 of this report.

Auditor’s Rebut: Cash receipts, along with other documents required to complete the audit, were requested in the Engagement Letter sent to the Chief Magistrate.

Finding No. 02: KMG Cash Disbursements Needs Improvement

Criteria

The KMG is required to conform to applicable Pohnpei statutes and regulations in the expenditure and management of its funds received through the “Local Revenue Sharing Act of 1989”. In general, the Pohnpei Government financial management legal framework require that no government funds shall be disbursed except: a) by authorization by law, b) to liquidate valid obligation of the government. The legal

frameworks also require that all cash disbursements, regardless of the source and amount, must be adequately supported by documents (Purchase Requisition, Travel Authorization (TA), Contract, Timesheet, Invoices, etc.).

Condition

Our review revealed that 100% or 295 disbursement transactions selected for testing were processed **without** supporting documentation and proper fund certification by the treasurer. Payroll checks were filed separately thus breaking the sequence of check filing. In addition, KMG did not have a cash disbursement journal to properly record, account for, and timely reporting of its disbursement activities in summary or detail form.

Further review disclosed other internal control weaknesses, relative to the following:

- a) **Payroll Checks** – Disbursements for payroll checks were not properly recorded and accounted for. Without proper records and documentation for payroll, the KMG may lapse on its payments of payroll related liabilities. It would be hard for KMG to prove and confirm future benefit entitlements for the KMG employees without proper recording and related supporting documents.
- b) **Projects/Program** – Our review also revealed that funds were disbursed for projects/programs without appropriation and contract agreement executed. We could not verify the legitimacy of the disbursements due to lack of appropriate files and supporting documents to justify and record the implementation, performance and reporting of the projects/programs.
- c) **Official Travel** – Disbursements for KMG travels were made without the required approved Travel Authorization (TA) or its equivalent form to document official travel activities during the two fiscal years under review. We also noted that certain payments made against the KMG travel account appeared to be for personal use and not for official purpose.

In addition, we observed the following internal control deficiencies during our review:

- Missing check vouchers,
- Disbursements not supported with original invoices,
- Voided checks not filed intact, and

We also noted that the Chief's Representative and the Treasurer are both residing on Kapingamarangi. The Chief Magistrate is domiciled in Pohnpei and was responsible for all financial activities for the KMG, including: a) purchasing, b) processing payments, c) filing and maintaining of records, d) financial reporting etc. The Chief Magistrate was and still is the sole signatory on the KMG approved bank account.

Cause

The deficiencies existed due to the following:

a) Lack of proper internal control structure in place to govern the cash disbursements activities of the KMG,

b) Inadequate skill set to ensure proper accounting and timely reporting of the KMG financial affairs;

c) No segregation of financial related duties and responsibilities to allow periodic management or second party review and comment on the financial activities of the KMG.

Effect

The KMG was exposed to high risk for loss of public monies, including abuse, mismanagement, and theft. The condition also caused negative impact on the KMG financial position, accountability, and transparency.

Recommendations:

We recommend:

1. The Chief Magistrate to develop, implement and maintain an adequate internal policy and procedures (P&P) to govern the cash disbursement activities. Policy should adopt and incorporate the principles and best practices provided in the Pohnpei Financial Management Regulations (FMR). (See appendix B for excerpt of FMR relating to disbursements.) The Chief Magistrate should ensure that the responsible staff is trained and oriented on the P&P.
2. The Chief Magistrate to appoint or relocate the KMG Treasurer to be based in Pohnpei proper to carry out the financial affairs of the government. In line with this, the Chief Magistrate should ensure that the responsible staff is trained properly to record KMG transaction and maintain appropriate books and facilitate financial reporting of the KMG for a transparent and accountable government.
3. KMG leadership and management to consider having at least two authorized signatories for the KMG approved depository account at the designated bank to provide adequate control and security of its funds and related resources.
4. The Chief Magistrate to develop and implement clear written duties and responsibilities of the KMG personnel to ensure clear separation of duties and responsibilities.

Auditee Response: Please refer to Appendix A on pages 9– 11 of this report.

Important Message

The Pohnpei Office of the Public Auditor (POPA) actively solicits and welcomes allegations of any insufficient and wasteful practice, fraud and corruption in the Pohnpei Government. Fraud, waste, mismanagement, misuse, abuse or any allegation or sign of corruption in the government should be a concern of everyone in Pohnpei. You can report allegations of fraud and abuse by contacting the POPA at the following addresses:

Mail: Pohnpei Office of the Public Auditor
P.O. Box 367
Kolonia, Pohnpei State, FM 96941

Phone: (691) 320-2638
Hotline: (691) 320-8497 (24/7)

E-Mail: opsa_psa@mail.fm

KAPINGAMARANGI MUNICIPAL GOVERNMENT

APPENDIX A
AUDITEE RESPONSE

FISCAL YEARS ENDED SEPTEMBER 30, 2015 & 2016

KAPINGAMARANGI MUNICIPAL GOVERNMENT

APPENDIX B
Excerpt from the Pohnpei State Financial Management Regulation (FMR)

FISCAL YEARS ENDED SEPTEMBER 30, 2015 & 2016

