

KWAJALEIN ATOLL LOCAL GOVERNMENT

INDEPENDENT AUDITORS' REPORT ON
INTERNAL CONTROL AND ON COMPLIANCE

YEAR ENDED SEPTEMBER 30, 2000



INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON INTERNAL CONTROL
OVER FINANCIAL REPORTING BASED UPON THE ENGAGEMENT TO AUDIT
PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Mayor Wilmer Bolkeim
Kwajalein Atoll Local Government
Republic of the Marshall Islands:

We were engaged to audit the general purpose financial statements of the Kwajalein Atoll Local Government (KALGOV) as of and for the year ended September 30, 2000. Our report dated May 8, 2001, stated that the scope of our work was not sufficient to enable us to express, and we did not express, an opinion on the financial statements due to our inability to determine that assets, liabilities, revenues and expenditures were fairly stated.

Compliance

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, require that an audit be planned and performed in order to obtain reasonable assurance about whether the general purpose financial statements are free of material misstatement. We performed tests of KALGOV's compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of general purpose financial statement amounts. However, providing an opinion on compliance with those provisions was not our objective and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance that are required to be reported under *Government Auditing Standards*, which are described in the accompanying Schedule of Findings (pages 3 through 15) as items 2000-12 and 2000-13.

Internal Control Over Financial Reporting

In planning the audit, we considered KALGOV's internal control over financial reporting in order to determine the auditing procedures for the purpose of expressing our opinion on the general purpose financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect KALGOV's ability to record, process, summarize and report financial data consistent with the assertions of management in the general purpose financial statements. Reportable conditions are described in the accompanying Schedule of Findings as items 2000-1 through 2000-11.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the general purpose financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider Findings 2000-5, 2000-6, 2000-9, 2000-10 and 2000-11 to be material weaknesses.

This report is intended solely for the information and use of management and the Board of Directors and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte & Touche

May 8, 2001

KWAJALEIN ATOLL LOCAL GOVERNMENT

Schedule of Findings
Year Ended September 30, 2000

Revenue/Receipts

Finding No. 2000-1

Criteria: Cash receipts should be deposited on a daily basis and evidenced with supporting documents.

Condition: Of twenty-five cash receipts tested, we noted one instance (OR #16717) where the validated deposit slip indicated the deposit was made fourteen months after receipt.

Cause: The cause of the above condition is the lack of established internal control procedures.

Effect: The effect of the above condition is a weakness in control over cash and the potential for misappropriation.

Recommendation: We recommend that KALGOV develop and maintain procedures to ensure that all cash receipts are deposited on a timely basis.

Prior Year Status: The lack of timely depositing of cash receipts was reported as a finding in the audits of KALGOV for fiscal years 1998 and 1999.

Auditee Response and Corrective Action Plan: Recommendation noted and action taken.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Schedule of Findings, Continued
Year Ended September 30, 2000

Revenue/Receipts

Finding No. 2000-2

Criteria: The Daily Cash Collection Report (CCR) should be reviewed and approved on a daily basis by the Controller and evidenced as such.

Condition: Of twenty-five cash receipts tested, one CCR (OR # 17070) did not indicate review and approval by the Controller.

Cause: The cause of the above condition is the lack of adherence to established internal control procedures.

Effect: The effect of the above condition is weakness in controls and documentation of cash receipts.

Recommendation: We recommend that all CCRs be properly approved by the Controller to indicate review and approval.

Prior Year Status: The lack of adherence to established internal control procedures was reported as a finding in the audit of KALGOV for fiscal year 1999.

Auditee Response and Corrective Action Plan: Recommendation noted and action taken to ensure that all CCRs are properly reviewed and approved.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Schedule of Findings, Continued
Year Ended September 30, 2000

Purchases/Disbursements

Finding No. 2000-3

Criteria: All disbursements should be evidenced by a check copy with the attached supporting invoice and the cancelled check.

Condition: Of twenty-five cash disbursements tested, check #17604 was missing. The check copy and cancelled check were not available. We noted that cancelled checks are not properly maintained. KALGOV was unable to provide cancelled check #17681.

Cause: The cause of the above condition is the lack of established internal control procedures over supporting documents.

Effect: The effect of the above condition is the lack of support for disbursements.

Recommendation: We recommend that all cash disbursements be supported and all cancelled checks be properly maintained to support disbursements.

Auditee Response and Corrective Action Plan: Recommendation noted and action taken.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Schedule of Findings, Continued
Year Ended September 30, 2000

Payroll

Finding No. 2000-4

Criteria: Payroll check vouchers should agree to payroll registers and the City Manager should review the payroll register for approval and ensure that all timesheets are approved by department heads.

Condition: For pay period ending (PPE) October 16, 1999, check vouchers did not agree to the payroll register. Checks for that pay period began with check #10544 and ended with check #10699. However, the payroll register began with check #10545 and ended with check #10700. Additionally, we noted that the payroll registers for PPE October 19, 2000 and December 25, 1999 were not reviewed by the City Manager to indicate approval. Additionally, one timesheet for PPE September 21, 2000 was not approved by the department head.

Cause: The cause of the above condition is the lack of adherence to established internal control procedures.

Effect: The effect of the above condition is the lack of approval of personnel expenditures.

Recommendation: We recommend that KALGOV follow procedures to ensure checks are properly recorded in the payroll register and that the City Manager review the payroll register for approval. Also, all timesheets should be approved by the department head.

Auditee Response and Corrective Action Plan: Action has been taken to ensure that all timesheets are signed and properly reviewed.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Schedule of Findings, Continued
Year Ended September 30, 2000

External Financial Reporting

Finding No. 2000-5

Criteria: Sufficient internal control over general ledger balances requires that control totals be periodically reconciled to subledgers, and reviewed for reasonableness.

Condition: KALGOV did not record beginning of the year general ledger control totals for liabilities and thus operated for the entire fiscal year with inaccurate general ledger balances. This situation would not have allowed the financial management system to determine budgetary adherence during the fiscal year.

Cause: The cause of the above condition is that policies and procedures that would require the posting of beginning of the year general ledger control totals and their subsequent reconciliation and review have not been established.

Effect: The effect of the above condition is that liability general ledger balances were misstated throughout the fiscal year.

Recommendation: We recommend that KALGOV establish policies and procedures that require the posting of beginning of the year general ledger control totals and their subsequent reconciliation and review.

Prior Year Status: Not recording beginning of the year general ledger control totals was reported as a finding in the audits of KALGOV for fiscal years 1993 through 1999.

Auditee Response and Corrective Action Plan: Recommendation noted and action has been taken. KALGOV has taken steps to install accounting software.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Schedule of Findings, Continued
Year Ended September 30, 2000

External Financial Reporting

Finding No. 2000-6

Criteria: Sufficient internal control over receivable and payable balances requires that general ledger control totals be periodically reconciled to subledgers and be reviewed for reasonableness.

Condition: Accounts receivable have not been reconciled to actual amounts due, and accounts payable and accrued liabilities have not been reconciled to actual obligations due. Additionally, no subsidiary ledgers were maintained to support the general ledger balances.

Cause: The cause of the above condition is that policies and procedures do not exist that require the periodic reconciliation of receivable and payable balances.

Effect: The effect of the above condition is that receivable and payable balances are misstated throughout the fiscal year.

Recommendation: We recommend that KALGOV establish policies and procedures that require the periodic reconciliation of receivable and payable accounts.

Prior Year Status: The lack of reconciliation of receivable and payable balances was reported as a finding in the audits of KALGOV for fiscal years 1987 through 1999.

Auditee Response and Corrective Action Plan: Recommendation noted and action taken.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Schedule of Findings, Continued
Year Ended September 30, 2000

Cash

Finding No. 2000-7

Criteria: An appropriate number of bank accounts should be maintained for operations.

Condition: KALGOV currently maintains five checking accounts for operations, which appears excessive for KALGOV's requirements.

Cause: The cause of the above condition is the lack of management review of operational requirements to determine an appropriate number of bank accounts.

Effect: The effect of the above condition is additional complexity in maintenance and reconciliation of the checking accounts.

Recommendation: We recommend that management review operational requirements and determine an appropriate number of bank accounts.

Prior Year Status: Lack of management review of operational requirements to determine an appropriate number of bank accounts was reported as a finding in the audit of KALGOV for fiscal year 1999.

Auditee Response and Corrective Action Plan: Action has been taken and implemented.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Schedule of Findings, Continued
Year Ended September 30, 2000

Cash

Finding No. 2000-8

Criteria: Checks should be safeguarded at all times and new checks should sequentially follow the last check number used.

Condition: Unused payroll checks leftover from payroll processing were not marked void or otherwise distinguished as unusable and were left unsecured. Additionally, checks issued from December 1999 to May 2000 were the same numbers as those issued from June 2000 to September 2000.

Cause: The cause of the above condition is the lack of policies and procedures requiring the safeguarding of checks and ensuring that checks are sequentially numbered.

Effect: The effect of the above condition is the susceptibility to theft and the lack of safeguarding of assets.

Recommendation: We recommend that leftover payroll checks be marked void and kept secure. Additionally, new check orders should follow the last series currently in use.

Auditee Response and Corrective Action Plan: Recommendation has been implemented already.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Schedule of Findings, Continued
Year Ended September 30, 2000

Fixed Assets

Finding No. 2000-9

Criteria: Accounting principles generally accepted in the United States of America require that government entities maintain accountability for and control of their general fixed assets.

Condition: KALGOV does not account for its general fixed assets.

Cause: The cause of the above condition is KALGOV has not established policies and procedures to ensure proper control of and accountability for fixed assets.

Effect: The effect of the above condition is the general purpose financial statements of KALGOV do not include a general fixed assets account group. The fixed assets account group is a necessary element of the financial statements of a government entity.

Recommendation: We recommend formal policies and procedures be implemented to establish accountability for and control of fixed assets. This can be accomplished by establishing a general fixed assets account group.

Maintaining a formal record of fixed assets will aid in budgeting, as fixed asset replacements will be easier to forecast. Having formal records of fixed assets also assists in ensuring assets are not misappropriated and assists in determining which assets have been lost or damaged.

Prior Year Status: Not accounting for general fixed assets was reported as a finding in the audits of KALGOV for fiscal years 1993 through 1999.

Auditee Response and Corrective Action Plan: Policies and procedures have been established.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Schedule of Findings, Continued
Year Ended September 30, 2000

Payables and Accrued Liabilities

Finding 2000-10

Criteria: Expenditures should be recorded when the related liability is incurred.

Condition: KALGOV did not record a liability for accrued annual leave as of September 30, 2000. Additionally, KALGOV did not withhold income and social security taxes for annual leave paid during the fiscal year. The amount of unrecorded liabilities and expenditures could not be determined.

Cause: The cause of the above condition is the lack of prescribed policies and procedures requiring annual leave to be recorded and to withhold income and social security taxes for annual leave paid.

Effect: The effect of the above condition is the misstatement of liabilities and expenditures and potential interest and penalty charges for taxes not withheld.

Recommendation: We recommend that expenditures be recorded when related liabilities are incurred and that management implement policies and procedures to ensure that income and social security taxes are appropriately withheld.

Prior Year Status: Lack of prescribed policies and procedures requiring annual leave to be recorded and to withhold income and social security taxes for annual leave paid was reported as a finding in the audit of KALGOV for fiscal year 1999.

Auditee Response and Corrective Action Plan: Action taken as recommended.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Schedule of Findings, Continued
Year Ended September 30, 2000

Payables and Accrued Liabilities

Finding 2000-11

Criteria: Contractual obligations should be adhered to.

Condition: On August 8, 1999, KALGOV entered an agreement with the Government of the Republic of the Marshall Islands (RepMar) whereby RepMar agreed to forgive KALGOV's income withholding tax payable amounting to \$287,754, contingent upon RepMar's receipt of \$99,492 from KALGOV. KALGOV has not made the required payment due to management's position that approximately \$100,000 is receivable from RepMar. Although KALGOV represented that \$99,492 was withdrawn from education grants owed to KALGOV by RepMar, management was unable to provide support for this withdrawal or the unrecorded receivable and, therefore, KALGOV's income tax payable could not be determined. Our follow-up with the RepMar Chief of the Division of Revenue and Taxation indicated that the \$99,492 had not been paid.

Cause: The cause of the above condition is unknown.

Effect: The effect of the above condition is the possible misstatement of receivables, revenues, and withholding tax payable and potential interest and penalty charges for unpaid taxes.

Recommendation: We recommend that management investigate the status of this agreement and record an adjustment, if any, based on the results of the investigation.

Prior Year Status: Possible misstatement of receivables, revenues, and withholding tax payable and potential interest and penalty charges for unpaid taxes was reported as a finding in the audit of KALGOV for fiscal year 1999.

Auditee Response and Corrective Action Plan: Recommendation noted and action taken.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Schedule of Findings, Continued
Year Ended September 30, 2000

Local Noncompliance

Finding No. 2000-12

Criteria: Section 5 of the Republic of the Marshall Islands (RepMar) Income Tax Act of 1989, as amended, states that the employer shall, once every four weeks or thirteen times per year, pay taxes withheld under Section 4 of the Act.

Condition: KALGOV did not remit income tax withholdings from employee wages to RepMar during the year ended September 30, 2000.

Cause: The cause of the above condition is unknown.

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

Recommendation: We recommend that management comply with the Income Tax Act of 1989, as amended.

Prior Year Status: Noncompliance with the Income Tax Act of 1989, as amended, was reported as a finding in the audits of KALGOV for fiscal years 1998 and 1999.

Auditee Response and Corrective Action Plan: Recommendation noted and action taken.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Schedule of Findings, Continued
Year Ended September 30, 2000

Local Noncompliance

Finding No. 2000-13

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 employer, under Sections 129 and 130, and 213 and 214, respectively, and pay into the Fund the contributions due.

Condition: KALGOV did not remit to the Marshall Islands Social Security Administration employer and employee contributions due totaling \$179,713.

Cause: The cause of the above condition is unknown.

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

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

Prior Year Status: Noncompliance with the Social Security Act of 1990 and the Social Security Health Fund Act of 1991 was reported as a finding in the audits of KALGOV for fiscal years 1998 and 1999.

Auditee Response and Corrective Action Plan: Recommendation noted and action taken.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Unresolved Prior Year Findings
Year Ended September 30, 2000

The status of unresolved prior year findings is disclosed within the Schedule of Findings section of this report (pages 3 through 15).