

YAP STATE GOVERNMENT

REPORT ON INTERNAL CONTROLS

YEAR ENDED SEPTEMBER 30, 1988

INDEPENDENT AUDITORS' REPORT ON INTERNAL
ACCOUNTING CONTROL

Honorable Petrus Tun
Governor
State of Yap

We have audited the general purpose financial statements of the State of Yap as of September 30, 1988, and for the year then ended, and have issued our report thereon dated March 15, 1989. These general purpose financial statements are the responsibility of Yap State's management. Our responsibility is to express an opinion on these general purpose financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and the standards for financial and compliance audits contained in the Standards for Audit of Governmental Organizations, Programs, Activities, and Functions issued by the U.S. General Accounting Office. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements and whether management has complied with laws and regulations and has established and maintained a system of internal controls. An audit in accordance with these standards includes examining, on a test basis, evidence supporting the amounts and disclosures in the general purpose financial statements and compliance with laws and regulations. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

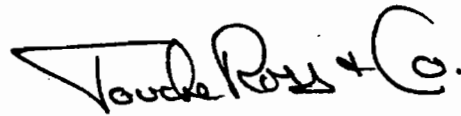
For the purpose of this report, we have classified the significant internal accounting controls of the State of Yap in the categories of: budgetary cycle, revenue and receipt cycle, purchases and disbursement cycle, payroll and personnel cycle, treasury cycle, and external financial reporting. The purpose of our study and evaluation was to determine the nature, timing and extent of the auditing procedures necessary for expressing an opinion on the financial statements administered by the State of Yap. Our study and evaluation was more limited than would be necessary to express an opinion on the system of internal accounting control taken as a whole or any of the categories of controls identified above.

The management of the State of Yap, is responsible for establishing and maintaining a system of internal accounting control. In fulfilling this responsibility, estimates and judgements by management are required to assess the expected benefits and related costs of control procedures. The objectives of a system are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with statutory authorizations and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any system of internal accounting control, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the degree of compliance with the procedures may deteriorate.

Our study and evaluation made for the limited purpose described in the first three paragraphs would not necessarily disclose all material weaknesses in the system. Accordingly, we do not express an opinion on the system of internal accounting control of the State of Yap, taken as a whole or on any of the categories of controls identified in the third paragraph. However, our study and evaluation disclosed no condition that we believe to be a material weakness.

This report is intended solely for the use of the State of Yap, the National Government of the Federated States of Micronesia, and the cognizant audit and other federal agencies and should not be used for any other purpose.

March 15, 1989



Certified Public Accountants

(1) Prior Year Findings

Criteria - All prior audit findings should be adequately addressed and resolved with corrective action being undertaken in a timely manner.

Condition - The following matters appear to be open and unresolved. These matters were addressed in the Letter on Internal Controls for the year ended September 30, 1987, dated August 2, 1988.

1. Prior Year's Findings C. and D.
2. Relationship with Sub-Recipient
3. License and Fees - Vehicles
4. Business Licenses
6. Utility Billing and Processing
7. Feedmill Operation Fund
10. Yap Fishing Authority
 - a. Travel Advances
 - c. Inventory Control
 - d. Receivable Collections
 - f. Monthly Billings
 - g. Competitive Bidding
 - h. Fixed Asset Control
 - i. Inventory Cost Data

Cause - It appears that because of the timing of the prior letter on internal control (August 2, 1988), the conditions noted therein were also active in fiscal year 1988.

Effect - The abovementioned matters were not acted upon in fiscal year 1988.

Recommendation - The above matters should be adequately addressed and resolved.

(2) Payroll Time Sheets

Criteria - All payroll time sheets should be signed by the respective employee responsible for time keeping and should be certified by authorized personnel.

Condition - We were not able to ensure that employees signed their own time sheets or that such were properly certified by authorized personnel.

Cause - Unknown

Effect - Incorrect payroll hours may be paid.

Recommendation - All time sheets should be signed by the required personnel.

(3) Payroll Deduction Forms

Criteria - Payroll deduction forms should be present supporting all deductions from employee payrolls.

Conditions - The current payroll deduction form appears outdated. For example, every time an employee wishes to increase an allotment, the deduction form is signed for only the incremental amount. In one instance, to prove a deduction, we counted approximately ten separate forms over a period of approximately the same numbers of years. As a result, the system is prone to the loss of substantiating documentation.

Cause - Incorrectly drafted payroll deduction forms are used.

Effect - Substantiation of payroll allotments becomes difficult.

Recommendation - Consideration should be given to revising the current allotment form to more adequately address State needs.

(4) Fund Certification

Criteria - All funds should be properly certified prior to the ordering of and the receipt of goods or services.

Condition - One instance came to our attention wherein merchandise was received (fuel oil) prior to fund certification.

Cause - Unknown

Effect - The State could be bound for acquisitions for which it has no funds available.

Recommendation - This instance could be an isolated case and is for a recurring purchase (fuel oil). However, State law requires fund certification. If the State does not believe compliance is required, then this matter should go to the State Legislature for an exemption to the purchase procedures.

(5) Control Over Checks

Criteria - All checks issued should be remitted to vendors or returned for cancellation or other disposition by finance.

Condition - The Scholarship Office, in its safe, is holding \$24,500 in checks to students as of February 24, 1989. These checks are dated from 1984-1988 and are already staledated.

Cause - Unknown

Effect - Expenditures for scholarships are overstated.

Recommendation - All checks held by the Scholarship Office should be remitted to finance for appropriate disposition. Additionally, because of the manner in which these checks have been held, consideration should be given to assigning Finance the function of scholarship check distribution.

(6) Advance Payments

Criteria - Payments made in advance of the receipt of goods or services should not be recorded as expenditures. A prepayment (asset) should be recorded in such situations.

Condition - Two instances were found (check #95538 in the amount of \$12,604.75 and check #95712 in the amount of \$5,275.84) where prepayments in the amount of \$15,104.75 should have been recorded.

Cause - Unknown

Effect - Although immaterial in amount, expenditures are overstated.

Recommendation - Prepayments should be recorded as assets until such time as receipt of good or services results.

(7) Travel Advance and Reconciliations

Criteria - Travel advance receivable detail should be periodically aggregated and agreed to the general ledger control account. Additionally, the outstanding balances of travel related encumbrances should usually equal or exceed the value of recorded travel advances.

Condition - No reconciliation of travel advance detail to the applicable general ledger control accounts was available. Additionally, for certain funds, travel advance receivables exceeded the balance of related travel encumbrances.

Cause - Inadequate reconciliation of travel advances occurred.

Effect - Errors in the financial statements occurred which necessitated audit adjustments.

Recommendation - Periodic reconciliation of travel advance receivable accounts should be made.