

OFFICE OF THE NATIONAL PUBLIC AUDITOR
FEDERATED STATES OF MICRONESIA

**FSM Customs & Tax Administration Not Fully
Implementing Prior Audit Findings and Recommendations**

REPORT NO. 2015-06



Haser H.Hainrick
National Public Auditor



FEDERATED STATES OF MICRONESIA

Office of The National Public Auditor

P.O. Box PS-05, Palikir, Pohnpei FSM 96941

Tel: (691) 320-2862/2863; Fax: (691) 320-5482

CID Hotline: (691) 320-6768; E-mail: hhainrick@fsmopa.fm

July 28, 2015

His Excellency Peter Christian, President
Honorable Members of the FSM Congress
Federated States of Micronesia

RE: Follow-up Audit on Customs and Tax Administration

We conducted a follow-up audit on the findings and recommendations of our prior audit on the FSM Customs and Tax Administration, which was our Audit Report No. 2012-01.

The objective of the follow-up audit was to determine whether the CTA management has implemented corrective actions to address the audit findings and recommendations disclosed in Audit Report No. 2012-01.

Based on our follow-up audit, we found that the CTA Management did not take appropriate corrective actions to address all of the findings and recommendations in Audit Report No. 2012-01. Specifically, of the five audit recommendations, one was implemented, two were partially implemented, and the other two were not implemented. The two recommendations that were not implemented are summarized below:

The Assistant Secretary for Customs and Tax Administration should:

1. Monitor the CTA Field Offices' performance to;
 - Obtain business listing from the respective local, state and national authorities for comparison; and,
 - Update the tax rolls for new businesses, non-filers and non-payers of taxes.
2. Monitor the CTA Main Office in Palikir and the Field Offices in the States to ensure the following;
 - Demand notices are regularly issued and distributed to non-filers and non-payers;
 - Levies are duly processed when non-compliant businesses continue to not pay taxes owed.

Respectfully yours,

Haser Hainrick
National Public Auditor

XC: Vice President
Secretary, Department of Finance & Administration
Assistant Secretary, Customs and Tax Administration Division

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INTRODUCTION

Background

On December 9, 2011, the Office of the National Public Auditor conducted a performance audit on Customs and Tax Administration (CTA) and reported that the CTA Management did not monitor adequately the Field Offices in carrying out their key activities of enhancing and enforcing tax collection throughout the FSM. Specifically, we reported the following findings:

- Poor internal controls over the system of manual cash receipts continued to put cash at risk of loss or theft.
- The tax rolls (list of active businesses) were incomplete and as a result, compliance and tax revenue collection was diminished.
- Unpaid or unreported taxes by businesses in Pohnpei were not followed-up and in Chuuk, they were followed up only when visited by a special task force.
- The accuracy of payment of import taxes was not verified by CTA and the inspection of freight containers was hap-hazard, not formalized, and seldom performed.
- CTA employees were not trained in the proper handling of potentially unethical situations including how to maintain independence with local businesses. In the absence of a CTA Code of Ethics, independence with local businesses was not specifically required.

In the Management Response dated October 25, 2011, attached to Audit Report No. 2012-01, the Acting Secretary for the Department of Finance & Administration noted and acknowledged the audit findings. He further stated that the CTA management and the DF&A would institute appropriate measures in order to address the findings and to implement the audit recommendations.

Objective, Scope and Methodology

Objective - The objective of this follow-up audit was to determine whether the CTA management has taken appropriate corrective actions to address the audit findings and recommendations reported in the audit of Customs and Tax Administration (Audit Report No. 2012-01) issued on December 9, 2011.

Scope - The scope of this follow-up audit focused on the status of the implementation of CTA management's action plans as agreed in the 2011 audit on Customs and Tax Administration.

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This follow-up audit was conducted at CTA main office in Palikir and at CTA Pohnpei field office from June to November 2014.

We conducted this audit pursuant to the authority vested in the Public Auditor as codified under Chapter 5, Title 55 of the FSM Code, which states in part:

“The Public Auditor shall inspect and audit transactions, accounts, books, and other financial records of every branch, department, office, agency, board, commission, bureau, and statutory authority of the National Government and of other public legal entities, including, but not limited to, States, subdivisions thereof, and nonprofit organizations receiving public funds from the National Government.

Methodology - We conducted this performance audit in accordance with generally accepted government auditing standards issued by the Comptroller General of the United States. 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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

To determine whether the CTA management has taken appropriate corrective actions to address the audit findings and recommendation, we reviewed, verified and assessed the evidence demonstrating that the agreed management action plans to address the prior audit recommendations have been implemented. Furthermore, we interviewed the staff responsible for implementing the recommendations and reviewed the supporting documents submitted by CTA officials. We also confirmed on a test basis the actions taken by CTA in response to the audit recommendations.

Conclusion

Based on the results of our follow-up audit, we conclude that the CTA management has not taken appropriate corrective actions to address all the findings and recommendations reported per Audit Report No. 2012-01. Specifically, we found that of the five audit recommendations, one was implemented, two were partially implemented, and the other two were not implemented.

The results of this follow-up audit are discussed in detail in the following pages.

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STATUS OF PRIOR AUDIT RECOMMENDATIONS

Recommendation 1: The Assistant Secretary should personally ensure that adequate policies and procedures are developed and that internal controls are implemented and functioning adequately, including:

- Controls and security of cash receipts stocks;
- Logging of all receipts activities;
- Security of receipt stocks in a locked drawer or safe; and
- Reporting of missing receipts.

Current Status: The Assistant Secretary of CTA implemented the recommendation above.

Audit Follow-Up Comment: CTA main office and field offices have maintained log for the official cash receipts. Official cash receipts stocks are stored in locked drawers.

Recommendation 2: The Assistant Secretary should monitor the field offices’ performance to obtain business listings from the respective local, state and National authorities for comparison and update of tax rolls for new businesses, non-filers, and non-payers of taxes.

Current Status: The recommendation was not implemented.

Audit Follow-Up Comment: Although Pohnpei CTA field office was able to obtain business listing from the respective local offices, the process of comparison to update the tax rolls was not documented during our period of review.

Recommendation 3: The Assistant Secretary should monitor local offices and /or CTA Main Office in Palikir to ensure the following:

- Demand notices are regularly issued and distributed to non-filers and non-payers;
- Levies are duly processed when non-compliant businesses continue to not pay taxes owed.

Current Status: The recommendation was not implemented.

Audit Follow-Up Comment: We tested the actions taken by CTA Pohnpei field office revenue officers in issuing demand notices to no-filers and delinquent tax payers. We found that demand notices were not regularly issued and distributed to non-filers or non-payers of taxes.

For example, in the third quarter of 2013, only 12% or 37 out of 315 businesses were issued demand notices for not filing business gross revenue tax (BGR) while 88% or 278 out of the 315 businesses were not issued demand notices.

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We further reviewed the levies processed for the delinquent taxpayers and found that the CTA main office had stopped monitoring the processing of levies since May 2014 and no levies have been issued since then.

Recommendation 4: The Assistant Secretary should develop policies and procedures regarding verification of Self-Assessment Declarations (SAD) and inspection of freight containers.

Current Status: The recommendation has been partially implemented.

Audit Follow-Up Comment: The verification of SAD or post clearance audit was implemented in 2014. CTA records showed that understatement of import taxes dues were detected for several businesses.

Although a set of written procedures for container inspection has been developed, our testing of the implementation of the policy indicated that the Pohnpei CTA field office did not always follow the process of having two Custom Officers performing physical examination of a container.

For example, for calendar year 2013, CTA records showed that 1,891 containers were discharged in Pohnpei. According to CTA annual reports, 45 containers or equivalent of 2% of incoming containers were inspected. We found that only 29 out of the 45 inspections were actually documented through inspection reports. Out of the 29 inspection reports, 12 inspection reports showed that containers were physically inspected by only one inspector.

Recommendation 5: The Assistant Secretary should develop and implement an ethics reinforcement program that include handling potential unethical situations, trainings for values reinforcement and mandatory reporting with annual declaration of gifts received, credit accounts with local businesses over a specific account and employee owned, or partially owned businesses.

Current Status: The recommendation has been partially implemented.

Audit Follow-Up Comment: A workshop on ethical issues was conducted by the CTA Tax Advisor and Legal Counsel following our prior audit on CTA. However, we found that the CTA staffs were not reporting any annual declaration as recommended in Audit Report No. 2012-01.

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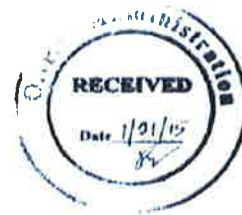
MANAGEMENT RESPONSE



Office of the
Assistant Secretary

GOVERNMENT OF THE
FEDERATED STATES OF MICRONESIA
Division of Customs & Tax Administration
Department of Finance & Administration
PO, Box PS 54
Palikir, Pohnpei FM 96941
Phone: (691) 320-5855/2826 Fax: (691) 320-5715

July 21, 2015



MEMORANDUM

TO: Office of the National Public Auditor
FROM: Assistant Secretary, CTA
SUBJECT: Audit Report#2012-01(Customs and Tax Administration)

This is in response to your follow-up audit report whether Customs and Tax Administration (CTA) management took appropriate corrective actions to address the findings and to implement the recommendation in your audit.

Recommendation 2: The Assistant Secretary should monitor the CTA-Field Offices performance to obtain business listing from the respective local, state and national authorities for comparison and update of tax rolls for new businesses, non-filers, and non-payers of taxes.

1. The Assistant Secretary will make sure the CTA-Field Offices obtain business listing from the respective local, state and national authorities for comparison on a quarterly basis.
 - a) In August 2014, CTA-Pohnpei Field Office took action to obtain business list from the local municipal government to start the process of inputting the new businesses in the tax roll.
 - b) In July 2015, CTA-Pohnpei Field office request business listing from the local municipal government to update the tax roll on a quarterly basis.

Recommendation 3: The Assistant Secretary should monitor local and/or CTA main office in Palikir to ensure the following:

1. The Assistant Secretary will make sure all demand notices are issued and distributed to non-filers and non-payers on a quarterly basis and levies are duly processed when non-compliant businesses continue not pay taxes.
 - a) Actual enforcement action taken for demand notices/levies
Pohnpei - 141 demand notices/10 levies issue for non-filers and non-payers.

Recommendation 5: The Assistant Secretary should develop and implement an ethics reinforcement program and mandatory reporting and annual declaration of gifts received, credit

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accounts with local businesses over a specific account and employee owned, or partially owned businesses.

1. The Assistant Secretary has developed the code of conduct that includes the following 11 key elements.

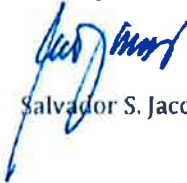
1. Personal Responsibility
2. Compliance with the Law
3. Relations with the Public
4. Acceptance of Gifts, Rewards, Hospitality and Discount
5. 5. Avoiding Conflict of Interes
6. Political Activities
7. Conduct in money matters
8. Confidentiality and Use of Official Information
9. Use of Official Property and Sevices
10. Private Purchase of Government Property by Staff
11. Work Environment

a) Ethics workshop was held on August 6-10, 2012 for the CTA Staff in Palikir Pohnpei.

Mr. Scott Garvey, CTA Tax Advisor and Legal Counsel conducted the workshop for the Customs and Tax Administration, Department of Finance and Administration in Palikir Pohnpei Central Office.

Please let me know if you have any questions or comments.

Thank you.


Salvador S. Jacob

Xc: Secretary, Department of Finance and Administration

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ONPA’s EVALUATION OF MANAGEMENT RESPONSE

The Assistant Secretary of Customs and Tax Administration (CTA) generally agreed with all the status of audit recommendations except for recommendation 5. We would like to thank CTA management for considering the recommendations and most importantly by indicating that CTA will be updating the tax roll and issuing demand notices on a quarterly basis.

The Assistant Secretary of CTA stated in his management response to audit recommendation 2 on updating tax roll that, *“In August 2014, CTA-Pohnpei Field Office took action to obtain business listing from the local municipal government to start the process of inputting the new businesses in the tax roll”*. We would like to emphasize that although CTA Pohnpei field office has been obtaining business listing from the local municipal governments, we found that the business listings were not used for that benefit of updating the tax roll.

Regarding recommendation 5, the Assistant Secretary did not address the recommendation for mandatory reporting of annual declaration of gift received by employees and employee’s credit with local businesses... and employee owned, or partially owned businesses. Instead, the Assistant Secretary provided minutes of an ethics workshop that was conducted. Accordingly, we reviewed the minutes of the ethics workshop and noted that the workshop was only partial implementation of the audit recommendation. Thus, we changed the status of implementation to partially implemented.

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NATIONAL PUBLIC AUDITOR'S COMMENT

We would like to thank the management of Customs and Tax Administration for their assistance and cooperation during the course of the follow-up audit.

In conformity with general practice, we presented our draft report to the Division of Customs and Tax Administration. We have incorporated their written comments in this final audit report.

In addition to providing copies of the final report to the President and the Members of the FSM Congress, we will also send copies to the Vice President, Secretary of the Department of Finance and Administration, and the Assistant Secretary for Customs & Tax Administration. We will also make copies available to other interested parties upon request.

If there are any questions or concerns regarding this report, please do not hesitate in contacting our Office. Contact information for the Office can be found on the last page of this report along with the National Public Auditor and staff that made major contribution to this report.



Haser Hainrick
National Public Auditor

July 28, 2015

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ONPA CONTACT AND STAFF ACKNOWLEDGEMENTS

ONPA Contact Haser H. Hainrick, National Public Auditor
Email: hhainrick@fsmopa.fm

Acknowledgements In addition to the contact named above, the following staff made key contributions to this report:

Manuel San Jose Jr., Audit Manager, CPA, CGAP, CIA
Julinida Weital, Auditor-In-Charge
Clayton Eliam, Staff Auditor

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Phone: (691) 320-2862/3

Contact Website: www.fsmopa.fm
Hotline: (691) 320-6768
