

SONSOROL STATE GOVERNMENT
(A State of the Republic of Palau)

Independent Auditors' Report on
Internal Control and on Compliance

Year Ended September 30, 2016

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF STATEMENT OF RECEIPTS AND DISBURSEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

Honorable Laura I. Miles
Governor
Sonsorol State Government

We have audited, in accordance with the 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, the statement of receipts and disbursements the Sonsorol State Government (the State) of the Republic of Palau for the year ended September 30, 2016, and the related notes to the statement of receipts and disbursements, and have issued our report thereon dated April 23, 2020.

Internal Control over Financial Reporting

In planning and performing our audit of the statement of receipts and disbursements, we considered the State's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the statement of receipts and disbursements, but not for the purpose of expressing an opinion on the effectiveness of the State's internal control. Accordingly, we do not express an opinion on the effectiveness of the State's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. However, as described in the accompanying Schedule of Findings and Responses, we did identify certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the State's statement of receipts and disbursements will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies described in the accompanying Schedule of Findings and Responses as Findings 2016-01 and 2016-03 to be material weaknesses.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompany Schedule of Findings and Responses as Findings 2016-02 and 2016-04 to be significant deficiencies.

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Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State's statement of receipts and disbursements is free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of statement of receipts and disbursements amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed one instance of noncompliance or other matters that is required to be reported under *Government Auditing Standard* and is described in the accompanying Schedule of Findings and Responses as Finding 2016-04.

The State's Response to Findings

The State's response to the findings identified in our audit is described in the accompanying Schedule of Findings and Responses. The State's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



April 23, 2020

SONSOROL STATE GOVERNMENT
Republic of Palau

Schedule of Findings and Responses
Year Ended September 30, 2016

Finding: 2016-01

Area: Accounting System - Municipalities

Criteria:

The State and its municipalities should maintain a financial management and accounting system to properly record and account for its financial activities, including getting the transaction data from source documents, recording the transactions in journals, and posting data from journals to ledgers. A sound system of internal control should include an organized set of manual and computerized accounting methods, procedures, and controls established to gather, record, classify, analyze, summarize, interpret, and present accurate and timely financial data for management decisions.

Condition:

The State is subdivided into four municipalities and funding is provided by the State to each municipality. We were not able to audit the cash receipts and disbursements for each municipality. Of the four municipalities, Pulo Anna is the only municipality that uses QuickBooks and it is maintained by the State Treasury. The remaining municipalities use manual and Excel spreadsheets to account cash receipt and cash disbursement transactions and were incomplete and properly updated. The State's accountant merely tracks the cash disbursements and cash receipts by preparing bank reconciliations that are not performed on a timely basis; and by reviewing the annual "Budget vs. Actual" Performance Reports that are not prepared and submitted on a timely manner.

In addition, the Fanna municipality uses calendar year end for its annual reporting purposes which does not comply with the State and the National Government's fiscal year of September 30th for reporting purposes.

Cause:

Funds were not allocated to hire a skilled and experienced bookkeeper to perform the accounting functions at the municipality-level or for additional staffing at the state-level. Internal control policies and procedures have not established and implemented over the financial management and accounting system to ensure that municipality funds were properly accounted for and reported in a timely manner.

Effect:

The potential exits for fraud, theft and misappropriation of assets to occur and not be detected in timely manner. The Fanna municipality cash disbursement and cash receipt transactions are not properly reported consistent with State's annual reporting for the Budget vs. Actual Performance Reports.

SONSOROL STATE GOVERNMENT
Republic of Palau

Schedule of Findings and Responses
Year Ended September 30, 2016

Finding: 2016-01, continued
Area: Accounting System - Municipalities

Recommendation:

The Governor, in consultation with the Treasurer, should consider hiring another bookkeeper to oversee and handling all of the accounting for each municipality or maintain and perform all municipality accounting functions at the state-level.

All municipalities accounting should be maintained on QuickBooks accounting software. The QuickBooks account structure and chart of accounts should be set up to mirror the State's accounting system to ease the consolidation of State and municipalities for overall financial management and reporting.

The annual reporting period for the Fanna municipality should be changed from a calendar year end to a fiscal year for its annual reporting to be consistent with the State and the National Government's fiscal year of September 30th reporting period.

The State should establish written internal control accounting standard operating policies outlining the delegation of duties for proper segregation and related internal control policies and procedures for processing transactions and carrying out assigned duties by function for all aspects of accounting for the State's financial management and reporting.

The State Treasurer and accountant should establish written accounting policies and procedures and/or standard operating procedures manual outlining the procedures for processing transactions and carrying out assigned duties by function including proper segregation of duties for all aspects of accounting for the State's financial management and reporting.

In the process of developing this manual, a comprehensive review should be performed to evaluate the existing accounting system and its related policies and procedures, offering management the opportunity to eliminate or improve procedures and enhance internal control thereby creating a more efficient and effective accounting system.

SONSOROL STATE GOVERNMENT
Republic of Palau

Schedule of Findings and Responses
Year Ended September 30, 2016

Finding: 2016-01, continued
Area: Accounting System - Municipalities

Auditee Response and Corrective Action Plan:

Name of Contact Person: Treasurer Lucy Pedro and State Accountant Alena L. Matias

Correction Action Taken: The three municipalities do not have QuickBooks and only use excel database. Merir and Fanna municipalities asked for assistance from the State to reconcile their books but not in a timely manner. They only request the State for assistance when they begin to have financial trouble. Dongosaro municipality continues to handle its own disbursement; however, the State Treasury handles its payroll and some purchase orders. They just submit reports to the State at the end of the fiscal year. The State has insufficient internal control and review with the funds disbursed to and held by the municipalities.

We will set a meeting with all the municipality Chiefs to discuss these findings and recommendations.

The Executive will meet with the municipalities to report on audit recommendations and offer the State Treasury's assistance request that municipal funds remain in the State Treasury. The State Treasury will be in charge of municipal funds according to the State budget act and disburse such funds appropriately as set forth in the municipal budget ordinance. Regular reports will be available to the municipalities.

If a municipality insists having funds transferred to its treasury, then that municipality's accounting system has to be set up on QuickBooks to mirror the accounting system set up at the State Treasury. A regular data sharing shall be agreed upon.

An additional clerk will be recruited and hired at the State Treasury to assist with municipal fiscal issues and other matters. At the same time, the State will be developing a policy and procedures manual that will be simple and practical based on what is agreed upon and the existing policies.

Proposed Completion Date: June 2020

SONSOROL STATE GOVERNMENT
Republic of Palau

Schedule of Findings and Responses
Year Ended September 30, 2016

Finding: 2016-02

Area: Procurement and Accounts Payable

Criteria:

A sound system of internal control should include an organized set of manual and computerized accounting methods, procedures, and controls established to gather, record, classify, analyze, summarize, interpret, and present accurate and timely financial data for management decisions.

A purchase order system and the use of an accounts payable voucher system is used to enhance internal control over authorized purchases and payments to vendors and services provided and receipt of goods and services performed. If every transaction of the State were recorded, it would mean that there is a voucher available as a proof to that transaction.

A voucher is often a prenumbered form used in the accounts payable department to standardize and enhance the State's internal control over payments to its vendors and service providers and receipt of goods and services performed.

Condition:

The State does not have a purchase order system for the acquisition of goods and services nor did it make use of an accounts payable voucher system.

Cause:

The cause of the above condition is a lack of internal controls over disbursements and compliance with procurement regulations.

Effect:

The potential exits for unauthorized or unnecessary purchases, improper charges, excessive costs incurred and for fraud, theft and misappropriation to occur and not be detected in timely manner.

SONSOROL STATE GOVERNMENT
Republic of Palau

Schedule of Findings and Responses
Year Ended September 30, 2016

Finding: 2016-02, continued
Area: Procurement and Accounts Payable

Recommendation:

We recommend that the State establish internal control procedures to implement a purchase order and accounts payable voucher system which is available in its QuickBooks accounting software. Requisitions and purchase orders should be used for all purchases and disbursements. The implementation of the purchase order system will assist in documenting compliance with procurement regulations, authorized purchases, verification of goods received and services performed and ensure that all purchases are properly recorded and paid in a timely manner.

The accounts payable voucher used should be numeric and include all necessary supporting documents and approvals. Some of the supporting documents include:

- The vendor's invoice
- The State's purchase order
- The State's receiving report
- Payee/vendor name
- Discount terms
- Amount and date to be paid
- General ledger account numbers to be charged
- Authorizing signatures

The unpaid vouchers provide the detail for the total amount reported as accounts payable

Auditee Response and Corrective Action Plan:

Name of Contact Persons: Treasurer Lucy Pedro and State Accountant Alena L. Matias

Correction Action Taken: The State has an existing Accounts Payable Voucher. Currently all disbursements have attached vouchers before processing the payment. At the same time the State is using laser checks for updated reports to proper recording. We will enhance the form and pattern to QuickBooks as well as the purchase order form. Purchase request forms will also be implemented. Prenumbered Purchase Order request forms will be ordered to be printed.

Proposed Completion Date: June 1, 2020 estimated completion

SONSOROL STATE GOVERNMENT
Republic of Palau

Schedule of Findings and Responses
Year Ended September 30, 2016

Finding No.: 2016-03

Area: Cash Receipts - Untimely Deposits and Segregation of Duties

Criteria:

A system of internal on internal control policies and procedures should be in place to provide a proper segregation of duties over the cash handling and deposit of cash receipts in a timely manner, usually within three (3) business working days.

Condition:

For seven (7) or 41% of the 17 cash receipts selected for testing, cash receipts totaling \$136,354.17 were not deposited in a timely manner as follows:

Item #	Receipt Date	Official Receipt #	Amount	BANK DEPOSIT	Revenue Source	Days Lapsed
			Received	DATE		
1	10/05/15	554925	\$ 4,966.65	10/09/15	Fishing Rights Fees	4 days
2	01/26/16	554939~49	395.00	02/17/16	Donations	22 days
3	03/10/16	554951	8,319.02	03/18/16	Fishing Rights Fees	8 days
4	04/12/16	554953	50,000.00	04/18/16	Grants	6 days
5	04/19/16	554958~59	511.50	05/04/16	Miscellaneous	15 days
6	05/18/16	554963	31,260.00	05/26/16	Barge Removal fees	8 days
7	06/23/16	554967~69	40,902.00	07/20/16	Grants and Permits	27 days
			<u>\$ 136,354.17</u>			

Daily cash receipts reports were not were consistently prepared.

In addition, there is a lack segregation of duties of the handling of cash receipts. The preparation of the daily cash receipts report, bank deposit slip, depositing of funds and posting in the general ledger is handled by one person with specific oversight or independent review.

Cause:

There is a lack of segregation of duties and a lack internal control policies and procedures over handling and monitoring of cash receipts to ensure that cash receipts are deposited in a timely manner and to ensure funds are properly accounted for.

SONSOROL STATE GOVERNMENT
Republic of Palau

Schedule of Findings and Responses
Year Ended September 30, 2016

Finding No.: 2016-03, continued

Area: Cash Receipts - Untimely Deposits and Segregation of Duties

Effect:

The potential exists for fraud, theft and misappropriation to occur and not be detected in timely manner.

Recommendation:

The State should establish internal control policies and procedures to ensure that cash receipts are deposited in a timely manner and monitored for adherence with such procedures.

The State should establish and implement of internal control of the handling of cash receipts for proper segregation of duties. Segregation of duties in the handling of cash is one of the most effective ways to gain control over this asset.

No individual should have complete control in the handling of cash. No one individual should be allowed to control all key aspects of a transaction or event. Responsibilities and duties involving transactions and events should be separated among different employees with respect to authorization, approval, processing and recording, making payments or receiving funds, review and the custodial functions and handling of related assets. Specifically, no one individual's duties should include the actual handling of money, recording receipt of money, and the reconciliation of bank accounts or with the State Treasurer. The State should consider arranging such duties so that the employee who handles cash receipts does not record the receipts in the accounting records. Arrange duties so that the employee who receives the cash does not disburse the cash.

Although entities vary their specific procedures for controlling cash receipts, the State should consider the implementation of the following principles:

- Prepare a record of all cash receipts as soon as cash is received. Most thefts of cash occur before a record is made of the receipt. Once a record is made, it is easier to trace a theft.
- Deposit all cash receipts intact as soon as feasible, preferably on the day they are received or on the next business day. Undeposited cash is more susceptible to misappropriation.

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Republic of Palau

Schedule of Findings and Responses
Year Ended September 30, 2016

Finding No.: 2016-03, continued

Area: Cash Receipts - Untimely Deposits and Segregation of Duties

Auditee Response and Corrective Action Plan:

Name of Contact Persons: Treasurer Lucy Pedro and State Accountant Alena L. Matias

Correction Action Taken: The State doesn't have a daily cash receipt report because we only do cash receipts upon receipt of cash or checks and prepare the report at the same time for deposits. But the State is consistently preparing it for records. Now we enhanced the form as suggested. The good thing is no cash receipts missing and all was recorded accordingly. We will continue to develop all accounting standards and will deposit on time.

Proposed Completion Date: Currently implemented the segregation of work and enhanced the cash receipt form with 2 signatures verifying received by, encoded by and deposited by.

SONSOROL STATE GOVERNMENT
Republic of Palau

Schedule of Findings and Responses
Year Ended September 30, 2016

Finding: 2016-04
Area: Procurement

Criteria:

RPPL 3-54 § 24, modified, § 625 for small purchases states: (a) any procurement not exceeding ten thousand dollars (\$10,000) may be made in accordance with the small purchase procedures to be established by regulations promulgated by the Minister of Finance. However, procurement requirements shall not be artificially divided so as to constitute a small purchase; and (b) formal bidding is not required but it is encouraged for all items not exceeding ten thousand dollars (\$10,000). Except that the competitive bidding procedure shall be required on any items sought by the state governments of five thousand dollars (\$5,000) or more.

Condition:

For two (2) of the 83 or 2% of the disbursements tested, there were no formal bidding or supporting invoice documentation for following:

1. There was no evidence of formal bidding for office space rental per review of check #2283 dated 7/1/16 for \$820/month or \$9,840 annually.
2. There was no invoice documentation on-file for check #2423 dated 8/24/16 for \$150 paid for maintenance labor costs incurred.

Cause:

There is a lack of internal control procedures over the procurement process to ensure that the State's procurement practices adhere to the Republic of Palau's procurement regulations.

Effect:

The State is noncompliance with established procurement regulations.

SONSOROL STATE GOVERNMENT
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Schedule of Findings and Responses
Year Ended September 30, 2016

Finding: 2016-04, continued
Area: Procurement

Recommendation:

The Governor should adhere to the policies and procedures of Republic of Palau's Procurement Law and Regulations when conducting procurements requiring competitive bidding. Internal control monitoring procedures should be established to ensure that procurement regulations are followed consistently. Procurement officers and other personnel involved in the procurement process should develop and use a checklist to ensure that all procurement regulations are followed consistently and properly documented.

Documentation should be obtained and properly filed to substantiate all cash disbursement transactions.

Auditee Response and Corrective Action Plan:

Name of Contact Person: Treasurer Lucy Pedro and State Accountant Alena L. Matias

Correction Action Taken: Since office rentals needs to be bid, the State will verify the Republic of Palau's Procurement Law and Regulation as the minimum amount to be bid is \$10,000.00. We don't have formal bidding for office rental but instead the State entered to a contract with the land owner.

Proposed Completion Date: By May 31, 2020 we will be able to comply.

SONSOROL STATE GOVERNMENT
Republic of Palau

Unresolved Prior Year Comments
Year Ended September 30, 2016

There are no unresolved findings from prior year audits of the State.