



Cook Islands Audit Office

2nd Quarter Report of the Audit Office

Part 1:

**Crown Financial Audit
Ministry Financial Audits**

1 October 2006 – 31 December 2006



PARLIAMENT OF THE COOK ISLANDS

PARLIAMENT PAPER NO. 14

Speaker of Parliament
Parliament of the Cook Islands
Nikao, Rarotonga
Cook Islands

Sir,

I have the honour to present the 2nd Quarter Report of the Audit Office, Part 1: Crown Consolidated and Ministry Financial Audits for the period 1 October to 31 December 2006.

Hon. Sir Dr Terepai Maoate
Deputy Prime Minister
Minister Responsible for the
Office of Public Expenditure Review Committee and Audit.

COOK ISLANDS



GOVERNMENT

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30 May 2008

Speaker of Parliament
Parliament of the Cook Islands
Nikao, Rarotonga
Cook Islands

Honourable Speaker

Pursuant to Section 33 of the Public Expenditure Review Committee and Audit Act 1995-96, I have the honour to submit my 2nd Quarter Report on the operations of the Audit Office, Part 1: Crown Consolidated and Ministry Financial Audits for the period 1 October to 31 December 2006.

Following its delivery and presentation to Parliament, the report will be placed on the Cook Islands Audit Office's website (<http://www.auditoffice.gov.ck/>).

Yours Sincerely,

Paul R.S. Allsworth
Director of Audit

OFFICE OF PUBLIC EXPENDITURE REVIEW COMMITTEE AND AUDIT

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1 INTRODUCTION AND COMMENTARY

This report is Part 1 of the Audit Office's second quarterly report to Parliament for the 2006/2007 financial year. It highlights and discloses for Parliament's attention all Ministry, Support Office and Crown Agencies financial audits carried out and completed by the office during the period 1 October to 31 December 2006.

Also included in this report is the Crown Consolidated Financial Audit for the periods 30 June 2003 and 30 June 2004.

The Audit Office issues Quarterly Reports, in addition to its Annual Report, in order to provide more timely information to Parliament and the general public on audit issues, problems identified and recommended solutions. It is hoped that timely quarterly information will better promote good governance.

1.1 FINANCIAL AUDITS

During the period 1 October 2006 to 31 December 2006, a total of 16 financial audit reports were completed. These included:

1. Ministry of Agriculture 30 June 2005
2. Office of the Ombudsman 30 June 2005
3. Office of the Ombudsman 30 June 2006
4. Financial Intelligence Unit 30 June 2005
5. Office of the Head of State 30 June 2005
6. Department of National Human Resources 30 June 2005
7. Department of National Human Resources 30 June 2006
8. Ports Authority 30 June 2006
9. Airport Authority 30 June 2006
10. Parliamentary Services 30 June 2005
11. Parliamentary Services 30 June 2006
12. Crown Law Office 30 June 2005
13. Crown Law Office 30 June 2006
14. Office of the Minister of Health 30 June 2005
15. Office of the Minister of Education 30 June 2005
16. Ministry of Transport 30 June 2005
17. Financial Supervisory Commission 30 June 2006

This represents approximately 33 % of 49 Ministry, Ministerial Support, Office, Outer Island Administrations and Government Agency's financial audits that the Cook Islands Audit Office (CIAO) is required to undertake on an annual basis.

1.2 SOUTH PACIFIC REGIONAL WORKING GROUP ON ENVIRONMENTAL AND SUSTAINABILITY AUDITING

The Director of Audit, Paul Allsworth and Audit Manager of the Special Reviews Division, Allen Parker attended the South Pacific Regional Working Group on Environmental and Sustainability Auditing workshop held in Canberra from the 18 to 20 October 2006. The conference was attended by 11 member countries in the South Pacific Region.

The purpose of the workshop was to discuss and address emerging issues, challenges and initiatives relating to environmental issues in each respective country. The conference also served as a platform for sharing knowledge and experiences on audit tools and audit methodologies for conducting environmental audits.

The Cook Islands Audit Office was also privileged to present a country paper on the Waste Management Facility on Rarotonga and the DVD presentation by Recycle Cook Islands Ltd. The Member Countries were impressed with the work undertaken by Recycle Cook Islands Ltd in addressing environmental issues through processing, sorting and exporting variety of wastes out of the Cook Islands. They were also overwhelmed to know that Cook Islands Recycle Ltd is a private company and a private sector initiative that was able to assist Government extend the life of the waste management facility and landfill through the exportation of waste outside of the Cook Islands.

It is planned that a government and private sector working group committee will be formed comprising of agencies that have a core service for environmental concerns such as legislation, (Environment Services and Public Health) implementation, (Ministry of Works), compliance (Audit), Recycle Cook Islands Ltd and others (private sector).

1.3 55th INTOSAI GOVERNING BOARD MEETING

The Director of Audit, Paul Allsworth as a Governing Board Member of INTOSAI, representing the South Pacific Association of Supreme Audit Institutions (SPASAI) attended the 55th Governing Board meeting in Mexico from 2 – 3 November 2006. INTOSAI is the International Organisation of Supreme Audit Institutions, a United Nations affiliated body representing all democratic public sector audit organizations world – wide.

Audit items discussed were:

1. Report by the General Secretary, Dr Josef Moser, Austria.
2. INTOSAI Strategic Plan 2007 – 2011.
3. Report by the Chairman of Finance and Administration Committee – Saudi Arabia

4. Report by the Professional Standards Committee – Denmark
5. Report by the Financial Audit Guidelines Committee – Sweden
6. Report by the Compliance Audit Committee – Norway
7. Report by the Committee on Audit Independence – Canada
8. Accounting and Reporting Standards – United States
9. Internal Control Standards – Belgium
10. Performance Audit – Brazil
11. Capacity Building Committee and the International Journal of Government Auditing – Morocco and United States.
12. INTOSAI Development Initiative (IDI).

1.4 SEMINAR FOR AUDITING OFFICIALS FOR PACIFIC ISLAND COUNTRIES – BEIJING, CHINA

On the 6th to the 20th of November 2006 senior auditor Alouise Kado and auditors Mataora Tutai and Ngatokorua Elikana attended a Seminar for Auditing Officials for the Pacific Island Countries in Beijing. The seminar was funded by the Chinese Government and participants were hosted by the Central University of Finance and Economics in Beijing.

The aim of the seminar was to expose and introduce participants to the development of Auditing and Accounting in China, particularly the challenges faced by certain professional accounting bodies in an ever growing Chinese economy. Presenters included representatives from the Chinese National Audit Office, Institute of Internal Auditors and the Institute of Certified Public Accountants for China.

The participants found the seminar to be very informative and educational as some of the audit work done in China is different from work done in the Pacific region. It was agreed that the most useful part of the seminar for both presenters and participants were the open discussions that followed each presentation. In these discussions an atmosphere of exchange was created between auditors of China and the Pacific region which benefited all present.

Following their return from the seminar all three auditors made individual presentations to the rest of the Cook Islands Audit staff on what they had learnt on their trip.

1.5 NEW ZEALAND INTERNAL AUDITORS CONFERENCE – WELLINGTON, NEW ZEALAND

The Director of Audit, Paul Allsworth and the Audit Advisor, Louise Wittwer attended the New Zealand Institute of Internal Auditors 'Raise the Bar' Conference late November 2006. This conference, spanning three days in Wellington, was opened by the Minister of Finance and Deputy Prime Minister The Hon Dr Michael Cullen. The conference primarily addressed the critical importance and need for 'Good Governance and Risk Management' throughout the public and private sectors.

Of particular interest to the Cook Islands Audit Office attendees were a number of guest speakers from prominent public sector entities in New Zealand. Representatives of the Inland Revenue Department,

Ministry of Agriculture and Fisheries, Ministry of Social Development, Department of Corrections and the Office of the Auditor and Controller General provided useful insights and practical examples of the best methodologies available to encourage good governance and optimal risk management within the public sector.

1.6 MICROSOFT EXCEL TRAINING FOR ALL PROFESSIONAL STAFF

All Audit Office staff took part in a one day Microsoft Excel training programme coordinated through local information technology business, On-2-It.

The training was provided once a week over a three week period.

The objective of the training was to learn, develop and apply skills associated with the Excel software. Given that a majority of the Office's Audit plans and procedures are presented in an Excel Format, this training was very beneficial for all staff and the Office as a whole.

1.7 APPLICATION OF SPECIFIC INTERNAL CONTROLS TO THE PRIMARY ACCOUNTING SYSTEMS IN ALL ORGANISATIONS

On the 8 November 2006 the Cook Islands Audit Office held a morning workshop for all financial auditors in the MFEM conference room. The workshop was administered by Catherine Trussler, ex National Audit Office (United Kingdom). Catherine kindly donated her time to the office on a part time basis for a period of 4 weeks reviewing the current structure in place.

The objective of this workshop was to improve the knowledge and understanding of internal control auditing tools applied to the different Financial Sections across all organisations.

1.8 UPDATE ON THE AUDIT OF THE CROWN CONSOLIDATED FINANCIALS 30 JUNE 2004 AND 30 JUNE 2005

Thursday, 9th November 2006 saw the Director of Audit, Paul Allsworth, sign the Cook Islands Government Consolidated Financial Statements for the year ended 30 June 2004. This milestone represented a significant step in the combined efforts of the Audit Office and MFEM to bring the Crown Account preparation and audit up to date. This major achievement was the culmination of several months' hard work by the Crown Accounts Audit Team.

2006 was a particularly successful year for the Crown Accounts team signing both the 2003 and 2004 Consolidated Accounts and materially reducing the previous back log. The Audit Office appreciates that this level of progress would not have been possible without the ongoing professional assistance provided by Kath Hutson and Teu Teulilo of MFEM and we thank them for their continual support.

As earlier acknowledged, the Audit Office is also very appreciative of the financial assistance which was provided by NZ Aid, via the Aid Management Division of MFEM, to 31 December 2006 ensuring the resources required to complete this mammoth task were available.

Our focus for 2007 is to finalise the Ministry, Crown Entity and Outer Island audits for the year ended 30 June 2005 as promptly as possible to allow the Crown Consolidated 2005 account audit to commence early in the year.

2 CROWN AUDIT FOR THE YEARS ENDED 30 JUNE 2003 AND 30 JUNE 2004

2.1 INTRODUCTION

We have completed our audit of the Financial Statements of the Government of the Cook Islands for the years ended 30 June 2003 and 30 June 2004. The purpose of this letter is to provide a summary of:

- our audit opinions,
- our assessment of aspects of compliance with legislative requirements, and
- significant issues arising during the audits.

You will appreciate that while our audits are carried out in accordance with New Zealand Codified Auditing Standards, they cannot, and should not, be relied upon to detect every instance of misstatement, fraud, irregularity or inefficiency.

The responsibility for public accountability and the implementation and monitoring of internal accounting and management controls rests with management.

2.2 AUDIT OPINIONS

We have issued qualified audit opinions on the Financial Statements of the Government of the Cook Islands for the years ended 30 June 2003 and 2004. The specific areas for audit qualification included:

- Fixed and Infrastructural Assets;
- Trading Revenues of Ministries and Outer Island Administrations;
- External Aid Funds;
- Cook Islands Government Property Corporation Lease Commitments;
- Borrowings;
- Members of Parliament Pension Liability; and
- Welfare Payments made on behalf of the Crown by the Ministry of Internal Affairs.

Audit observes a number of these issues arise at a Ministry, rather than Crown, level however due to materiality are qualified in the Crown, as well as the Ministry, Accounts.

2.3 COMPLIANCE WITH LEGISLATIVE REQUIREMENTS

Sections 25 and 26 of the Ministry of Finance and Economic Management Act 1995-96 contain the financial reporting requirements for the Crown and all Crown Ministries, Ministerial Support

Offices, Island Administrations, and other Crown Entities. These legislative requirements have been met by the Crown.

2.4 SIGNIFICANT ISSUES

This portion of the audit report is categorised as follows:

- Issues raised in the 2002 Audit Report, ie. consideration of prior year audit findings;
- Specific areas for Audit Qualification in 2003 and 2004;
- Significant 2003 and 2004 Audit Issues that were adjusted for; and
- Matters for consideration.

Issues raised in the 2002 Audit Report

INTERNAL CONTROL WEAKNESSES

The Ministry of Finance and Economic Management's ('MFEM') Crown Team has taken significant steps to implement and enhance systems of internal control surrounding all Crown reconciliations. The Audit Office commends MFEM on the completeness and accuracy of the numerous monthly reconciliations performed.

Furthermore, Audit acknowledges the continuing focus by the Crown Accounts Team to 'clear' all outstanding reconciling/balancing items and accounts. In often frustrating circumstances, the accountants have persevered, ensuring that the preciseness of the Crown Accounts is significantly improved year upon year.

CONSOLIDATION AUDIT TRAIL

The Consolidated Audit Trail provided to our office was comprehensive, accurate and very easy to follow. Given the number of entities consolidated at Crown level this is no easy feat and again we commend the Crown Accounts team at MFEM on the 'Reader Friendly' template they have developed.

INTER-MINISTRY BALANCES

Audit acknowledges the usefulness and timeliness of the new system of generating a Crown Receivable/Crown Payable Reconciliation for each individual crown entity. In this regard, Audit tests have been adapted to ensure the Crown Reconciliation is fully utilised by our Office to ensure the accuracy of Crown Receivable and Crown Payable disclosures in the various Ministry and Outer Island Financial Statements.

The Audit Office supports all endeavours to clear out inter-ministry balances as soon as possible.

CREDITORS

No significant issues identified during 2003 or 2004 Audits.

CAPITAL PROJECTS

Adjustments were properly captured by MFEM to ensure the Waste Management Project was accurately capitalized.

CLASSIFICATION

The 2003 and 2004 audit team encountered no difficulties in respect to accounts classification.

BORROWINGS

Audit shares MFEM's frustration in respect to the difficulties encountered in seeking third party loan confirmations from international lenders. It is envisaged that this issue should not be so pertinent in 2005 with the Nauru and SACE loans subsequently settled.

TAXATION

Comprehensive taxation testing was performed as part of the 2003 and 2004 Crown Audits.

An area for improvement, with regard to accrual of taxes, is addressed below at paragraph 4.19.

ACCESS TO RMD INFORMATION

The 2003 and 2004 Crown Audit team encountered no difficulties accessing taxation information. Accordingly, we thank the Revenue Management Division ('RMD') for their assistance and co-operation.

Additionally, we note, the Taxation qualification forming part of the 2002 Audit Opinion was subsequently removed in 2003.

MANAGEMENT SUCCESSION PLANNING

The Audit Office recognizes that efforts are being made by MFEM to 'spread the knowledge' amongst staff and focus is being given to the development of potential successors.

Overall, aside from further progress which can be made in respect to capturing taxation accruals, considerable improvements have been made in respect to systems, controls and accuracy of reporting since the 2002 audit.

Moreover, Audit takes this opportunity to congratulate the MFEM Crown Team on the vast disclosure and accounting enhancements made between the 2002 and 2004 Consolidated Statutory Accounts. In particular, the following notable improvements were introduced:

- *Move from partial to full consolidation of all State Owned Enterprises ('SOEs');*
- *Inclusion of Balance Sheet classifications, ie. current, term, etc;*
- *Removal of 'Appropriation' columns from the key Statements of Account;*
- *Consistent use of account descriptions and terminology; and*
- *Comprehensive 'Reader Friendly' narrations and presentation.*

The final 2003 and 2004 Financial Statements are a quality product. We highlight that this commendation was reiterated by our external quality assurance advisor, Marcus Henry of Ernst Young.

Specific Areas for Audit Qualification in 2003 and 2004

Aside from the removal of the 2002 qualification in respect to Taxation Revenue, the 2003 and 2004 Audit Opinion Qualifications are consistent with those forming part of the 2002 Audit Opinion. In summary, the following categories of the Crown Accounts did not comply with Generally Accepted Accounting Practice ('GAAP') or systems lacked sufficient controls for Audit to conclude on the accuracy of the disclosed amounts.

FIXED AND INFRASTRUCTURAL ASSETS

In line with previous periods, Audit qualified the Crown Accounts in respect to the valuation of Fixed and Intangible assets due to non-compliance with various aspects of International Accounting Standard ('IAS') 16, 'Property, Plant and Equipment'.

Audit notes MFEM's prior response to this matter and sympathises with them in this regard. That is, the valuation of assets will be a time consuming and financially burdensome task that is likely to extend well beyond the 2006/2007 financial year.

Audit reiterates its support of this mammoth task being undertaken as soon as finances allow.

TRADING REVENUES

In 2004, the following Ministries and Island Administrations:

- Ministry of Justice;
- Ministry of Marine;
- Ministry of Works;

- Aitutaki Island Administration;
- Manihiki Island Administration; and
- Rakahanga Island Administration

had insufficient financial records and/or internal control weaknesses which were of such significance (ie. \$2.5 million in total) that we were unable to conclude as to the completeness and accuracy of reported Trading Revenues.

Audit appreciates this is outside the control of the MFEM Crown Team and observes, especially in relation to the Outer Islands, this qualification may be difficult to eliminate.

EXTERNAL AID FUNDS

In both 2003 and 2004 we were unable to carry out auditing procedures necessary to obtain adequate assurance regarding the completeness and appropriateness of aid funded activities accounted for within the Aid Management Division ('AMD') of MFEM. This was attributable to the lack of supporting evidence available to substantiate the amounts disclosed.

Audit appreciates that significant changes, post the 2004 financial year end, were made to the accounting policies, procedures and personnel at AMD. Given our dealings, and enquiries, to date with the current staff we envisage this qualification will be removed from the 2005 Crown Accounts.

On Monday 4 December 2006 we commenced the AMD 2005 audit and our opinion is scheduled to be issued mid January 2007. Provided our audit work supports the information we have been presented with to date, a non-qualified audit opinion will be issued next month. This will consequently result in the 'External Aid Funds' qualification being removed also at Crown level.

LEASE COMMITMENTS

Cook Islands Government Property Corporation ('CIGPC') has not fully disclosed commitments on its land leases due to incomplete records. This is a departure from IAS 17, 'Leases', which requires full disclosure of all current and non-current lease commitments.

The above qualification also formed part of KPMG's Audit Opinion for CIGPC (and consequently Cook Islands Investment Corporation ('CIIC')) for the year ended 30 June 2005.

Accordingly, it is anticipated this qualification will remain for the consolidated Crown 2005 accounts due to the significant value of the lease commitments.

BORROWINGS

The Crown has a liability of \$106 million recorded for Borrowings.

The Audit Office acknowledges the extensive 'Statement of Borrowings' (6 pages) disclosed in the Crown Accounts for the year ended 30 June 2004. This Statement provides the reader with significant detail in respect to the terms, maturities, movements and currency analysis of the external debt.

However the current disclosures do not fulfil the comprehensive requirements of IAS 32, 'Financial Instruments - Disclosure and Presentation'. This standard stipulates that additional disclosure must be made in respect to the 'Fair Value' of each class of financial asset and liability, both recognised and unrecognised.

Audit acknowledges the requirements of IAS 32 are cumbersome, however we draw MFEM's attention to paragraph 77 which provides some leeway when it is not practical, within the constraints of timeliness or cost, to determine the 'Fair Value' of financial assets or liabilities with sufficient reliability. IAS 32 specifies that in this situation that fact should be disclosed together with information about the principal characteristics of the underlying financial instrument that are pertinent to its 'Fair Value'. Potentially, the MFEM Crown Team may be able to attain this 'lesser' borrowings disclosure requirement in the 2005 accounts providing the opportunity for removal of this area of qualification.

MEMBERS OF PARLIAMENT PENSION LIABILITY

The Crown Liability for the Cook Islands Government Superannuation Scheme for Members of Parliament was captured in the statutory accounts at an amount in excess of \$7 million as at 30 June 2004.

The last actuarial valuation conducted for the Super Scheme was as at 30 June 1997, some seven years before this balance date. Consequently the amount recognised in the Financial Statements does not reflect the current defined benefit obligation as required under IAS 19, 'Employee Benefits'.

The Financial Secretary has confirmed this matter is currently being addressed. Accordingly, Audit will review progress made in this regard as part of the Crown 2005 Audit.

WELFARE PAYMENTS

The Ministry of Internal Affairs administers the Old Age, Child and the Destitute and Infirm Benefits on behalf of the Crown.

Audit was unable to satisfactorily confirm the \$6.9 million welfare payments disbursed for the year ended 30 June 2004.

Given the timing of our recent Payment on Behalf of the Crown ('POBOC') Audit Report, issued on 29 August 2005, it is unlikely this qualification will be removed from the next Crown Audit Opinion. Nevertheless, it is hoped that the enhancements which John Henry confirmed would be implemented, in his correspondence of 16 September 2005, will be readily validated during our Crown 2005 Audit.

Audit observes this is an area which has been identified for 'Special Review' by our office in 2007.

Significant Audit Issues (Adjusted)

The Audit Office praises the Crown Team on their continual willingness, and co-operation, in our combined efforts to ensure optimal disclosure was made in both the Crown 2003 and 2004 Consolidated Financial Statements.

The following material audit adjustments were posted to further advance the quality of external reporting:

FIXED AND INTANGIBLE ASSETS GENERATED FROM POBOC'S

Historically POBOC's have been utilised to fund operating expenditure, yet recently there appears to be an increasing number of instances whereby POBOC's are funding expenditure which, in a GAAP sense, should be capitalised and amortised over the ensuing useful life.

Thus, the appropriate adjustment was made to correctly account for the Ministry of Justice's new software.

Audit recommends that procedures be implemented to ensure that all fixed and intangible asset acquisitions by Crown Entities are accurately captured in the accounts, ie. capitalised appropriately.

In the interests of trying to address both the readers own understanding of the particular Ministry's accounts (as compared to their Appropriation), whilst preserving compliance with GAAP, Audit recommends that MFEM consider the option of recognising all expenditure against budgeted expenditure/ Appropriation in the first instance and then have separate disclosure of amounts transferred to capitalised items in order to comply with GAAP.

TAXATION RECEIVABLES

The year end taxation accruals for Value Added Tax ('VAT') and Pay as You Earn ('PAYE') lacked appropriate supporting documentation to substantiate the balances accounted for.

As a result the Audit Office conducted full substantive testing for all significant balances to enable appropriate adjustments to be made to the Financial Statements, this included accruing Customs Levy due from the Oil Companies.

The RMD system requires that year end reports be run on 30 June as there is no ability to back date information. We are aware that the MFEM Crown Team is now ensuring these key reports are printed at the end of each financial year to assist in properly accounting for Taxation Receivable.

Audit recommends that proper analysis and a complete audit trail is prepared and checked to ensure the accuracy of taxation accruals in future accounting periods.

CONSOLIDATING THE CIVIL LIST

Adjustment was made to the 2003 and 2004 draft Financial Statements to account for the balance of the Civil List bank account as at year end.

It is my understanding that previously a separate annual audit was undertaken, and a specific audit opinion issued, for the Civil List. I have been unable to ascertain why this procedure ceased but I would like to reinstate the annual Civil List Audit.

In this regard, the Audit Office seeks MFEM's support to re-introduce an annual audit of the Civil List as this POBOC is not immediately captured as it does not currently form part of Parliament's Accounts. This will assist the MFEM Crown Team to fully consolidate the Civil List on an annual basis.

Unless MFEM objects to this solution the Audit Office will commence auditing, as an individual client, the Civil List from the year ended 30 June 2005.

ELIMINATION OF RELATED PARTY TRANSACTIONS

Treasury (MFEM) pay RMD (MFEM) the Pay as You Earn ('PAYE') tax amount deducted from all public sector employees' wages and salaries administered by Treasury on a monthly basis. The annual Government PAYE accounted for by Treasury totals in excess of \$4.5 million. Upon Audit's request this was eliminated from the 2004 Crown Accounts.

Subsequent expert advice was received stating that this adjustment was incorrect and PAYE should not have been eliminated on consolidation. Due to the net impact on the Statement of Financial Performance being nil the 2004 Financial Statements will not be restated, however the comparatives carried over to the 2005 accounts will be. This inadvertent error is regretted.

Matters for Consideration

WORKERS COMPENSATION FUND

The Audit Office and MFEM agree that the review of the 'Workers Compensation Fund' is well overdue.

The Financial Secretary has confirmed that this matter is to be addressed and it is intended that a Cabinet Paper, recording his recommendations regarding Terms of Reference for a committee, will be submitted by 28 February 2007.

Thus, the Crown Audit team will review any developments/recommendations in respect to the 'Workers Compensation Fund' as part of the Crown 2005 audit.

GAAP and INTERNATIONAL FINANCIAL REPORTING STANDARDS

For a number of years the Crown has asserted that its Financial Statements are created in accordance with International Accounting Standards. However, it has always been apparent that in certain circumstances the Crown has adopted (eg. via SOE reporting) New Zealand Generally Accepted Accounting Practice ('GAAP') rather than international GAAP. Whilst the Crown is continuing to make substantial improvements in terms of its GAAP compliance it is rapidly approaching a cross roads where it will have to decide on an appropriate future GAAP framework.

In this regard, Audit is aware that MFEM is constantly monitoring the developments in the New Zealand Public Sector in respect to introduction and implementation of the International Financial Reporting Standards ('IFRS').

Audit appreciates the significant time and cost that will be involved in the transition to reporting under IFRS and supports MFEM in their endeavours to determine the most appropriate way forward for the Cook Islands Public Sector. Both MFEM and Audit recognise external assistance is going to be required to ensure a smooth and timely transition along with appropriate training for the Finance Managers, MFEM and Audit staff.

Audit endorses MFEM's decision to await finalisation of IFRS implementation in New Zealand before commencing IFRS reporting in the Cook Islands.

TIMEFRAME FOR PREPARATION OF FINANCIAL STATEMENTS

Audit observes that the statutory timeframe for completion of the annual Crown Accounts is impossible to achieve. Section 26(1) of the MFEM Act requires that the annual Cook Islands Government Financial Statements be delivered to the Audit Office within three months of balance date. The requirement of this section is simply unattainable, ie. it is impossible for MFEM to comply.

The Crown Accounts consolidate ALL Crown Entities including Ministries, Island Administrations, Offices of Parliament, State Owned Enterprises and all other public bodies into one set of Financial Statements. This means before preparation of the annual Crown Accounts can commence all other Crown Entities must have final audited accounts signed off beforehand. To meet the unrealistic timeframe provided for in the Act this would need to be completed just two months after balance date. Given the number of entities involved there is no way audited accounts for all Crown bodies could be completed in two months.

Audit supports MFEM in promoting a change to their legislation in this regard. Section 26 should be amended to set a realistic achievable time frame for consolidated Crown accounts to be prepared and passed to Audit.

2.5 AUDIT FOCUS CROWN ACCOUNTS 2005

This portion of our report is included simply for your information.

We have commenced, with the assistance of Marcus Henry, our planning for the 2005 Crown Audit. Hence, I thought it would be useful to bring to your attention the areas we have selected for focus on this year end, they include:

- Government Payroll;
- Italian Loan;
- State Owned Enterprises; and
- Legislative Compliance.

A brief synopsis as to the reason for the areas of focus identified is summarised below, however I note that we welcome any additional points of focus which MFEM would like to see addressed as part of the Crown 2005 Audit.

GOVERNMENT PAYROLL

As you are aware we currently audit all personnel expenditure at a Ministry, Outer Island and Crown Entity level. However, we have not recently completed a review of the systems of internal control surrounding the actual payroll function which is housed in Treasury, MFEM.

Given the magnitude of the Government Payroll we believe a full audit review of the systems of internal control surrounding personnel expenditure is overdue and are scheduled to undertake this review as part of our Crown 2005 Audit in 2007.

ITALIAN LOAN

As reported in the 'Subsequent Events' note the Italian loan has been re-negotiated. A brief review of MFEM's Crown Team computations as to the balances brought in to the 2005 Crown Accounts will be performed.

Our intention is to simply confirm that the loan balance depicted in the next Crown Accounts accurately reflects the written down value of the debt.

STATE OWNED ENTERPRISES

In 2005 the Audit Office performed the audits of the Airport and Ports Authorities, however the following major SOE audits were outsourced, predominantly to KPMG:

- Bank of the Cook Islands;
- Cook Islands Government Property Corporation;
- Cook Islands Investment Corporation; and
- Te Aponga Uira.

We have identified some areas of concern in the Financial Statements for some of the above entities and for this reason have resolved to do further analysis of the key SOE externally audited accounts for the year ended 30 June 2005.

As Auditor of the Government of the Cook Islands Financial Statements it is imperative that the Audit Office is comfortable with assertions made in the consolidating entities accounts.

LEGISLATIVE COMPLIANCE

A high-level review will be undertaken giving consideration to MFEM's awareness, application and compliance with all relevant legislation.

RESPONSE TO THE CROWN AUDIT REPORT FOR YEARS ENDED 30 JUNE 2003 AND 30 JUNE 2004.

The Management report for the Crown Financial Accounts 30 June 2003 and 30 June 2004 financial years end audit was issued on the 7 December 2006 to the following:

- Kevin Carr, Financial Secretary
- Hon. J Marurai, Prime Minister
- Hon. Dr. Terepai Maoate, DPM and Minister of Finance
- Charles Little, Chairman of Public and Expenditure Review Committee and Audit
- Navy Epati, Commissioner, Public Service Commission

Attached is a copy of the response from Kevin Carr, Financial Secretary

Audit notes that as at the date of this report all responses were received by the Audit Office.

3 SIGNIFICANT ISSUES IDENTIFIED DURING FINANCIAL AUDITS

The findings and recommendations contained in the Management Reports issued by the audit office are summarized below.

3.1 MINISTRY OF AGRICULTURE 30 JUNE 2005

SIGNIFICANT ISSUES

PUNANGA NUI MARKET TAKINGS

Our audit of the Punanga Nui Market takings revealed the following issues upon which our qualification of trading revenue was issued:

1. A significant number of receipt amounts have been altered or adjusted. This makes it difficult to reconcile and verify the total amount of money received to the receipts issued.
2. Receipts issued to customers have not been completed properly. That is, customer names were not eligible, amount of money received was not written in words, receipts did not show whether cash or cheque was received. This makes it difficult to identify whether customers were hut or stall holders and therefore unable to determine whether the correct fee was charged.
3. No summary or reconciliation sheet is prepared when submitting takings from the Punanga Nui Market to the Ministry of Agriculture.
4. No third party confirmation to monitor the exact number of stalls and huts in operation on any one day. This will determine the total number of takings expected from the Punanga Nui Market on a daily basis.

The internal controls operating over the collection of Punanga Nui Market revenues are weak and almost non-existent. Along with the issues highlighted above, our Office is currently finalizing a special investigation on the Manager of Punanga Nui Market for possible mismanagement of market takings while under the control of the Ministry of Works for the financial years ending 30 June 2003 and 30 June 2004.

Audit recommends that the HOM and the Finance Manager should put in place a system of internal controls that addresses:

1. *The use of summary and reconciliation sheets that the Finance Manager uses to check physical cash received to the sequentially attached receipts.*
2. *The Manager of Punanga Nui Market is given proper training on filling out and issuing receipts.*

3. *A Vendor Application Form is implemented and completed by all vendors wishing to set up stall.*
4. *A centralized system of collecting cash and issuing receipts is implemented whereby payment should be made to the Ministry of Agriculture upon the completion and approval of Vendor Application Forms. No cash should be exchanged between the Market Manager and the vendor at the Punanga Nui Market. On Market day, the Manager uses the listing of approved and paid vendors prepared by the Ministry of Agriculture to verify to vendor receipt copies ensuring that these are the only stalls set up.*

BANK RECONCILIATIONS

Our review of bank reconciliations revealed that although monthly bank reconciliations were being performed, they were:

- not checked or reviewed for accuracy
- not signed and dated to signify that checking had taken place and
- not signed by the preparer of the bank reconciliation.

Audit recommends that given that bank reconciliation statements are now being checked, the Finance Manager should sign and date the reconciliation signifying that she was the preparer and the Accountant should (after checking) sign and date the reconciliation signifying that he has checked the reconciliation statement.

CLASSIFICATION OF ITEMS

The review of operating revenue identified several items incorrectly classified. These were:

1. Reimbursements made to the Ministry for travel & allowances have been posted to the “Miscellaneous - Sales” account and not credited against “travel & allowances” expenditure.
2. The creation of a “Miscellaneous – Sales” account was used to post sales earned from plants & produce, quarantine fees, etc. being sales collected by other departments on behalf of the responsible department. These accounts can be posted directly to “Quarantine – Sales” and “Plants & Produce - Sales” account instead of posting transactions to the “Miscellaneous – Sales” account.

It is essential that trading activities be correctly coded to the right revenue account in order to provide the Ministry with accurate and complete account balances that can be used to analyze account fluctuations and performance to budgets.

Audit recommends that:

- *independent checks are performed on a regular basis by the Accountant of postings made in the general ledger for all items,*
- *the “Miscellaneous-Sales” account is not used as all revenues should be posted directly to their respective revenue accounts*
- *all reimbursements of costs incurred by the Ministry are credited against the account where the expense was incurred.*

TRAVEL & ENTERTAINMENT POLICY

The Ministry's Manual of Operations briefly stipulates their policy for official travel but is silent on the per diem entitlements of employees traveling domestically or internationally.

The Office does not have an entertainment policy in place.

A written travel (domestic and international) and entertainment policy is important because it provides employees with written detail of their various entitlements therefore meaning that it would not be subject to the changing personal circumstances of any one employee.

Audit recommends that the HOM ensures that the Manual of Operations details the following areas of domestic and international travel:

- airfare class,
- per diem rates for travelling personnel,
- level of accommodation, meal allowances, and
- vehicle allowances entitled to during the period spent overseas.

Similarly, we recommend that the Ministry design and implement written policies and procedures governing entertainment expenses. The policies and procedures should define and limit legitimate business entertainment expenses. The following areas should be addressed:

- *Purchase of food and alcohol for staff parties including birthdays, catering, etc.*
- *Payment of fees for local sports tournaments that the Office may wish to participate in.*
- *Payments for official business lunches or dinners with visiting dignitaries.*
- *Purchase of flowers and gifts for bereavements, maternity, etc.*
- *Morning staff teas.*

INFORMATION TECHNOLOGY

In analyzing the information systems, Audit found that the Ministry doesn't have a system of control in place to safeguard its accounting information. Sensitive and confidential information can be viewed by everyone due to the absence of passwords in the accessing the MYOB system.

The lack of access controls to computer systems exposes the risk of the manipulation of financial information and even the loss of information as a result of technically unskilled personnel accessing data files.

Audit recommends that passwords be implemented for access of confidential or sensitive information within the Ministry particularly with regards to MYOB.

RESPONSE TO THE FINANCIAL AUDIT REPORT FOR THE MINISTRY OF AGRICULTURE 30 JUNE 2005

The Management report for the Ministry of Agriculture 30 June 2005 financial year end audit was issued on the 14 December 2006 to the following:

- Nga Mataio, Secretary of the Ministry of Agriculture

Attached is a copy of the response letter from Nga Mataio, Secretary of the Ministry of Agriculture.

Audit notes that as at the date of this report all responses were received by the Audit Office.

3.2 OFFICE OF THE OMBUDSMAN 30 JUNE 2005 AND 30 JUNE 2006

SIGNIFICANT ISSUES

OPERATING EXPENDITURE

The Office incurred an operating deficit of \$12,044.88 for the 2005/2006 fiscal years. The major factors that led to the deficit for the 30 June 2006 financial year were;

- a) overspending by the Office in personnel of \$33,428.96 excluding annual leave and payroll accrual of \$3,012.61
- b) overspending in operating expenses of \$2,618.01 and
- c) a reduction in crown appropriation revenue to \$100,000.00 (prior year appropriation being \$161,457.00). However, total actual appropriation received was \$127,845.49, a excess of \$27,845.49 to what Cabinet had approved.

The overspending in personnel expenses was caused by a reduced budget to \$80,000.00 upon which, Cabinet had advised the Ombudsman to restructure the Office or redeploy staff to other agencies in order to perform within the allocated budget. This did not happen hence the overspending.

Operating expenses also exceeded budget despite recommendations from the budget committee to reduce costs. We were unable to verify exactly how each account performed to budget as a detailed phased budget was not submitted to Audit. However, the accounts that appeared to be excessive taking into consideration the size of the Office, were telephone, electricity and vehicle expenses that totaled \$4,513.69, \$1,768.94 and \$3,393.91 respectively.

The Budget Committee and Cabinet decisions to reduce the Office of the Ombudsman's budget appropriation for the fiscal year was largely influenced by the submission of a poor business plan, overspending in prior years and poor output performance from the Office.

Audit also found the lack of monitoring and accountability for expenditure together with the absence of a detailed phased budget for both years eventually resulted in the 2006 deficit position.

The subsequent effect of the deficit placed the Office in a negative cash flow situation for the 2006 year further hindering the Office's ability to meet its desired outcomes and certain significant operating expenses. These outstanding commitments included \$11,000.00 in rent and \$5,279.84 in audit fees.

The Ombudsman should ensure compliance to Section 39(1) of the Ministry of Finance and Economic Management (MFEM) Act 1995-96 at all times. This states that "Upon passing of an Appropriation Act, the Head of a Government Department responsible for the appropriation may authorize expenditure but only in accordance with the allocations specified and voted in that Act, and the Head of Government Department alone shall be responsible for ensuring that the moneys are expended for the purposes intended".

In future, the Office of the Ombudsman must also provide meaningful Business plans that comply with the budgetary process requirements. The Office should also prepare a detailed phased budget aligned to the outputs of the Office as a guide for achieving its desired outcomes by output, within its appropriated funding.

Audit recommends that the Ministry of Finance and Economic Management (MFEM) take a proactive approach through monitoring monthly expenditure by the Office, and promptly reprimanding the Ombudsman whenever overspending occurs.

REFUSAL TO RETURN THE OFFICE VEHICLE

Audit could not sight the Ombudsman's motor vehicle, as it was not at the Office during the audit.

The vehicle has become the centre of a dispute between the Office and the former Ombudsman who refuses to return the vehicle unless the Office meets its outstanding rent commitments to its Landlord Uritaua Proprietor, for which he is a related party to.

Audit recommends the Office seek legal advice and enforcement for breach of the following legislation:

- 1) *Section 244 of the Crimes Act 1969 which states that "Everyone commits theft who, having received any money or valuable security or other thing whatsoever on terms requiring him to account for or pay it....."*
- 2) *Section 5 of the Ombudsman Remuneration Order 1994 requires the vehicle be used of "official duties" of the Ombudsman.*
- 3) *Part D Section 10, 3.4.2 specifies that all Crown assets are to be secured and not be removed from the office premises.*
- 4) *The Ministry of Finance and Economic Management (MFEM) Act 1995-96 deem assets to be "public money", so the withholding of the car by the ex-Ombudsman constitutes theft of public money.*

Audit also recommends that the current Ombudsman does everything in her power to retrieve the motor vehicle.

PERSONNEL & ANNUAL LEAVE

Our audit revealed the following anomalies:

1. There were no personnel files maintained for all staff at the Office including the Ombudsman.
2. Employees did not have employment contracts or formal letters of appointment but were verbally aware of their salary and leave entitlements.
3. Annual leave balances were incorrect and leave requests were made in writing to the Ombudsman on an adhoc basis.
4. Poor administration of annual and sick leave balances. This led to the Ombudsman over using his sick leave entitlement by 4 days.

5. Staff charging fuel on the Office account without supporting documentation authorizing this entitlement. This could lead to the use of the fuel account by unauthorized personnel for non-official duties.

Audit recommends that the Ombudsman take responsibility for ensuring that:

1. *All staff (inclusive of the Ombudsman) have a personnel file which includes an employment contract/agreement detailing at least their remuneration, terms of employment, performance, leave entitlement, other employee benefits and termination provision*
2. *Leave application forms are implemented and staff are advised to complete these forms when requesting to take leave. All leave should be approved by the Ombudsman prior to any staff taking leave.*
3. *The Finance Officer updates sick and annual leave balances on a monthly basis and informs all staff of their respective balances.*
4. *A letter is sent to the fuel supplier informing them of the personnel authorized to use the Office's fuel account. A copy of the letter should be kept on file for Office and audit purposes.*

INCOMPLETE FIXED ASSETS REGISTER (FAR)

The Fixed Asset Register (FAR) maintained by the Office was incomplete as there were assets still in use by the Office that were not shown on the FAR. This was highlighted in prior years (2003 & 2004) audits, but the FAR was never updated to reflect this.

Audit recommends the Office ensures the FAR is maintained correctly and is in compliance with Part B Section 2 of the Cook Islands Government Financial Policies and Procedures manual. The manual provides that all assets (including expensed assets) that are in a working condition must be recorded on the FAR.

ABSENSE OF A RENTAL AGREEMENT

The Office has occupied the Uritaua building since 2001 without a rental agreement in place.

The former Ombudsman was a related party to the landlord Uritaua Proprietor and received rental cheques on behalf of the landlord. This circumstance presents a conflict of interest situation that was never reported to the Public Service Commissioner, nor did the Ombudsman remove himself from this conflicting position.

The cash flow problems of the Office from prior year overspending led to the accumulation of rental arrears totalling \$11,000.00. The unpaid rent expenses ultimately led to the former Ombudsman's retention of the Office motor vehicle as compensation.

Audit recommends that despite the absence of a rental agreement the Crown should honour its obligation and clear its outstanding rent commitment in view of the International Accounting Standard 37's definition of "a constructive obligation". It states that a constructive obligation is an obligation that derives from an enterprise's actions where:

- (a) by an established pattern of past practice, the enterprise has indicated to other parties that it will accept certain responsibilities*
- (b) as a result, the enterprise has created a valid expectation on the part of those other parties that it will discharge those responsibilities.*

Audit recommends that a lease agreement is drawn up to reflect the terms and conditions agreed upon by both parties.

OVERDRAWN BANK ACCOUNT

Audit found the Office bank account was overdrawn as at 30 June 2006 and on 2 other occasions during the years audited (November and December 2005.)

These situations were a direct result of the cash flow problems of the Office and were in breach Ministry of Finance and Economic Management (MFEM) Act 1995-96.

Section 45 of the MFEM Act states that:

“...an account or fund within the Public Account may be overdrawn only where this is consistent with fiscal and other financial policies of Government, and that it can be shown how that account will return to credit within a reasonable time having regard for the purpose of that account...”

Audit recommends that the current Ombudsman ensures that the operating bank account is effectively managed so that it does not go into overdraft as encountered by her predecessor.

UNDEPOSITED ACCOUNT

The Office uses an un-deposited account as a transit account for un-deposited funds.

The account is unnecessary for a small office and creates more administrative monitoring that the Office does not need.

Audit recommends this account be closed because the revenue and expenditure flows of the Office do not justify the need for this account to exist.

MISSING SUPPORTING DOCUMENTS

Audit found the internal controls over expenditure were weak and almost non-existent

Of the sample selected, 28% of payment vouchers lacked supporting documentation, proper authorization and payment vouchers were not filed in any logical order. The Ombudsman is responsible for the authorization of expenditure as stipulated in Section 39 of the MFEM Act 1995-96.

Audit recommends that the Ombudsman ensures that:

- 1. all payment vouchers are certified for authorization of payment*
- 2. all payments are bona fide and are relative to the operations of the Office*





3. *payment vouchers should not be certified without the necessary supporting documents attached*
4. *payment vouchers are filed sequentially, usually in cheque number order.*

TRAVEL POLICY

Audit has recommended the preparation of a travel policy every financial year audited since 30 June 2002 and no travel policy has been produced by the Office to date.

Audit previously highlighted that the absence of a travel policy led to unauthorized travel expenditure that subsequently contributed to the overspending for the 2003/04 appropriation.

Audit recommends that the Office develop and implement a travel policy governing the incurrance of travel expenditure. The following specific areas should be addressed:

-  *Authorisation of all office related travel*
-  *Domestic and International travel*
-  *Travel allowances ie: per diems*
-  *Meals, accommodation and transport*

The Audit Office acknowledges that the Ombudsman Remuneration Order 1994 provides for personal travel by the Ombudsman, his wife and one family member from Rarotonga to Auckland return each year. The Ministry Travel Policy should include this provision.

MYOB BACKUPS

MYOB systems backups are performed manually twice a year.

The Cook Islands Government Financial Policies and Procedures Manual (CIGFPPM), Part D, Section 13 states that system backups should be done weekly but at a minimum must backup monthly.

Audit recommends that the Office adhere to the requirements of the CIGFPPM, Part D, Section 13.

RESPONSE TO THE FINANCIAL AUDIT REPORT FOR THE OFFICE OF THE OMBUDSMAN 30 JUNE 2005 AND 30 JNE 2006

The Management report for the Office of the Ombudsman 30 June 2005 and 30 June 2006 financial years end audit was issued on the 23 January 2007 to the following:

- Janet Maki, Ombudsman

As at the date of this report no response has been received by our Office

3.3 FINANCIAL INTELLIGENCE UNIT 30 JUNE 2005

SIGNIFICANT ISSUES

Fixed Assets

Our audit of fixed assets register (FAR) revealed the following:

1. The amounts and details of expensed assets were not separately listed on the FAR.
2. Physical verification of assets was difficult to perform as assets were not uniquely identifiable.
3. Physical verification of assets revealed a significant number of assets not listed on the FAR.
4. Where the quantity of a particular asset was more than one, it was not separately listed.
5. A donated computer system was recorded as an expensed asset.

The Cook Islands Government Financial Policies and Procedures (CIGPP) Manual Part B, Section 2 stipulates the requirements for good asset management.

Audit recommends that:

1. *Expensed assets are separately disclosed consistent the FAR example documented on attachment 1 of the CIGPP manual.*
2. *All fixed assets (if not uniquely identifiable) should have a fixed asset control number consistent with the requirements of CIGPP manual, Part B, Section 2, requirement 3.3 and 3.9*
3. *An annual stocktake of fixed assets is conducted to ensure the existence, security and condition of each stock item. This is consistent with the CIGPP manual, Part B, Section 2, requirement 3.10. The Audit Office has complied a listing of assets observed but not the FAR however, a full stocktake of fixed assets should still be conducted. Differences identified in the annual stocktake between the physical count of fixed assets and the FAR should be notified in writing to the Financial Secretary.*
4. *Fixed assets of should always be recorded separately on the FAR. For example, 2 air condition units should be recorded separately and not as “2x air condition units”.*
5. *Donated fixed assets received directly from the donor should be recorded as aid revenue in the Statement of Financial Performance. Part B, Section 5, Aid Assets of the CIGPP manual stipulates the requirements of accounting for aid assets.*

Subsidiary Ledgers

The posting of accounts payable and accounts receivables were done through the use of both the Purchases/Sales Journal (PJ/SJ) and the General Journal (GJ). The subsidiary ledgers did not balance to the general ledger as a number of transactions were coded through the GJ as opposed to the PJ or SJ.

While creditors and debtors may be recorded in both the GJ and the PJ and SJ respectively, in order to minimize errors when accruing for expenditure and revenue only one journal should be used. More commonly used and appropriate when accounting for accounts payables and accounts receivables (or other payables/receivables) is the Purchases Journal and Sales Journal. This is because it also provides an aged payables/receivables report, which is useful in identifying outstanding payables/receivables.

Audit recommends that accounts payable/receivables be recorded through the Purchases/Sales Journal only and the accountant to ensure that the general ledger is always in balance with the subsidiary ledgers.

Payment Vouchers

All payments were made on an invoice basis then filed away in cheque sequential order. Throughout the period beginning 1 July 2004 to 30 June 2005 there was no evidence of payment vouchers ever being prepared. Although Audit does understand that the Financial Intelligence Unit is comparatively smaller than other Ministries this fact alone does not negate the importance of preparing payment vouchers.

Payment vouchers are important as it has the quality of ensuring that authorisation for payments are always given. It also classifies the details of invoices into general ledger accounts thus minimizing the misallocation of expenses.

Audit recommends therefore that the preparation of payment vouchers becomes a priority in the future, especially as the Financial Intelligence Unit begins to expand.

Annual Leave

Applying for annual leave was understood by Audit to be done verbally. Verbal requests for annual leave are conveyed to the Head who then accepts or declines the employee's application. The concern here is the lack of control over the management of personnel resources within the Office. It also fails to provide evidence or proof that proper authorization was given, which is required by the Ministry of Finance and Economic Management's Payroll division.

Formal non-verbal requests for annual leave are important as it proves authorization and thus gives the Head of Office opportune time to take the appropriate course of action in relation to managing and controlling personnel movement.

Audit recommends that only written annual leave forms are devised for use when applying for annual leave. The employee wishing to take their annual leave must therefore produce a formal application a week or two weeks in advance in order to give the Head ample time to decide how best to allocate personnel resources.

Travel and Entertainment Policy

Discussions with Head of Office revealed that there is no formal standard procedure for either domestic or international travel or any formal provisions for entertainment expenditure. Per diem rates, level of accommodation, meal allowances, or vehicle allowances on any overseas travel is determined subjectively by the Head.

The Office does not have an entertainment policy in place.

A written travel (domestic and international) and entertainment policy is important because it provides both employees and auditors with written detail as to the various entitlements of each – therefore meaning that it would not be subject to the changing personal circumstances of any one employee.

Audit recommends that a domestic and international travel procedure be established. The details of which should stipulate:

- *airfare class,*
- *per diem rates for travelling personnel,*
- *level of accommodation, meal allowances, and*
- *vehicle allowances entitled to during the period spent overseas.*

Similarly, we recommend that the Ministry design and implement written policies and procedures governing entertainment expenses. The policies and procedures should define and limit legitimate business entertainment expenses. The following areas should be addressed:

- *Purchase of food and alcohol for staff parties including birthdays, catering, etc.*
- *Payment of fees for local sports tournaments that the Office may wish to participate in.*
- *Payments for official business lunches or dinners with visiting dignitaries.*
- *Purchase of flowers and gifts for bereavements, maternity, etc.*
- *Morning staff teas.*

REPOSENSE TO THE FINANCIAL AUDIT REPORT FOR THE FINANCIAL INTELIGENCE UNIT 30 JUNE 2005

The Management report for the Financial Intelligence Unit 30 June 2005 financial year end audit was issued on the 4 December 2006 to the following:

- Bob Williams, Acting Head of Office

Attached is a copy of the response letter by Bob Williams, the Acting Head of Office

Audit notes that as at the date of this report all responses were received by the Audit Office.

3.4 OFFICE OF THE HEAD OF STATE 30 JUNE 2005

SIGNIFICANT ISSUES

3.4.1 Payment Vouchers

Throughout the period beginning 1 July 2004 to 30 June 2005 there was no evidence of payment vouchers ever being prepared. Although Audit does understand that the Office of the Head of State is comparatively smaller than other Ministries this fact alone does not negate the importance of preparing payment vouchers.

Payment vouchers are important as it has the quality of ensuring that authorisation for payments are always given. It also classifies the details of invoices into general ledger accounts thus minimizing the misallocation of expenses.

Audit recommends therefore that the preparation of payment vouchers becomes a priority in the future.

3.4.2 Fixed Assets Register

Audit conducted a stock take of the Office of the Head of State's fixed assets to confirm the existence and completeness of their fixed assets register.

The stock take revealed that:

1. a number of stock had been disposed of in prior years but were still listed on the current fixed asset register. Some of these assets were found to be damaged and beyond repair.
2. some assets were not on site during the stock take and we were informed that these assets were at the Queens Representatives residence at Matavera. According to the Finance Officer and the Cleaner, these assets were transferred to Matavera for protection during the cyclone period and since then, had not been returned. Audit had not sighted those assets.

A fixed assets stock take should be performed on an annual basis in line with the Cook Islands Government Policies and Procedures (CIGPP) Manual, Part B, Section 2, Asset Management. This should ensure the existence, security and condition of each item and should be reconciled to the asset register and the general ledger.

Audit recommends the following:

1. *The fixed asset register is amended to remove those assets disposed of in prior years*
2. *Those assets that were transferred to Matavera should be returned to the official residence of the Head of State.*

ANNUAL LEAVE RECORDS

The following issues were identified during our audit of annual leave:

1. Leave application forms were not used to record leave taken and authorization given
2. There was no provision made to accrue unused annual leave balances as at 30 June 2005
3. Prior year provision for annual leave balances had not been reversed.

Audit is concerned that the Office is not keeping good annual leave records. As a result no accrual had been made to provide for unused annual leave balances at year end.

Audit recommends that

1. *Annual leave are accurately recorded and monitored on the leave cards so that end of year leave balances are correctly accrued in the financial statements.*
2. *Leave application forms should be implemented to assist with the recording process.*
3. *A letter from the Official Secretary should be obtained as approval for carry forward of unused leave balances into the next financial year.*

3.4.3 Accrual accounting

Audit noted that all invoices received from suppliers during the 2005 financial years, were not initially entered into the “suppliers” or subsidiary accounts in MYOB when they were received. Instead, the invoices were entered through the “cheque book module” when they were paid. This resulted in several invoices that were unpaid and unrecorded at balance date. The extent of unrecorded creditors for the 2005 financial year was \$1,328.36.

The Office only recognized an invoice when it was paid thereby not fairly stating their operating expenses and creditors balances under the accrual basis of accounting. Accrual accounting is based on the principle that all revenue and expenses are recognized in the financial period in which they are earned and incurred, this ensures a clearer picture of the actual performance of the organization.

Audit recommends that the Office ensure that the accounts payable module of the general ledger is fully utilized to provide a complete and correct disclosure of outstanding payments and accruals at balance date. The use of the payables module:

1. *acts as a good internal control devise as subsidiary accounts should always balance to the total of the control (Statement of Financial Position) account*
2. *gives a complete and accurate position of the outstanding payments*
3. *ensures that the balance of the payables account is inclusive of VAT.*

3.4.4 IMPLEMENTATION OF AUDIT REPORT RECOMMENDATION

Audit noted that although several of the recommendations contained in the management letter issued in conjunction with the audit of the fiscal year 2003-2004 had been successfully implemented by the Office, a few recommendations were still outstanding. These issues have been highlighted again and are documented above under the following paragraphs:

1. Accrual Accounting
2. Annual Leave records

Audit commends the Office for their quick response in addressing most of the prior year's issues however notes the importance for the Office to address all issues stated in the current management letter.

Audit recommends that the Head of State take measures to ensure that all agreed-upon recommendations are implemented.

REPONSE TO THE FINANCIAL AUDIT REPORT FOR THE OFFICE OF THE HEAD OF STATE 30 JUNE 2005

The Management report for the Office of the Head of State 30 June 2005 financial year end audit was issued on the 30 November 2006 to the following:

- Harry Ivaiti, Acting Official Secretary

As at the date of this report no response has been received by our Office

3.5 DEPARTMENT OF NATIONAL HUMAN RESOURCES 30 JUNE 2005 AND 30 JUNE 2006

SIGNIFICANT ISSUES

Hours of Work and Annual Leave

Our review of the systems in place for the processing of payroll revealed that the hours worked and recorded in the time book (the sign in/out book) differed greatly from the hours worked by an employee in the time sheet and also differed from the hours recorded in the Attache report received from the Ministry of Finance and Economic Management (MFEM).

The time book is the source upon which information is derived for the preparation of the timesheet (that is sent to MFEM) and accordingly the payment of salary and wages. The inconsistencies identified raise alarm bells as to the existence of fictitious and/or duplicate transactions as well as whether proper payroll authorization procedures are in place.

Audit recommends that:

- ✓ *Employees fill in the time book upon arrival to work, lunch time and when departing for home at the end of the working day.*
- ✓ *The Finance Officer preparing the timesheet (for remittance to MFEM) uses the time book as the source upon which an employee's fortnightly remuneration is based.*
- ✓ *The Finance Officer performs a reconciliation of the timesheet to the Attache printouts to identify any variances between what the HOM has approved to pay (via the timesheet) and what has been processed and paid to each employee. Any variances should be addressed with MFEM for immediate action.*

Annual Leave

We identified the following issues:

- ✓ There were inconsistencies between annual leave recorded in the time book and annual leave recorded on the timesheet that is sent to MFEM for payment.
- ✓ Although there is an annual leave application form in place, some annual leave was verbally approved.

The time book should always capture the leave that has been approved by the HOM as it is the basis upon which the information is derived for the preparation of timesheets (that are sent to MFEM) and accordingly the payment of salary and wages. Accordingly, the annual leave application forms provide the source upon which leave cards/ records are updated and administered.

Audit recommends that:

- ✓ *The Finance Officer ensures that each employee's leave, be it sick, annual, LWOP or TOIL, is recorded in the time book at all times.*
- ✓ *The Finance Officer performs a reconciliation of the timesheet to the Attache printouts to identify any variances between what the HOM has approved to pay (via the timesheet) and what has been processed and paid to each employee. Any variances should be addressed with MFEM for immediate action.*
- ✓ *The Finance Officer regularly updates the annual leave records. The authorised leave application forms and the time book should both be used in this exercise.*
- ✓ *The HOM should ensure that employees apply for leave in writing. The leave application form should be used at all times.*
- ✓ *The HOM should instigate a policy whereby annual leave applications are received and authorized at least 10 days prior to the taking of leave. Only in emergency situations should allowances be made.*

Contracts and or Letters of Appointment

Of the six employees in the Department, only 3 had formal employment notices.

Of concern to Audit was the fact that no engagement letter or other contract document formalizing the employment arrangements between employees and the Department exists.

We recommend that the HOM ensures that all employees of the Department have formal letters of offer or contracts stipulating the terms and conditions of employment that have been agreed to by both parties.

Two Data Files

There were two data files that were administered for EU Aid Funding.

As a result, Audit was presented with conflicting information as one data file was updated and the other wasn't. This caused confusion and misunderstanding while auditing the EU bank account.

While there were no unusual transactions or any fraud detected, Audit recommends that the Department only maintains one data file for the administration of EU Aid funds.

Subsidiary Ledger vs Main General ledger

The posting of accounts payable and accounts receivables were done through the use of both the Purchases/Sales Journal (PJ/SJ) and the General Journal (GJ). The subsidiary ledgers did not balance to the general ledger as a number of transactions were coded through the GJ as opposed to the PJ or SJ.

While creditors and debtors may be recorded in both the GJ and the PJ and SJ respectively, in order to minimize errors when accruing for expenditure and revenue only one journal should be used. More commonly used and appropriate when accounting for accounts payables and accounts receivables (or other payables/receivables) is the Purchases Journal and Sales Journal. This is because it also provides an aged payables/receivables report, which is useful in identifying outstanding payables/receivables.

Audit recommends that accounts payable/receivables be recorded through the Purchases/Sales Journal only and the Finance Officer should always ensure that the general ledger is always in balance with the subsidiary ledgers.

Bank Reconciliation

Our review of bank reconciliations revealed that although monthly bank reconciliations were being performed, they were:

- not checked or reviewed for accuracy
- not signed and dated to signify that checking had taken place and
- not signed by the preparer of the bank reconciliation.

The internal controls are significantly strengthened by

- ensuring the bank reconciliation process is segregated,
- showing evidence of who prepared the monthly bank reconciliation and
- obtaining confirmation that it was appropriately and independently checked.

Audit commends the Department for the monthly completion of bank reconciliation's and encourages them to ensure these are signed and dated by the preparer and subsequently signed and dated by the person that checks the reconciliation.

Cost of donated assets

Four CD players donated by EU were valued at \$10,000.00 (\$2,500 each). Audit found that when donated assets are received there is no confirmation of the value of the donated assets hence the asset value is estimated and included in the fixed assets register (FAR) accordingly. A confirmation of the value of these assets was sought during the course of this audit and an audit adjustment was proposed to correct the valuation.

Valuations of fixed assets, donated or other wise cannot be determined by the Department staff as they are not qualified valuers. At all times, supporting documents should be received in order to record assets into the FAR and the financial statements at their real value.

Audit recommends that when receiving donated assets, the Department obtain a valuation of the asset (through requesting for costing documents from the donors) to ensure that assets are fairly stated in the Statement of Financial Position as well as the FAR.

RESPONSE TO THE FINANCIAL AUDIT REPORT FOR THE DEPARTMENT OF NATIONAL HUMAN RESOURCES 30 JUNE 2005 AND 30 JUNE 2006

The Management report for the Department of National Human Resources 30 June 2005 and 30 June 2006 financial years end audit was issued on the 4 December 2006 to the following:

- Frances Topa Apera, Manager for the Department of National Human Resources.

Attached is a copy of the response letter by Frances Topa Apera, Manager

Audit notes that as at the date of this report all responses were received by the Audit Office.

3.6 PORTS AUTHORITY 30 JUNE 2006

SIGNIFICANT ISSUES

A. Vesting and Ownership of Property

As highlighted in our Audit Opinion we observe that legal ownership of all fixed assets remain with the Cook Islands Government awaiting vesting to the Ports Authority. The fixed assets are included in the Financial Statements of the Ports Authority as if legal ownership was transferred on 1 July 1995, the date from which the Ports Authority took over responsibility for managing the Ports of the Cook Islands and the planned date for vesting the assets.

Given it is now nearly twelve years since that date, Audit recommends that the Ports Authority and Cook Islands Investment Corporation immediately take the necessary steps required to bring about resolution of this matter.

The 2007 Audit team will be closely reviewing all steps (if any) taken by the Ports Authority to finalise this outstanding issue.

B. Failure to seek 'Optimal Return' on Sale of Assets

Tugboat (Orongo II)

Aitutaki's Tugboat, Orongo II, was sold to Mike Henry (previous Board Director) for \$7,000 (VAT inclusive), resulting in a \$70,000 loss on sale of this significant crown asset. That is, the Ports Authority sold an asset for less than one tenth of its book value on 3 March 2006.

Audit observes that four months earlier, whilst the Ports Authority was under the chairmanship of Bim Tou, valuations of the tugboat had been sought from independent valuers. These valuations ranged from \$22,500 to \$50,000 confirming that the Tug Orongo II was worth significantly more than that later obtained from its sale by the Ports Authority under the chairmanship of Don Beer Jnr.

It was further noted that Mike Henry had submitted an earlier bid for the tugboat when it was first tendered for a higher amount of \$8,500. In a subsequent letter to Mike Henry, the then Chairman, Bim Tou advised his tender had been declined on the basis that the tender amount was materially less than the prospective value of the tug as determined by independent valuers.

Audit was unable to determine firstly, why the Ports accepted a bid at \$70,000 lower than the book value of the asset and significantly less than the current value placed on the tugboat by valuers and secondly, why they accepted a lower tender from the same person which had previously been declined.

It is of considerable concern to Audit that the Ports Authority made no endeavour to determine whether a higher price could be achieved by offering the Tugboat for sale to neighbouring South

Pacific ports. During various discussions with the Ports General Manager and Chairman they have frequently referred to their close working relationship with neighbouring ports yet at a time like this when an email may have solicited interest no such step was taken. A single email, at no cost, may have drastically increased the return to the Ports Authority and instead the only effort made by the Ports Authority to promote the sale of this asset was a single advert in the Cook Islands Herald, a single advert in the Cook Islands Times and three adverts (over one week) in the Cook Islands News.

Audit recommends that the Ports Authority immediately review their procedures for 'Sale of Assets'. It is apparent that currently there is little, or no, focus on securing the best price possible to optimize the return to the Ports Authority. This represents negligent management of Crown Assets and is of significant concern to the Audit Office.

Ford Ute - Explorer (#2328)

On 28 February 2006 the Ports Authority purchased a 2006 Isuzu DMax Double Cab Pick Up (3 litre). This brand new vehicle was acquired for Andrew McBirney, General Manager ('GM') from Pickering Motors at a purchase price of \$39,900 (VAT inclusive). Audit has been unable to substantiate why the General Manager needed to upgrade his vehicle from the well maintained Ford Explorer. The new vehicle cost the Ports Authority a further \$22,900 above that gained from the sale of the GM's previous vehicle.

On 27 February 2006 the Ports Authority received a cheque from Tony Armstrong's business Hawaii Pacific Maritime for \$17,000 (VAT inclusive) for the purchase of the Ford Ute.

This vehicle was never tendered for sale which would have ensured the maximum return to the Ports Authority was obtained.

Given that, in the same financial period, a motorcycle worth \$400 was tendered this would suggest that the Ford Ute was sold on a 'friendly arrangement' without tender to the prior General Manager. It is of further concern to audit that as at balance date Tony Armstrong's company Hawaii Pacific had an overdue debtor balance exceeding \$13,000. It is also noted that a number of Tony Armstrong's business's have failed to pay various material outstanding debts due. This further suggests the debt collection procedures of the Ports Authority (refer paragraph E below) are extremely lacking, given Hawaii Pacific could readily pay \$17,000 immediately for a vehicle yet various material trading debts remain unpaid as at balance date.

Following the significant loss incurred by the Ports Authority in disposing of the Orongo II Tugboat (without any attempt to advertise the sale outside the Cook Islands) and the unexplained failure to tender a significant motor vehicle it is evident that the Ports Authority Management are failing to strive to obtain the optimal return for this crown entity from the disposal of assets.

This is of major concern to the Audit Office and we reiterate the need for consistency in sale of assets, ie. public tender to all potential markets (including neighbouring ports where specialized/technical marine assets are being sold) and for all assets to be disposed of.

C. Failure to seek 'Optimal Return' from Assets Employed

Given the material loss on sale of the Aitutaki tugboat, the failure to tender the sale of a significant asset and the aged debtors balance in excess of 90 days outstanding as at 30 June 2006 exceeding \$164,000 (40% of all Rarotonga debtors) it is certainly difficult to understand how this translates to a 25% increase in salary based on financial performance.

It is evident to Audit that the current financial performance of the Ports Authority is certainly nowhere near the optimal return it could be making if it was managed in a fiscally responsible manner.

Audit recommends the General Manager's performance be reviewed on an annual basis, in line with his contract, and specific 'Key Performance Indicators ('KPI's)' are determined to facilitate a proper appraisal process. The KPI's should include, but not be limited to, measures regarding the financial performance of this crown entity.

E. Inadequate Debt Collection Procedures

As at 30 June 2006 \$163,973.16 of debts over three months old remained uncollected as per the Rarotonga Port Accounts Receivable schedule. That is, in excess of 40% of the total Rarotonga debtors (\$405,377) were over 90 days old. A summary of the 90 day + debts follows:

Express Cook Islands Line	\$46,552
Mataroa International Shipping	\$41,940
TM Stevedoring/Devanning	\$27,799
Mataroa Shipping & Trading Ltd	\$21,895
Bounty Bay	\$6,262
Cook Islands Tuna Fisheries	\$4,204
Fresh Off the Boat	\$3,560
Others	\$11,761

Total Debtors over 90 days old as at 30 June 2006 **\$163,973**

The Ports Authority places itself in an extremely precarious position by allowing the above debts to age to beyond three months whilst at the same time continuing to extend credit.

As at 30 June 2006 the Express Cook Islands Line Rarotonga Port debt has escalated to \$115,000.

The Ports Authority is not in the business of providing finance/credit and accordingly their debt collection policies should reflect this, ie. credit should be stopped if any client fails to meet its debt obligations in full within the Ports normal terms of trade, eg. one month from invoicing. The current system of tolerating over 90 + days before pressing for payment simply cannot continue.

Audit will be undertaking a full review of aged debtors during the 2006/2007 Audit to ensure timely collection, and timely 'stopping of credit', procedures are in place and being adhered to.

F. Inaccurate Accounting

Audit observed two separate receipts from the Ministry of Transport for \$7,500 each which were inappropriately offset against 'Wage and Salary' expenditure. By coding these receipts to Wages and Salaries both this expense and Trading Revenue are understated by \$15,000 in total.

Offsetting revenue against expenditure understates the true amount of both accounts and jeopardizes the reliability of the financial information or Financial Statements produced. Offsetting of this nature breaches both International Accounting Standards and Generally Accepted Accounting Practice.

Audit recommends that all revenue received, regardless of whether it is unusual in nature or not, should be accurately disclosed as income, and should not be offset against expenditure resulting in the inaccurate understatement of both revenue and expenditure.

G. Internal Control Issues

1. Frequency of Banking

Based on sample tests performed, Audit identified that banking generally only occurs weekly on a Friday. Given that a relatively high level of cash is often held in the office safe, and significant dollar value cheques are frequently received, audit recommends that banking occur at least twice a week.

Audit accentuates that due to the negotiability and therefore attractiveness of cash, it is imperative that tight internal controls surround this asset at all times. The longer cash is held, the more at risk these funds are placed.

Furthermore, general 'good cash management' should be practiced, ensuring that cheques are also lodged on a twice weekly basis at a minimum.

2. Checking of Payment Vouchers

Audit testing found some payment vouchers that were not evidenced as being checked. It is imperative that proper systems of internal control surround all payments and this should include evidence of all vouchers being checked for accuracy before disbursements are approved for payment.

Audit recommends that the person checking the voucher should confirm the following before approving the voucher for payment:

- a. The voucher is supported by an original invoice;*
- b. The goods/services on the invoice are bona fide expenses of the Ports;*
- c. The payment is for the same amount as the invoice(s);*
- d. The voucher has accurately been coded to the correct account;*
- e. VAT has been correctly claimed (if appropriate); and*
- f. The cheque is payable to the actual supplier as identified on the invoice.*

3. Time Recording

Audit notes that the sign-in and sign-out time record book completed by the wharf supervisor appears 'artificial', in that everyone starts exactly at 8.00am and everyone finishes exactly on the hour. Audit emphasises that the effectiveness of internal controls disappear if the basic data recorded is not a true reflection of what actually happens at the Ports Authority, ie it is a waste of time providing a 'manufactured' time book to the payroll clerk every week, if the control is not going to be properly implemented then this has no more effect than the payroll officer simply paying everyone for set hours every week without receiving any form of supporting documentation to verify the actual hours worked.

Audit recommends that employees themselves fill in the daily sign in/sign out book upon arrival to work, departure/return for lunch break and finally when departing work each day. The daily schedule can then be signed (as correct) by the appropriate Supervisor for verification that the time record books can be relied upon as an accurate reflection of actual hours worked.

4. Accounting Personnel

The Finance/Administration Manager has sole access to the financial system of the Ports Authority, that is, she is the only person with access to the data file. In her absence, there is no alternative access. Whilst Audit appreciates the importance of a secure accounting system, the Ports is currently in an extremely vulnerable position should the Finance/Administration Manager be away or fall ill.

Audit recommends that the Ports Authority consider training other administration staff to provide a back up system, which allows the alternative designated staff to access the financial system in her absence.

H. Sand Pump

Audit notes that their Special Review Report into the acquisition of the Sand Pump has not yet been released. Due to the Audit Office and MFEM's focus on completing the consolidated Government of the Cook Islands Financial Statements for 2003 and 2004 during the year to 31 December 2006 the Sand Pump report was placed on hold.

The 2003 Consolidated Crown Accounts were signed in September 2006 and the 2004 in November 2006 allowing for key personnel to return to completing outstanding Special Reviews. The draft and final Sand Pump report will be issued in February 2007.

I. Outstanding Issues as Identified in the 2005 Audit Report

Audit was disappointed to note that some of areas of concern detailed in our previous Management Letter remained unchanged as at 30 June 2006. Audit briefly refers to these below and directs Ports Authority Management back to our letter of 7 October 2005 for further detail.

1. Inadequate Budgeting

As identified during the 2005 Audit, a review of actual expenditure against budget for the year ended 30 June 2006 also identified significant variances in the budgeting for many reasonably routine business costs. By way of example I note, interest costs exceeding \$30,000 were incurred however the detailed budget made no provision for this readily predetermined cost of financing.

Audit reiterates the importance of preparing as accurate as possible budget based on knowledge, past year's performance, etc every year and not just rolling out the previous period's budget. The entity opens itself to significant criticism with the current lack of proper financial planning.

2. Property Lease Agreements

As previously recommended formal lease agreements should be prepared for all tenants. The purpose of the lease agreement is to clearly document the arrangements that have been entered into and is a point of referral should any dispute subsequently arise.

Audit recommends the Ports Authority instruct their legal advisor to prepare a simple tenancy lease agreement to be signed by all current, and any new, tenants.

3. Employment Contracts

As at 30 June 2006 Audit reiterates that, with the exception of the General Manager and the Harbour Master, all other employees do not have employment contracts. As previously recommended it is imperative all permanent staff have a legally binding employment contract. This may be in the form of a simple short form signed letter which confirms the terms and conditions of employment.

It is important that the employer/employee relationship is clearly defined and all significant terms of employment properly agreed between parties to assist in any subsequent employment disputes that may arise. This should be formally documented and signed by both parties.

In closing, Audit commends the Ports Authority on the introduction of their new policies and administration manual during the 2005/2006 year and recognizes the challenge now will be to ensure adherence to the documented procedures.

RESPONSE TO THE FINANCIAL AUDIT REPORT FOR THE PORTS AUTHORITY 30 JUNE 2006

The Management report for the Ports Authority 30 June 2005 financial year end audit was issued on the 9 February 2007 to the following:

- Andrew McBirney, General Manager
- Hon. Tangata Vavia, Minister of Cook Islands Investment Corporation
- Taukea Rau, Chief Executive Officer, Cook Islands Investment Corporation
- Kevin Carr, Financial Secretary
- Mike Mitchell, Solicitor General, Crown Law

Specific recommendations were addressed to the following:

- Andrew McBirney, General Manager

As at the date of this report no response has been received by our Office.

Audit notes that the clients' response deadline of 14 days has yet to lapse as at the date of this report.

3.7 AIRPORT AUTHORITY 30 JUNE 2006

SIGNIFICANT ISSUES

The Audit Office is pleased to report that the management and operations of the Finance Division and the record keeping of the other divisions of AACI is of a high standard.

Audit discovered some issues that need to be addressed by management in order to raise these standards even higher and thereby enhance internal controls even further.

Revenue

The review of revenue revealed that the Finance Officer, Haua Numanga, was responsible for the complete flow of revenue transactions from start to finish. Also there was only minimal checking done on transactions by anyone other than the Finance Officer.

This is of concern as there is no segregation of duties and minimal independent checking of transactions is performed.

Recommendation

Audit recommends that the responsibility of recording a debtor/or sale, receipting, banking and accounting for revenue transactions, be segregated. The likelihood of errors going undetected increases significantly when there is no separation of duties in the process. The segregation of duties should also require evidence of checks being performed so that in the normal process of capturing a transaction, the internal controls over revenue is enhanced.

Concessionaries

AACI generates revenue from concessionaries who as part of their rental agreements, are required to pay a percentage of their gross sales to AACI. The same applies to Juhi and Mobil who pay AACI for every litre of fuel pumped at the airport. The review of this showed that sales/pump figures were not being reported monthly to AACI; therefore concessionary revenue could not be accrued. This means that the matching concept could not be applied to concessionary revenue, as it should be. Audit also found that sales and fuel pumped reports submitted by concessionaries to AACI, were done on spreadsheets and were not generated from the client's accounting system. This is an issue of concern as reports done on spreadsheets are open to manipulation and could mean that AACI may be missing out on potential revenue.

Recommendation

As repeated requests from the Administration Division for concessionaries to submit monthly reports has failed, Audit recommends the Board or CEO issue directives to all concessionaries that sales/pump reports generated from the client's accounting system must be submitted monthly to the Administration Division for recording purposes. Alternatively, AACI may wish to review the

appropriateness of billing in the current manner and consider simply increasing the set lease fees for clients.

Taxable Allowance

The Chief Executive Officer as part of his contract, receives an allowance for private entertainment of \$5,000.00. This allowance forms part of the CEO's income and is not taxed. The Income Tax legislation states that all personal income is taxable.

Recommendation

In keeping with Section 46 (1b) of the Income Tax Act 1997, it is recommended that the CEO's entertainment allowance be taxed.

Board Minutes

The Board minutes for the 29th June 2006 meeting were missing from the Board Minutes file. Audit identified this from the next Board minutes that made reference to this meeting.

Board minutes are an important record that should be safeguarded as they record all resolutions passed by the Board. The Board governs actions taken by AACI.

Recommendation

Due to their importance, Audit recommends that all Board minutes be signed, filed and be safeguarded against misplacement.

Management Team Contracts

Employment contracts for all seven-division managers lapsed at 30 June 2005.

All employment contracts should be current, especially for key personnel, as they are a point of reference in case of any labour disputes.

Recommendation

Audit advises that it is good management practice to have current employment contracts for personnel especially those in key positions. In the transition period between old contracts and new contracts being prepared and signed, a letter of continuance should be issued to employees. This letter should stipulate that until such time that new contracts are signed, the terms and conditions of the old contracts still hold.

Disclosure of Commitments

On the 27th June 2005, the Chairman of the Board and the Chief Executive Officer signed an agreement with Smiths Detection, to hire an x-ray machine for 36 months at a monthly rental of \$2,175.00. AACI only discloses the monthly rentals in their Profit and Loss Statement. However, as the agreement forms a commitment, AACI should be disclosing this as a note in their financial statements.

Recommendation

Although the amount of the commitment is immaterial, Audit recommends in order to comply with International Accounting Standard 17, in future, this commitment should be disclosed as a note in the financial statements.

Monthly Financial Reports Presented to the Board

The Finance Manager submits monthly financial statements to the Board for their consideration. The audit of the Board Minutes revealed that the Board discussed the financials, however, the actual financial statements were not kept with the Board Minutes but were shredded by the Board Secretary. The Secretary explained that the Finance Manager kept copies so there was no need for her to keep copies as well.

Recommendation

It is recommended that the Board Secretary keep copies of all monthly financial statements that are discussed by the Board. The Finance Manager may make changes to the financial statements that the Board may not be aware of, and filing an original copy of the financials discussed, will ensure that this does not happen.

Bank Issues

a) Over Draft Facility

The Audit revealed that AACI pays a monthly line fee of \$60.00 at ANZ Bank, for over-draft facilities. This facility was set up during the last financial year. AACI has not used this facility at all during this financial period.

Recommendation

Audit recommends that with the current good management of funds, the monthly payments for over-draft facilities is unnecessary and an unnecessary use of AACI's resources and should be discontinued.

b) ANZ Bank Statements from New Zealand

AACI currently has to perform monthly bank reconciliation on their New Zealand Bank Account with statements dated partway through the month, as requests for timely statements by month end have not been heeded.

Recommendation

It is recommended that AACI consider using the internet to access "read only" bank statements which they can print out at month end and use when performing their bank reconciliation. This will ensure that their bank reconciliation is for the whole month rather than for only part of the month.

Debt Collection

Under the current procedures for debt collection, the Finance Officer sends out a reminder notice to debtors and follows up with phone calls until the bill is settled. She does not, however, record dates, times, person contacted or responses given.

This system is unsatisfactory as Audit noted that \$92,135.10 or 16% of debtors were 45 days or more, overdue for payment. There was also no evidence that follow-up phone calls had been made to clients with outstanding debts.

Recommendation

It is recommended that AACI revise their debt collection procedures and implement a more robust policy that will ensure debts are collected in a more timely and effective manner.

RESPONSE TO THE FINANCIAL AUDIT REPORT FOR THE AIRPORT AUTHORITY 30 JUNE 2006

The Management report for the Airport Authority 30 June 2005 financial year end audit was issued on the 30 October 2006 to the following:

- Joseph Ngamata, Chief Executive Officer
- Arama Wichman, Chairman, Board of Directors
- Taukea Rai, Chief Executive, Cook Islands Investment Corporation
- Kevin Carr, Financial Secretary

Attached is a copy of the response letters by the following:

- Joseph Ngamata, Chief Executive Officer
- Kevin Carr, Financial Secretary

Audit notes that as at the date of this report all responses were received by the Audit Office.

3.8 PARLIAMENTARY SERVICES 30 JUNE 2005 AND 30 JUNE 2006

SIGNIFICANT ISSUES

4.1 Fixed Assets

The following issues were identified from the audit:

- a) Prior year audit issues have not been addressed. This included the following issues:
 - i. Recording of dicta-phones purchased in 2004, as agreed by management, would be included in the fixed assets register (FAR) – *this was not done*.
 - ii. Damaged or obsolete assets, which cost \$67,623.84 and with a net book value of \$4,804.53 identified by Audit and the Assistant Clerk in the prior year audit still remain on the fixed assets register. During our review, Audit urged the Clerk to seek approval from the Financial Secretary and the Minister of Finance to write off obsolete assets. *This was obtained, and Parliamentary Services is currently adjusting the FAR to reflect asset write offs.*
- b) Expensed Assets of \$7,925.34 for the year ending 30 June 2005 was not recorded in the FAR as required by Cook Islands Government Financial Policies & Procedures Manual (CIGFPPM). This was also an issue for the 30 June 2006 financial year where \$2,496.89 of expensed assets has not been separately listed on the FAR.

In addition, a significant number of donated assets, received over the last few years had not been recorded. Of concern to audit was the lack of supporting documentation and proper accountability of these assets to ensure correct valuation, existence, ownership and completeness of these items can be determined.

- c) 2 shipping containers containing expensed assets are administered by the Assistant Clerk (AC) of Parliament. These were checked by Audit and the following discrepancies were found:
 - 1 missing plastic chair,
 - 50 (miniature paddles) gift pieces were not recorded in inventory listing provided by the AC and
 - Personal effects were also kept in the container.

In addition, the contents of the two containers are not recorded in the FAR as required by CIGFPPM.

- d) Motor Vehicle GA 91 - Ford Futura car purchased in 1997 has been used by PS, however was never recorded in their FAR. There was dispute between the Minister at the time (Woonton) and Foreign Affairs as to whom the vehicle belonged to. A review of the BCI motor vehicle registration showed that the vehicle belonged to Parliament, additionally the maintenance and utilization costs of the vehicle for work related activities is incurred and

undertaken by Parliament. Therefore recording of this vehicle should be included in Parliament's FAR.

- e) Audit also found assets purchased through Civil List's operating funding not recorded on the FAR. These expensed items include assets such as 2 laptops, furniture and a DVD camera purchased over the past 2 years. Audit physically verified the DVD camera and a laptop currently used by Asst Clerk. Civil List expensed assets are usually recorded in the PS fixed assets register, however not for the last 2 years.

Audit recommends the following:

- a) i. *The dicta-phones are included on the list of expensed assets on the fixed assets register.*
- iii. *The issue of the removal of damaged and obsolete assets from the assets register was raised in the 2002, 2003 & 2004 Audit reports. The approval to write off these assets has since been obtained. Audit recommends that adjustments to the financial statements and fixed asset register is undertaken to reflect the write off of all assets identified as inoperable and obsolete.*
- b) *The Ministry must ensure that all fixed assets, obtained through budgetary or donated means:*
- ✓ has and keeps proper documentations of all fixed assets purchased or donated;*
 - ✓ is formally authorized and approved by the Clerk of Parliament;*
 - ✓ is in accordance with capital expenditure appropriation;*
 - ✓ is properly recorded in the Fixed Assets Register as required by CIGFPPM;*
 - ✓ has appropriate guidelines with regards to the proper management of fixed assets including identification tags, safety, accountability and maintenance issues and*
 - ✓ regularly up-dates the register to reflect the true and fair value of the Ministry's Fixed Assets.*
- c) *Assets purchased through the Ministry's budget or obtained through donations, are the property of the Ministry and the responsibility of the Clerk of Parliament and should be kept on the Ministry's premises unless formally approved by the Clerk. Ministry assets should not treated as personal property by any staff member.*
- d) *Management has obtained a valuation assessment of the vehicle by an independent motor vehicle mechanic at today's market value of \$6,400.00. Audit recommends the Ministry account for the vehicle as proposed by Audit.*
- e) *Audit recommends that Parliament compiles a separate listing of all expensed assets purchased through Civil List funding and that it be maintained on a regular basis.*

4.2 Donated Inventory

There were variances identified between the stock take balance and the general ledger balance. This was due to the following reasons:

- ✓ The unit price per set of legislation disclosed on the stock listing received during the stock take included VAT. Adjustments have since been made to exclude the VAT from the inventory valuation.
- ✓ The listing provided to Audit for the stock take was prepared without consulting the general ledger carrying values.
- ✓ The general ledger balances have not included the Laws of the Cook Islands – Blue volumes as opposed to our stock take. The Accountant has represented that these legislations are produced in house by Parliament staff and should be treated the same as all other documents that they produce for sale.

The Laws of the Cook Islands – Green volumes is valued at the selling price as these are donated items. While this is a departure from the valuation stipulated in the International Accounting Standards (IAS) 2, Inventories, there is no accounting standard on donated assets/inventory and thus a qualification is not warranted.

Given that the green volumes are deemed to be obsolete (and are in fact slow moving) as represented by Management, a provision for obsolete stock has been disclosed taking into consideration the number of volumes that have been sold post balance date.

Audit recommends that:

- ✓ *The Finance Manager ensures that the stock listing provided to Audit during the stock take is consistent with the inventory listing per the general ledger.*
- ✓ *The Clerk ensures that consistency is maintained when accounting for inventory. All legislations produced in house should be expensed.*
- ✓ *The Accountant should revisit the provision for obsolete stock on a regular basis to ensure that it fairly reflects the quantities deemed to be obsolete at financial year end.*

4.3 Employee Entitlements 30 June 2005 issues

4.3.1 Sick Leave

Our review of staff contracts for the 30 June 2005 financial year revealed that 3 staff was entitled to 15 days sick leave rather than 10 days as stipulated by the PSC policy.

Audit recommends the Clerk formally adjust sick leave entitlement to reflect 10 days and inform staff affected of the changes made.

4.3.2 TOIL

There is no written policy in regards to managing TOIL, this was confirmed by the Clerk. The total TOIL balance for 30 June 2005 was \$19,986.71 (1,254 hours).

This issue was also an issue for the 30 June 3006 financial year where the audited TOIL balance was \$9,262.26 (499.73 hours).

Audit recommends that the Clerk of Parliament formally set policies relating to all TOIL matters and ensure that management of such policies is properly adhered to by staff.

4.3.3 Leave Entitlements

Due to the lack of employment contracts or letters of appointments, Audit could confirm the leave entitlements for the following staff:

- ✓ Senior Administration Officer;
- ✓ Assistant Clerk;
- ✓ Motu Kora;
- ✓ 2 watchmen and
- ✓ cleaner.

This issue was also evident in the 30 June 2006 financial year.

It is imperative that the Clerk of Parliament ensures that all existing staff have formally approved contracts or letters of offer clearly stipulating the terms and conditions of employment, such as salary rate, entitlements, responsibilities and employer expectations.

4.4 **Employee Entitlements 30 June 2006 issues**

4.4.1 Carry Forward of Annual Leave & Adherence to Leave Policy

The 30 June 2006 employee entitlements balance was over stated by \$8,407.71. This was a result of prior year (04-05) annual leave entitlements carried forward and not used within the year. As per Section 1.2.2 of the Parliament leave policy, unused prior year entitlements carried forward are forfeited if not used in the subsequent year.

The 30 June 2005 carry forward of unused annual leave was inconsistent to the leave policy in place.

Pursuant to Section 1, Sub-section 1.2, 1.2.1 of Parliament's leave policy

“The maximum number of days a HOM may approve annual leave to be carried forward shall not exceed 50% of the employee's total annual leave entitlement”.

Clearly this was not adhered to by Management. One staff member was paid 1.5 days leave more than he was entitled to and also forfeited 3 days (c/fwd from 04-05) due to the lack of adhering to the annual leave policy.

Audit adjustments were proposed to reflect the adherence to Section 1.2.2 in the Statement of Financial Position.

The Clerk should ensure that the leave policy is adhered to at all times.

4.4.2 Secondary Checks

Secondary checks on annual leave records were not performed on a monthly basis by a person other than the administrator of leave.

Checks should to performed to ensure:

- ✓ The recording of annual leave is correct;
- ✓ Leave entitlements are consistent with contracts and letters of offer and
- ✓ Adherence to the leave policy adopted in July 2005 (which is a duplicate of the PSC policy) is followed by all staff.

Audit recommends that once the Technician updates leave records, secondary checks should be performed by the Finance Officer to ensure errors are detected on a timely basis and records are accurate and complete.

Management should always ensure that staffs are made aware of their leave balances. In addition, Management should ensure they communicate to staff the leave policies and procedures that are in place.

4.4.3 Under-Payment of Annual Leave

A total of 55 days of annual leave was paid out to respective staff for the year 2006.

A calculation error was found which showed that staffs were underpaid by \$1,623.17. Staff have been paid subsequently.

Audit reiterates the importance of secondary checks and recommends that the Clerk ensures that this is implemented for subsequent financial years.

4.4.4 Tampering Leave Records

The audit of the annual leave records showed that some annual leave recorded in the time book by the leave administrator had been tampered with, by being twinked out. These changes were not initialed by the Technician (the person responsible for the administration of leave) or who ever made the changes.

This was an issue in the 2003 and 2004 financial year audits.

It is recommended that the procedure for applying for and getting leave approved is followed as the practice has not been consistent. The leave applications would act as verification for leave taken in conjunction with that recorded in the time book. It is further recommended that the leave administrator initial any changes he makes in the time book (for leave) and anyone found to be tampering with leave records is reported to the HOM and dealt with accordingly.

4.4.5 Annual Leave Policy

Parliament adopted the Public Service Commission (PSC) annual leave policy during 2005 and formally implemented a policy as at 1 July 2005 which is consistent with PSC policy.

Parliament's leave policy, Section 1.2 states that:

- 1.2.1 "At the end of the leave year, where an employee has not used his/her total leave entitlements, the employee shall seek and obtain the approval of

his/her Head of Ministry to carry up to half of the balance of his/her annual leave forward to the next leave year. The maximum number of days a Head of Ministry may approve annual leave to be carried forward shall not exceed 50% of the employee's total annual leave entitlement. The Head of Ministry may exercise ***one*** of the following options in approving the carrying forward of the employees unused annual leave –

Option 1

- (a) the *carrying forward of the employee's unused annual leave not exceeding 50%* of the total annual leave entitlement; OR

Option 2

- (b) the *carrying forward of 50% of the employee's unused annual leave AND paying out to the employee, the remaining 50%* of the employee's unused annual leave.

1.2.2 Where the Head of Ministry has approved the carrying forward of unused annual leave into the next leave year, such leave **MUST** be used within that year and if it is not used with that year, it shall be forfeited. The carried forward annual leave to the next leave year **CANNOT BE** accrued in subsequent leave years”.

Audit recommends that the Clerk methodically communicate to his employees the policy and processes in place for annual leave entitlements and the ramifications of not utilizing leave when it falls due.

In particular, Section 1.2 above, as there appears to be some confusion amongst staff as to the desired option regarding the carry forward of annual leave.

4.5 VAT returns and payment obligations

Parliament has not furnished VAT returns to MFEM on a monthly basis as required under the VAT Act 1997.

Audit recommends that the Ministry ensure taxes owing to RMD are paid on a timely basis once they fall due.

Pursuant to Section 7 of the Cook Islands Govt. Financial Policies and Procedures Manual (CIGPPM), all Ministries are bound by the VAT Act (97) to complete and submit to MFEM, Vat returns on a monthly basis, along with any payments owing.

4.6 Contract of Employment

An issue that has been long outstanding since our 30 June 2002 audit, the absence of either a contract or letter of offer for staff member, Motu Kora, and the recommendation that one be drawn up along with a job description.

There has been no action to our recommendation that was initially raised in the 30 June 2002 management letter.

We reiterate the recommendation that it is imperative that the Clerk of Parliament ensures that all existing staff have formally approved contracts clearly stipulating terms and conditions of employment, such as salary rate, entitlements, responsibilities employer expectations and the like. This will be of significant help in the case of any employment dispute.

4.7 Outstanding Prior Year Management Issues

Audit notes that many of the recommendations contained in the management letter issued in conjunction with the audit of the 30 June 2003 financial year remain outstanding and have not been addressed by the client. These recommendations have therefore been repeated in this management report.

Audit Office's recommendations shown above are aimed at ensuring the Parliamentary Service's accountability and transparency in the use of public funds and therefore protect and preserve its reputation within the community. It is therefore strongly recommended that management take necessary steps to ensure that the issues raised above are attended to in a timely and efficient manner.

RESPONSE TO THE FINANCIAL AUDIT REPORT FOR THE PARLIAMENTARY SERVICES 30 JUNE 2005 AND 30 JUNE 2006

The Management report for the Parliamentary Services 30 June 2005 and 30 June 2006 financial years end audit was issued on the 19 December 2006 to the following:

- Nga Valoa, Clerk of Parliament

Attached is a copy of the response letter from Nga Valoa, Clerk of Parliament.

Audit notes that as at the date of this report all responses were received by the Audit Office.

3.9 CROWN LAW OFFICE 30 JUNE 2005 AND 30 JUNE 2006

SIGNIFICANT ISSUES

4.1 Absence of a Detailed Expenditure Budget

The Crown Law Office does not use nor does it have a detailed expenditure budget. This would display a break down of budgeted total operating expenditure to specific account levels or on a line-by-line basis.

A detailed budget helps both the Finance Officer and the Head of Ministry monitor expenses more efficiently. By clearly identifying the budget at the account level, the finance officer for instance knows approximately how much should be spent per the budget's fiscal year on each type of expense. Thus enabling better control of expenditure and reducing the likelihood of spending over budget.

Audit commends Crown Law for spending within the Ministry's allocated total budget appropriation. This includes appropriately returning to Crown all surpluses generated as a result of staying within budget.

Audit however recommends that, a 'Detailed Expenditure Budget' is generated in order to enhance monitoring of expenditure and payment procedure controls.

The Office can generate future detailed budgets by:

- 1. Identifying how much was spent in prior year on each specific expense account – using this as the base; **THEN***
- 2. Determining what future events (for this budgeted fiscal year) may cause these expenses to be either higher or lower this year; **WHILE***
- 3. Ensuring that total expenditure budgeted for stays within the Ministry's allocated appropriation*

By following this simplified method of generating a detailed expenditure budget, the Office would then be better equipped to monitor and control expenditure more efficiently.

4.2 Fixed Assets Register

Audit identified some areas of improvement with the layout of the fixed assets register (FAR) provided by the client. These were a result of the following anomalies identified:

- 6. The amounts and details of expensed assets were not separately listed on the FAR.*
- 7. A physical stocktake was difficult to perform, as assets were not uniquely identifiable.*
- 8. Some assets permitted for write-off were in the office but were not on the FAR.*

The Cook Islands Government Financial Policies and Procedures (CIGPP) Manual Part B, Section 2 stipulates the requirements for good asset management.

Audit recommends that:

6. *Expensed assets are separately disclosed consistent the FAR example documented on attachment 1 of the CIGPP manual.*
7. *All fixed assets (if not uniquely identifiable) should have a fixed asset control number consistent with the requirements of CIGPP manual, Part B, Section 2, requirement 3.3 and 3.9*
8. *An annual stocktake of fixed assets is conducted to ensure the existence, security and condition of each stock item. This is consistent with the CIGPP manual, Part B, Section 2, requirement 3.10. Differences identified in the annual stocktake between the physical count of fixed assets and the FAR should be notified in writing to the Financial Secretary.*

4.3 Cash

Our review of bank reconciliations revealed that although monthly bank reconciliations were being performed, they were:

- not checked or reviewed for accuracy
- not signed and dated to signify that checking had taken place and
- not signed by the preparer of the bank reconciliation.

The internal controls are significantly strengthened by

- ensuring the bank reconciliation process is segregated,
- showing evidence of who prepared the monthly bank reconciliation and
- obtaining confirmation that it was appropriately and independently checked.

Audit commends Crown Law Office for the monthly completion of bank reconciliation's and encourages them to ensure these are signed and dated by the preparer and subsequently signed and dated by the person that checks the reconciliation.

4.4 Monthly VAT & PAYE Returns

Audit discovered that Crown Law has not filed monthly VAT and PAYE returns since 1999.

All entities registered for VAT are required to file their monthly returns by the 20th day of each, month.

Audit recommends that the Crown Law Office file their VAT and PAYE returns on monthly basis.

4.5 Posting of Accounts Payables/Receivables

The posting of accounts payable and accounts receivables were done through the use of both the Purchases/Sales Journal (PJ/SJ) and the General Journal (GJ). The subsidiary ledgers did not balance to the general ledger as a number of transactions were coded through the GJ as opposed to the PJ or SJ. This resulted in a number of uncleared payables/receivables and stagnant account balances over prior and current fiscal years.

While creditors and debtors may be recorded in both the GJ and the PJ and SJ respectively, in order to minimize errors when accruing for expenditure and revenue only one journal should be used. More commonly used and appropriate when accounting for accounts payables and accounts receivables (or other payables/receivables) is the Purchases Journal and Sales Journal. This is because it also provides an aged payables/receivables report, which is useful in identifying outstanding payables/receivables.

Audit recommends that accounts payable/receivables be recorded through the Purchases/Sales Journal only. This will ensure that account balances correctly reflect accruals that are made and minimizing the level of uncleared or stagnant payable/receivable accounts.

4.6 Expired Rental Agreement

The formal rental agreement between Centrepont Ltd and the Crown Law Office (CLO) has been expired since November 2002.

By not having a current written rental agreement that sets out the terms and conditions of the lease, puts Crown Law in a vulnerable position should the landlord decide to terminate the lease.

Audit recommends that Crown Law ensure that the lease agreement is renewed (and kept current at all times) to reflect the terms and conditions agreed upon by both parties.

4.7 Prior Year Audit Recommendations Not Implemented

The following issues were raised in prior year audit reports but have not been addressed:

- σ Travel Policy - The Crown Law Office has no written travel policy governing overseas and outer island travel. As yet no remedial action has been undertaken by the Office to address this issue.
- σ Bank Reconciliation - Audit found unreconciled differences in closing balances as per the bank reconciliation and the general ledger. There appears to have been no changes in this area, the issues identified are reoccurring.

RESPONSE TO THE FINANCIAL AUDIT REPORT FOR THE CROWN LAW OFFICE 30 JUNE 2005 AND 30 JUNE 2006

The Management report for the Crown Law Office 30 June 2005 and 30 June 2006 financial years end audit was issued on the 24 November 2006 to the following:

- Janet Maki, Solicitor General

Attached is a copy of the reply letter by Dorothy Ivaiti, for the Solicitor General.

Audit notes that as at the date of this report all responses were received by the Audit Office.

3.10 OFFICE OF THE MINISTER OF HEALTH 30 JUNE 2005

SIGNIFICANT ISSUES

3.10.1 Lack of Sufficient Audit Evidence

Audit is concerned over the lack of supporting documents during the financial audit of the Office of the Minister of Health – Hon. Peri Vaevaepare for the year ended 30 June 2005. The only supporting documents provided to audit included a cashbook, fixed assets register and bank statements.

Given the limited supporting documents available, we were unable to obtain independent confirmation of employee liability, accounts payable and total operating expenses, and we were unable to satisfy ourselves as to these balances by other audit procedures.

In addition, the Audit Office was unable to ascertain information on, and explanations of, trends identified as a result of comparative analysis of the current year against prior year's reported operating results.

Audit acknowledges that the main reason behind the lack of sufficient supporting documentation was the fact that the Office of the Minister of Health – Hon. Peri Vaevaepare ceased operations before the financial audit was conducted.

3.10.2 Vat on Donations

Audit found that the Office had incorrectly charged VAT on cash donations of up to \$3,470.04 made during the financial year.

Audit notes that the error was most likely due to there being a lack of sufficient monitoring of general ledger entries by management.

Audit has recommended an adjustment to correct this issue in the Offices accounts.

REPONSE TO THE FINANCIAL AUDIT REPORT FOR THE OFFICE OF THE MINISTER OF HEALTH 30 JUNE 2005

The Management report for the Office of the Minister of Health 30 June 2005 financial year end audit was issued on the 13 November 2006 to the following:

- Ratu Mato, Chief Executive Officer, Office of the Deputy Prime Minister

As at the date of this report no response has been received by our Office

3.11 OFFICE OF THE MINISTER OF EDUCATION FOR THE SIX MONTHS ENDED 31 DECEMBER 2004

SIGNIFICANT ISSUES

3.11.1 LACK OF SUFFICIENT SUPPORTING DOCUMENTS

Audit notes that the only supporting documents provided during the audit included a cashbook, fixed assets register and bank statements. This was largely due to the fact that the Office was no longer operating at the time the audit was conducted.

Therefore given the limited supporting documents available, we were unable to obtain independent confirmation of Employee Entitlement, Other Revenue and Operating Expenses, and we were unable to satisfy ourselves as to these balances by other audit procedures.

In addition, the Audit Office was unable to ascertain information on, and explanations of, trends identified as a result of comparative analysis of the current year against prior year's reported operating results.

3.11.2 USE OF A NON-ACCOUNTING SOFTWARE PACKAGE

The Office of the Minister of Education used Microsoft Excel spreadsheets to prepare their financial reports. As a consequence, compliance with Section 25 of the MFEM Act 1995-96 and the Generally Accepted Accounting Practice (GAAP) was not fully adhered to and was also an area qualified under this audit.

Audit recommends that a proper accounting package such as MYOB be used for the preparation of financial accounts and reports. This ensures that the financial statements for the Office are accurate and complete. It also forms the basis for the preparation of the annual statutory accounts, a format consistent with the requirements of Section 25 of the MFEM Act and GAAP.

3.11.3 LEGITIMACY OF DONATIONS

Audit found several items of expenditure coded as donations. These were made to schools and sports/cultural groups on Mangaia Island, the constituency that the Honorable Jim Marurai, Prime Minister and Minister of Education. Donations were also made to schools on Rarotonga and other outer islands.

Although the donations to schools have an association with the Minister's portfolio, appropriation given to any Minister's Support Office is only intended for funding operational expenses such as communication, stationery, power and etc. Donations to constituencies are accommodated under the Social Responsibility Fund (SRF).

Audit recommends that the in future, the Office refrain from making donations out of their annual appropriation. Where donations may be warranted, the Social Responsibility Fund, a POBOC, should be utilised with the consent of the Ministry of Finance and Economic Management.

RESPONSE TO THE FINANCIAL AUDIT REPORT FOR THE OFFICE OF THE MINISTER OF EDUCATION 30 JUNE 2005

The Management report for the Office of the Minister of Education 30 June 2005 financial year end audit was issued on the 15 November 2006 to the following:

- Trevor Pitt, Executive Advisor, Office of the Prime Minister

Attached is a copy of the response letter by Maara Peraua, the former CEO of the Office of the Minister of Education.

Audit notes that as at the date of this report all responses were received by the Audit Office.

3.12 MINISTRY OF TRANSPORT 30 JUNE 2005

SIGNIFICANT ISSUES

The Audit Office is pleased to report that the management and operations of the Ministry of Transport is of a high standard. It was also very encouraging to see that the Ministry has taken steps to address all the issues raised in the prior year's Audit Management letter. We commend the Head of Ministry and his staff for their good work.

The 2005 Audit has identified a few more issues, which when addressed, will enhance the record keeping of the Ministry even further.

Use of Purchase Orders

Purchase orders should be issued to staff whenever they are going to make purchases for the Office. The purpose of a purchase order is to act as a form of control to ensure that only those MOT personnel with the appropriate delegated authority incur expenditure on behalf of the ministry. The invoice from the supplier must be checked against the purchase order when goods are received to ensure that all goods have been delivered and that there are no extra charges, above what has been authorized.

MOT uses purchase orders, which they complete when preparing their payment vouchers. A copy is then sent with the cheque to suppliers. This current system defeats the fundamental purpose of using purchase orders.

Recommendation

Audit recommends that MOT use the purchase orders correctly i.e. at the initial time of purchase, and not when they are preparing cheques for payments of invoices. Using the purchase orders to initiate the purchase or supply is an effective mechanism to strengthen internal controls.

Liquor Licensing Authority Board Minutes

A review of the Liquor Licensing Board Minutes identified two issues, which should be addressed:

- 1) The minutes for meetings held on the 22 December 2004 and 21 June 2005, have not been signed by the Chairman.

The minutes provide a point of reference for the activities of the Authority. The Chairman should sign the minutes, as they are also an important source document that evidences whether a license has been approved or denied.

Recommendation

Audit recommends that the Board Secretary ensure that all Board Minutes are signed by the Chairman in a timely manner to prove their authenticity and correctness.

- 2) The secretary, through phone calls to Board members, has sometimes sought approval for licenses. This is noted as “approved” on memorandums and filed with the Board minutes, however there is nothing in writing (signatures) to prove members have approved the applications.

This indicates a lack of internal control over the approval of licenses.

Recommendation

It is recommended that members sign the memorandums to prove their verbal agreements for a license to be approved. This will ensure an appropriate audit trail is maintained should anyone question the approval or non-approval of a particular license.

Value Added Tax (VAT) Returns

MOT has not submitted any VAT Returns for the year ended 30 June 2005 due to the Chief Administration Officer being verbally advised by the Funds Manager (FM) of MFEM, that they had not been completing the returns correctly. The FM was to issue instructions on how this should be done. To date these instructions have not been received and therefore no Returns submitted.

Failure to submit monthly VAT Returns is a breach of the VAT Act 1997 and Section B, 7 (3.2) of the Cook Islands Government Financial Policies and Procedures.

Recommendation

Audit recommends that MOT submit monthly VAT Returns to ensure compliance with the above statutory requirements. The VAT Return is a straightforward document to complete and if the MOT requires further guidance they should seek assistance from RMD staff. It is important that any VAT payable is paid on the 20th of the following month to avoid further penalties.

Evidencing checks performed

In the normal course of performing their duties, the Chief Administration Officer (CAO) and Finance Officer (FO) carry out a number of checks. For example checks on pay slips received from MFEM, against timesheets submitted by MOT and the monthly bank reconciliation done by the FO that is doubled checked by the CAO. However, there is no evidence that these checks are performed as neither the CAO nor the FO signs any of the documents they check.

Recommendation

There is a need for good audit trails for any checking performed and Audit recommends that the CAO and FO list any checks they have performed on a document, and sign these, as evidence that

the checks have been done. Checking that documentation is correct helps strengthen internal controls and helps ensure the good use of the ministry's resources.

RESPONSE TO THE FINANCIAL AUDIT REPORT FOR THE MINISTRY OF TRANSPORT 30 JUNE 2005

The Management report for the Office Ministry of Transport 30 June 2005 financial year end audit was issued on the 16 October 2006 to the following:

- Aukino Tairea, Secretary for the Ministry of Transport
- Kevin Carr, Financial Secretary

Attached is a copy of the response letter by Aukino Tairea, Secretary of Transport

Audit notes that as at the date of this report all responses were received by the Audit Office.

3.13 FINANCIAL SUPERVISORY COMMISSION 30 JUNE 2006

SIGNIFICANT ISSUES

Segregation of duties

Audit found that the Finance Officer was checking the accuracy of the deposit form, preparing the monthly bank reconciliation's and posting all transactions to the general ledger.

Audit notes that it is not good practice to have one person with sole access and responsibility for all aspects of the preparation and posting of transactions to the General Ledger. This increases the opportunity for mistakes and discrepancies to remain undetected.

Recommendation:

Audit recommends that another member of FSC team be trained to prepare or check the bank reconciliation and posting of transactions to the general ledger.

Succession Planning

In line with the above, Audit observed that when the Finance Officer is on leave there is no one trained to take on the Finance Officer's key accounting duties such as preparation of bank reconciliation and posting of transactions to the general ledger.

This leaves FSC in a vulnerable and inappropriate position if the Financial Officer takes leave or is sick, in that anything to do with accounts processing effectively comes to a halt.

Recommendation:

As suggested in 4.1 above, proper training should be given to another member of the FSC team to ensure a backup person is always available to allow for some rotation of duties.

Banking reconciliation.

A Bank Reconciliation has been prepared for each month of the year to 30 June 2006. However, no one is checking the banking reconciliation at the end of each month to ensure that the reconciling items are valid and that the Reconciliation correctly agrees to the Bank Statement.

Audit's concern is that there is no assurance that the reconciliation is correct due to no independent review taking place.

Recommendation:

Audit recommends that another member of the FSC team, possible the Commissioner herself become involved in signing off the month's bank reconciliation as reasonable.

Prior Year's Accruals not reversed

Audit observed that prior year's accruals were not reversed. This included

- Cleaning \$160.00
- Communications \$1,822.23
- Petrol of \$52.98

Audit has proposed an adjustment to rectify the above.

Recommendation:

Audit recommends that FSC ensure that prior year's accruals are appropriately reversed as of 01 July for future periods.

Supplier Invoices

Invoices received is not being posted to the accounts payable subsidiary ledger upon receipt. Audit noted posting to the general ledger was conducted at the time the Commission is paying for the invoice.

Recommendations:

Audit recommends that FSC introduce a procedure to capture all invoices received into their accounting system on a timely basis, rather than at the date of payment.

Funds of the Commission

Section 24(2) of the Financial Supervisory Commission Act 2003 states

"...Where in any financial year the Board is of the opinion that the funds of the Commission will be in excess of the amount which the Board considers will be sufficient to enable the Commission to carry out its functions, the Board shall authorize the excess to be paid to the Cook Islands Government Account..."

The FSC posted a net surplus of \$371,127 for the year ended 30 June 2006 and as at that date were holding in excess of half a million dollars in bank deposits.

Recommendation:

Accordingly, Audit recommends that timely payment of excess funds to the crown be authorized by the Board.

3.14 RESPONSE TO THE FINANCIAL AUDIT REPORT FOR THE FINANCIAL SUPERVISORY COMMISSION 30 JUNE 2006

The Management report for the Financial Supervisory Commission 30 June 2006 financial year end audit was issued on the 06 October 2006 to the following:

- Lorraine Allan, Commissioner
- Kevin Carr, Financial Secretary
- Charles Little, Chairman of PERCA

As at the date of this report no response has been received by our Office