Compliance and Internal Control

Department of Chamorro Affairs – Non-Appropriated Funds

(A Component Unit of the Government of Guam)

Year ended September 30, 2014

Building a better working world

Department of Chamorro Affairs – Non-Appropriated Funds
(A Component Unit of the Government of Guam)

Report on Compliance and Internal Control

Year ended September 30, 2014

Contents

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Report of Independent Auditors on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

The Board of Trustees
Department of Chamorro Affairs – Non-Appropriated Funds

We have audited, in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Department of Chamorro Affairs – Non-Appropriated Funds (DCANAF), which comprise the statement of net position as of September 30, 2014, and the related statement of revenues, expenses and changes in net position, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated June 1, 2015.

Internal Control Over Financial Reporting

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

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Internal Control Over Financial Reporting, continued

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist, that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify deficiencies in internal control, described in the accompanying schedule of audit findings and responses that we consider to be significant deficiencies. These findings are listed as 2014-1 to 2014-4.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether DCANAF's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards.*

DCANAF's Response to Finding

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

Purpose of this Report

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

Ernst + Young LLP

June 1, 2015

Schedule of Audit Findings and Responses

Finding No. 2014-1

Criteria or specific requirement:

Internal controls over the financial statement close process should be established and implemented to ensure that transactions, including audit adjustments, are timely recorded in the proper accounts.

Condition:

Prior year audit adjustments were not recorded. Information initially gathered during phases of the closing process was incomplete; resulting in revisions to DCANAF's financial statements. As a result, there was significant delay in the completion of accurate financial reporting.

Context:

The improper recording of prior year 2013 adjusting journal entries was identified during our reconciliation of beginning net position.

Effect:

The beginning balance of net position did not reflect the audited balance as of September 30, 2013.

Cause:

There are no monitoring controls in place to ensure audit adjustments are recorded.

Recommendation:

The following steps should be undertaken to improve the timeliness and effectiveness of the financial statement close process:

- Evaluate the efficiency and effectiveness of the current procedures and modify the current procedures where considered appropriate;
- Develop formal closing instructions and deadlines based upon the revised procedures and distribute them to individuals responsible for specific closing procedures;
- Follow the designed process each month so that the accounting personnel becomes familiar with their role within the process; and
- Monitor the status of the established closing process deadlines and reallocate resources when possible to ensure that timelines are met.

Finding No. 2014-1, continued

Management's Response:

Internal controls and the monitoring of transactions, adjustments and the closing of financial statements are now established and implemented with the changing of operational procedures. All recommendations are taken into consideration. Formal policies and procedures are being developed and compliance will be mandatory on a monthly basis to ensure efficiency and effectiveness.

Finding No. 2014-2

Criteria or specific requirement:

Bank reconciliations should contain sufficient reconciling item detail and should be reviewed on a timely basis.

Condition:

The DCANAF performs monthly bank reconciliations; however, the reconciliation is not reviewed and approved by an individual independent of the preparer. In addition, the information relating to reconciling items on the bank reconciliations is not sufficient. The date of the check drawn and the payee are not shown on the reconciliation and a separate request had to be made for the details.

Context:

The bank reconciliation statements as of September 30, 2014 provided by DCANAF contained errors such as duplicate entries and reconciling items that are more than six months old.

Effect:

Without an appropriate review and approval of bank reconciliations, it is possible that errors made in the reconciliation process go undetected or reconciling items worthy of investigation go unaddressed for long periods of time. This can lead to fraud or error not being detected on a timely basis which could result in losses of cash and errors in financial reporting.

Cause:

There is no appropriate review of the bank reconciliation process to ensure reconciling items are monitored, followed up and adjusted on a timely basis.

Finding No. 2014-2, continued

Recommendation:

Bank reconciliations should be prepared in a systematic manner with the following details for each reconciling item:

- Date on which the check is written/ received
- Amount
- Payee
- Reason for the item appearing in reconciliation
- Date of subsequent clearance of the reconciling items

Reconciliations should be reviewed by a person independent of the reconciliation process. The process should include a monthly worksheet listing all of the DCANAF's bank accounts that will serve as a control sheet. The sheet should track the dates at which bank reconciliations have been prepared and reviewed. To improve accountability, management should initial the reconciliation as evidence of review.

Management's Response:

The bank reconciliation process will be changed to include the Chamorro Village Manager's and DCA Administrative Services Officer's review, approval and signatures. The 2013 QuickBooks and the Bank Reconciliation Reports will be monitored to ensure reconciling items are cleared immediately the following month. Supporting documents are required of any change being made.

Finding No. 2014-3

Criteria or specific requirement:

Governmental Accounting Standards Board (GASB) Accounting Standards Codification (ASC) I40, *Inventory*, section 107 states that "A departure from the cost basis of pricing the inventory is required when the utility of the goods is no longer as great as its cost. A loss should be recognized and accounted for in the current period whenever the utility of goods is impaired by damage, deterioration, obsolescence, changes in price levels, or other causes. Such losses should be measured by applying the method of pricing inventories at cost or market, whichever is lower."

Condition:

Book inventories are sold at 30% off the regular list price which is below the unit cost.

Finding No. 2014-3, continued

Context:

The recorded balance of DCANAF's inventory is not in accordance with GASB ASC I40, *Inventory*.

Effect:

In order to record the book inventory at lower of cost or market, it was necessary to write down the value of inventory at year end by approximately $32,000.

Cause:

There is no regular assessment by management of the carrying value of inventories against their net realizable value.

Recommendation:

Management should regularly review gross margins and sales prices in comparison to inventory cost values. When net realizable value is less than cost, management should write down the inventory values and investigate the related causes for these write downs.

Management's Response:

The gross margins and sales prices in comparison to inventory cost values will be reviewed regularly and addressed immediately to comply with GASB ASC 140. Book sales have been very slow, therefore, the book inventory remains stagnant.

Finding No. 2014-4

Criteria or specific requirement:

Purchases and the corresponding payables should be recorded on receipt of purchased goods or upon the service being received.

Condition:

DCANAF records vendor/supplier invoices into the general ledger when they have been approved for payment.

Context:

The practice of recording the asset or expense when paid has resulted in liabilities not being recorded in the correct period.

Finding No. 2014-4, continued

Effect:

Sixteen (16) invoices pertaining to the year ended September 30, 2014 were not recorded. As a result, DCANAF's liabilities and expenses were understated by approximately $63,000.

Cause:

There are no monitoring controls in place to ensure proper cut-off of purchases and disbursements is applied.

Recommendation:

DCANAF should record an accrual for all purchases/expenses into the general ledger once the product or service purchased has been received and the liability incurred; and reconcile its accounts payable balances to vendors' statements monthly for all major and regular vendors. Any unusual items noted should be promptly investigated.

Management's Response:

All invoices will be posted to accounts payable as soon as invoices are received. The practice of waiting until payment has stopped.

Schedule of Prior Audit Finding

Finding in the prior year Audit Report dated May 19, 2014 follows:

Finding No. 2013-1 Audit Adjustments

Finding:

Prior year audit adjustments were not recorded in the books or were recorded in the wrong account.

Status:

Management has not recorded the prior year adjustments. Similar finding was noted during the audit of the September 30, 2014 financial statements.