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REPORT TO THE CONGRESS

Improvements Needed In Financial Management System Of Trust Territory Of The Pacific Islands⁴¹

B 114888

Department of the Interior

BY THE COMPTROLLER GENERAL OF THE UNITED STATES

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JUNE 26, 1970

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

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To the President of the Senate and the
Speaker of the House of Representatives

This is our report on the improvements needed in the financial management system of the Trust Territory of the Pacific Islands, Department of the Interior. Our review was made in accordance with the provisions of the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

Copies of this report are being sent to the Director, Bureau of the Budget, and to the Secretary of the Interior.

A handwritten signature in cursive script that reads "James B. Stacks".

Comptroller General
of the United States

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D I G E S T

WHY THE REVIEW WAS MADE

The Trust Territory of the Pacific Islands (Micronesia), under the trusteeship of the United Nations, is administered by the United States. To promote the well-being of the people of the Trust Territory, the Congress has appropriated increasingly larger sums--\$48 million for fiscal year 1970--to carry out the planned activities and programs of the Trust Territory.

The General Accounting Office (GAO) reviewed financial management activities of the Trust Territory primarily to determine if effective action had been taken to correct weaknesses previously identified in audit reports issued by GAO and by the Department of the Interior's Office of Survey and Review.

FINDINGS AND CONCLUSIONS

Reports and studies on the Trust Territory issued during the period 1955-66 revealed serious weaknesses in financial management and recommended corrective actions. Although these actions were promised and some improvements had been made, GAO found that the basic defects continued. (See p. 8.)

GAO is of the opinion that the financial management system is so weak that neither top management officials nor the Congress can trust it to provide essential and reliable information for management's use in attaining an efficient and economical operation and to satisfactorily report on the custody and use of resources. (See p. 44.)

Deficiencies existed in the accounting for cash resources. Accounting controls over cash were not effective. (See p. 10.)

- The cash-in-bank balances shown in the Trust Territory's accounts differed substantially from the amounts shown on bank statements. The differences had not been reconciled. (See p. 11.)

--The cash on hand in suboffices as shown in the overall control account at September 30, 1968 (\$569,357), differed substantially from the cash on hand reported by the suboffices (\$287,066). This difference had not been reconciled. Of this difference, \$167,664 had existed prior to July 1, 1967. GAO was told that adequate documentation was not available to account for the \$167,664. (See p. 13.)

--There was no reliable record as to the amount of imprest fund cash (petty cash) each cashier was responsible for. (See p. 14.)

A large part of the accounts receivable were old and were not supported by adequate documentation. Normal collection and accounting procedures were not followed. GAO believes that many were of questionable collectibility. (See p. 17.)

--Recorded billed receivables at March 31, 1969, totaled \$359,830, about 84 percent of which was over 90 days old. Forms designed to be used for follow-up of delinquent accounts were not being used. No follow-up had been made. (See p. 17.)

--Adequate controls did not exist for providing reasonable assurance that billings and collections were made for property which the Trust Territory leased to others or for ensuring that the rental charges were reasonable. (See p. 20.)

--At March 31, 1969, \$304,351 due from others, which had not been billed, was recorded in the accounts. This included \$178,690 from prior years. The Trust Territory billing clerk stated that he believed most of the unbilled items lacked adequate documentation to support a billing. (See p. 23.)

--The Headquarters account showed receivables outstanding in the suboffices totaling \$407,706 at June 30, 1968. Ten months later, the June 30, 1968, balance had not been changed because listings of receivables received from the suboffices subsequent to June 30 were not believed by Headquarters personnel to be complete and accurate. As of April 1969 the latest listings of suboffice receivables in the Headquarters files showed an amount outstanding of only \$209,022. (See p. 23.)

--As of May 1969 the status of travel advances outstanding had not been reviewed since September 1968. (See p. 25.)

The amounts shown in the control accounts for supplies differed from the amounts recorded in the inventory records, but no attempt had been made to reconcile the difference. For example, at June 30, 1968, the control account showed medical supplies totaling \$159,345, whereas the inventory record showed \$61,518--a difference of \$97,827. (See p. 27.)

Also, significant amounts of financial obligations either had not been recorded in the accounts or, although recorded, were not correct--thus reports as to the remaining funds available for programs were inaccurate. For example, in reporting the status of funds as of June 30, 1968, about \$988,000 of unliquidated obligations for materials and supplies on order were not considered. (See p. 28.)

Construction funds were used for other than the specific purposes originally cited by Trust Territory officials in justifying to the Congress the need for such funds. Information which would disclose this to management and to the Congress was not systematically reported. (See p. 34.)

The above-cited problems were caused, in part, by weaknesses in internal control functions concerned with organization, procedures, personnel and supervision, and internal audits. (See pp. 37 and 41.)

GAO believes that there is a need for improvement in surveillance techniques at the departmental level to ensure correction of the financial management weaknesses in an orderly and timely manner. (See p. 44.)

RECOMMENDATIONS OR SUGGESTIONS

The Secretary of the Interior should instruct the High Commissioner of the Trust Territory of the Pacific Islands to take certain steps--specified in various sections of this report--which are designed to establish reliable records and appropriate procedures for obtaining adequate accountability control over assets and financial obligations. (See pp. 36, 40, and 43.)

Appropriate surveillance techniques designed to ensure that corrective actions are taken should be established at the departmental level. These should include the preparation of a written plan of action listing each item in the financial management area needing improvement and the requirement for monthly progress reports to the Office of the Secretary. (See p. 45.)

AGENCY ACTIONS AND UNRESOLVED ISSUES

The Department advised GAO that the Trust Territory had taken several corrective actions, primarily involving the reconciliation of cash accounts and ascertaining the validity of unpaid obligations. In addition, the High Commissioner of the Trust Territory assured that action was being taken (1) to obtain adequate control over assets and financial obligations and (2) to make monthly reviews to ensure correction of all inadequacies pointed out in this report.

Negotiations were under way to hire a financial consulting firm to design and install an accounting system for the Trust Territory. (See app. I.) An essential element for success of the new financial management system--the ability of the Trust Territory personnel to operate and maintain the system--was being considered in the design and installation of the system.

The Department did not comment on the GAO recommendation concerning the need for improved surveillance, but a departmental official subsequently stated that the Department did not believe it was necessary to institute the type and level of surveillance recommended. GAO still believes that its recommendation should be instituted at the departmental level.

MATTERS FOR CONSIDERATION BY THE CONGRESS

This report is being issued to the Congress because of its continuing interest in the improvement of financial management systems by executive agencies.

CHAPTER 1

INTRODUCTION

The General Accounting Office has made a review of financial management activities of the Trust Territory of the Pacific Islands which is administered by the United States under a trusteeship agreement with the United Nations. The scope of our review is discussed on page 48 of this report.

The Trust Territory of the Pacific Islands comprises more than 2,000 small islands in the Western Pacific Ocean scattered over an area approximately the size of the continental United States, with a total land mass of about 700 square miles and with a population in 1967 of about 92,000 people. These islands also are known collectively as Micronesia.

On July 18, 1947, the United States and the United Nations entered into a trusteeship agreement whereby the islands were placed under the United Nations trusteeship with the United States as administering authority. The first civilian High Commissioner was appointed in January 1951; and, effective in July 1951, the President assigned administrative responsibility for the Trust Territory to the Secretary of the Interior. The High Commissioner is appointed by the President with the advice and consent of the Senate.

For administrative purposes, the Trust Territory is divided into six districts--Marianas, Marshalls, Palau, Ponape, Truk, and Yap--which have differing languages and cultural patterns. Trust Territory operations in each district are directed by a district administrator who reports to the High Commissioner. Representatives of the United Nations monitor Trust Territory activities by means of periodic inspection trips and annual reports issued by the Department of State.

Article 6 of the trusteeship agreement states that the United States shall, among other things, promote among the inhabitants self-government, economic development, social advancement, and education. In carrying out these

objectives, there has been a large increase in Federal appropriations for the Trust Territory, which is shown in the following schedule.

<u>Fiscal</u> <u>year</u>	<u>Funds appropriated</u>		
	<u>Regular</u>	<u>Supplemental</u>	<u>Total</u>
	—————(000 omitted)—————		
1962	\$ 6,104	\$ 200	\$ 6,304
1963	6,600	7,290	13,890 ^a
1964	15,000	-	15,000
1965	17,500	-	17,500
1966	17,344	103	17,447
1967	17,494	1,700	19,194
1968	24,000	6,200	30,200
1969	30,000	-	30,000
1970	40,612	7,500	48,112

^aDoes not include \$1,100,000 for Saipan transferred from the Navy Department.

The appropriated funds were used for constructing and operating hospitals, schools, water and sewer systems, and numerous other activities normally carried out by a government.

An accounting manual was approved for the Trust Territory by the General Accounting Office in 1954 but was not implemented. In a prior report (B-114888 dated March 21, 1957), we pointed out that there was a need for revision of the then-existing accounting system. In a subsequent report (B-114888 dated March 20, 1962), we again pointed out the need for improvements in the accounting system.

In a memorandum dated July 13, 1966, to all district administrators and department heads of the Trust Territory, the High Commissioner pointed out that prominent goals in the financial management of the Trust Territory included adequate programs, budgets, control of funds appropriated for operations and capital improvement projects, and reporting. He stated that the financial activities development and operation "shall be in conformance with the Accounting

Principles and Standards for Federal Agencies as prescribed by the General Accounting Office."

The principal officials of the Department of the Interior responsible for administration of the activities discussed in this report are listed in appendix II.

CHAPTER 2

IMPROVEMENTS NEEDED IN FINANCIAL MANAGEMENT SYSTEM

In three GAO reports to the Congress on audits for fiscal years 1953-60 and in two more recent reports by the Department's Office of Survey and Review, significant weaknesses were pointed out in the financial management system of the Trust Territory.¹ These weaknesses included inadequate internal control over property and revenues and serious problems in accounting policies and practices that precluded the presentation of reliable financial statements. Corrective actions were promised by the Department of the Interior and some improvements were made.

On the basis of our current review, however, we believe that the same basic weaknesses have continued. In our opinion substantial improvements are required in the financial management system to provide the necessary information to

¹GAO reports:

Audit of Trust Territory of the Pacific Islands:

1. For the Fiscal Years Ended June 30, 1953 and 1954, B-114888, dated August 23, 1955.
2. For the Fiscal Years Ended June 30, 1955 and 1956, B-114888, dated March 21, 1957.
3. For the Fiscal Years 1957-60, B-114888, dated March 20, 1962.

Office of Survey and Review reports:

1. Evaluation of Financial Management System, Trust Territory of the Pacific Islands, dated December 1965.
2. Transitional Audit of Selected Activities, Trust Territory of the Pacific Islands, dated October 1966.

assist management in carrying out its programs in an effective and economical manner and to ensure reliable accountability for the appropriations made by the Congress for the operation of the Trust Territory.

Our findings, together with the applicable views of Trust Territory and departmental officials, are discussed in detail in the following sections of this report.

ERRONEOUS INFORMATION AND INADEQUATE
PROCEDURES DECREASED THE EFFECTIVENESS
OF THE FINANCIAL MANAGEMENT SYSTEM

An accounting system is an integral part of financial management and, to be effective, should be designed to provide:

- full disclosure of the financial results of the agency's activities,
- adequate financial information needed for the agency's management purposes,
- effective control over and accountability for all funds, property, and other assets for which the agency is responsible, including appropriate internal audit, and
- reliable accounting results to serve as the basis for preparing and supporting the agency's budget requests, for controlling the execution of its budget, and for providing financial information required by the Bureau of the Budget.

The deficiencies which we found in the financial data produced by the Trust Territory's accounting system are summarized below.

Deficiencies in accounting for cash resources

Procedures adopted by a Federal agency to account for cash resources should ensure accurate accounting and minimize the possibility of irregularities involving cash resources.

We found that substantial unreconciled differences existed between the cash-in-bank balances shown in the Trust Territory's general ledger accounts and the balances shown on bank statements. Similarly, most of the cash-on-hand balances shown in the controlling accounts for district finance offices or other custodians differed substantially from such balances reported by the offices and custodians. Generally accepted cash control procedures, which require

regular reconciliation of cash balances and timely deposit of cash collections, were not followed in the Trust Territory. These deficiencies in accounting for cash resources are discussed in more detail below.

Cash in banks

The Trust Territory maintains cash in accounts with commercial banks. The balances in the main bank accounts at September 30, 1968, according to the general ledger and the applicable bank statements, were as follows:

<u>Account number</u>	<u>Account title</u>	<u>Cash balance at September 30, 1968</u>	
		<u>General ledger</u>	<u>Bank statement</u>
1201	General fund (special advance) Bank of Hawaii--Guam	\$133,772	\$332,300
1202	General fund, Bank of America--Guam	-412,405	-549,144
1204	Special advance, Bank of America--Guam	457,772	642,903

Under generally accepted procedures for controlling cash, bank statements must be reconciled to the controlling general ledger or subsidiary accounts when received--usually monthly.

Funds, as needed, are transferred from general fund account number 1202 to the other two accounts cited above. Account number 1202 is, in turn, replenished by checks drawn on funds of the U.S. Treasury, appropriated for operations of the Trust Territory.

Although the bank statement showed that account number 1202 was overdrawn by \$549,144 on September 30, 1968, and was not in agreement with the balance shown in the general ledger, a reconciliation between the bank statements and the general ledger balances had not been made since February 1968. The bank statement for the month ending October 31, 1968, showed that the overdraft in account number 1202 had increased to \$828,354.

The Chief, Finance and Accounting Division, told us that he was aware the general ledger account showed a credit balance (overdraft) but that he did not consider the balance shown by the general ledger to be correct. He stated, however, that he had been unaware of the bank statement's also showing an overdraft and that he was unable to offer an explanation for this condition.

The Treasurer of the Trust Territory, who is responsible for initiating action to have funds transferred to the various bank accounts as needed, stated that he maintained a separate register which was supposed to show the current balance in the bank accounts. He stated, however, that he did not have access to all the information needed to maintain the register properly and that he had been unable to reconcile the account balances shown in his register with the balances shown in the general ledger. For example, in March 1969 he advised us that his records showed a balance of \$184,000 in account number 1204 whereas the general ledger showed a balance of only \$43,000. He indicated that he did not know which balance to rely on for the purpose of making transfers of funds.

Our review of analyses prepared by the Trust Territory's Internal Auditor indicated that the balances recorded in the general ledger as cash in banks--as of September 30, 1968, for some accounts and as of October 31, 1968, for other accounts--were erroneous partly because transactions which should have been recorded in the general ledger had not been recorded or had been recorded in the wrong account. For example, the September 30, 1968, balance shown by the general ledger for account number 1204 (special advance, Bank of America--Guam) was \$457,772.30 whereas the analyses prepared by the Internal Auditor indicated that the general ledger account balance should have been \$1,185,014.83. According to the analyses, the erroneous general ledger account balance apparently resulted primarily from recording erroneous entries in the account (\$200,000) and from not recording a transfer of funds to the account (\$500,000).

In view of the large posting errors found by the Internal Auditor, we believe that the accounting records did not provide reliable information on the amount of cash on deposit in commercial banks.

Cash in district finance offices

Large unreconciled differences existed between the cash balances reported as being on hand by the district finance officers and the balances shown in the controlling accounts in the general ledger. Collectively, the 10 finance officers reported cash on hand of \$287,066 at September 30, 1968, whereas the amount shown by the general ledger at that date was \$569,357--a difference of \$282,291. The Chief, General Accounting Branch, told us that the last reconciliation between the cash balances reported by the districts and those shown by the general ledger was made in 1965.

During our review the Trust Territory's Internal Auditor attempted to prepare such a reconciliation and indicated that \$167,664 of the \$282,291 difference represented unreconciled differences which had existed prior to July 1, 1967. The balance of the differences reportedly were caused primarily by erroneous postings and in-transit items. The Chief, General Accounting Branch, told us that available documentation was not adequate to account for the \$167,664.

Most of the cash reported as being on hand in finance offices was in two districts--the Yap District and the Marshalls District. According to a Trust Territory official, two locations in these districts did not have commercial banks and, therefore, retained large cash balances to perform such normal banking functions as cashing checks for individuals and private businesses. Collections received by the finance offices were retained and used for disbursement purposes. In addition, business firms exchanged excess cash funds for Trust Territory checks that could be cashed at other locations.

The Trust Territory's Internal Auditor reviewed the cash operations in the Marshalls District and, in a report dated April 22, 1969, noted, among other things, that:

1. Checks cashed for others were not made payable to the Trust Territory but, rather, were made payable to the finance officer personally or to "Cash."

2. Checks on hand at the end of the month were usually held over a period of 4 to 6 weeks before being forwarded to the Headquarters office for deposit. Checks for \$162,862.35, which were on hand at February 28, were not forwarded to Headquarters until the latter part of March.
3. Excessive cash balances were being held in the finance office. The Internal Auditor accompanied the Finance Officer to Kwajalein to deposit \$148,000 determined to be excess to the needs of the district.

We concluded that accounting controls over cash in the district offices had not been effective and that substantial improvements were needed to establish proper accountability for cash resources in district offices.

Imprest funds (petty cash)

The term "imprest funds," as used in the Trust Territory, refers to fixed amounts of cash which are advanced to various Trust Territory officials, primarily in the district offices, who are authorized to perform limited cash-disbursing functions. The imprest funds are intended to be used for travel advances and for small local purchases. The fund was authorized also for making change and for cashing certified checks.

Trust Territory procedures require that the amount of an imprest fund and the official designated to administer the fund (imprest fund cashier) must be authorized by the Trust Territory Treasurer in a form letter, referred to hereinafter as a "letter of designation." The letters of designation provide that petty cash payments from an imprest fund may not exceed \$100 for any one transaction. To avoid unnecessarily large cash balances, the Trust Territory requires that replenishment of the funds, in the amount of disbursements from such funds, must be requested at least monthly but may be requested more frequently.

The general ledger control accounts established at the headquarters office for each imprest fund should show balances equal to that authorized by the initial letter of designation, as increased or decreased on the basis of

changes authorized by subsequent letters of designation. We found, however, that the total amount of cash accountability shown by the general ledger for imprest funds at September 30, 1968 (\$90,815.04), differed substantially from the authorized amounts shown by the letters of designation (\$59,500) and from the amounts reported by the imprest fund cashiers (\$68,264.64)¹ in their requests for fund replenishments. The difference had not been reconciled.

The Treasurer of the Trust Territory told us that, in some cases, the amount of funds advanced to some of the imprest fund cashiers had been increased without changing the amounts shown in either the letters of designation or the general ledger. He stated that he had been advised by the official formerly responsible for controlling the imprest funds that new letters of designation were not necessary when fund amounts were increased.

We believe that accounting control over cash in imprest funds--which is particularly vulnerable to irregularities--was not effective because there was no reliable record as to the amount of imprest fund cash for which accountability should be ascertained.

Also, we believe that certain other practices followed in administering the imprest funds were not appropriate, as follows:

1. Expenditures were made from the imprest funds for individual transactions which were materially in excess of \$100, the maximum amount authorized for an individual transaction by the letters of designation. For example, one transaction involving a payment identified as being for "Utility" was in the amount of \$1,101.19.

¹Includes \$3,500 shown in the general ledger for which agents' reports were not available.

2. Many of the items paid for with imprest funds, such as purchases of food, appeared to us to be items that might more appropriately have been purchased under the more stringent procurement procedures required when purchases are not made from the imprest funds.

3. Requests for replenishment of the imprest funds were not always submitted promptly although applicable instructions required that they be submitted at least monthly. In some cases, this resulted in imprest fund expenditures exceeding the authorized amount in the fund. The excessive disbursements were made by the imprest fund cashiers with cash improperly transferred from other cash resources available to them.

Weaknesses in accounting for receivables and in collection procedures

Proper accounting for receivables is an important form of control over agency resources. Such accounting should result in a systematic record of amounts due from others, which must be accounted for. Estimates should be made from time to time of the portion of accounts receivable that may not be collectible, and such estimates should be recorded in a separate account. A periodic analysis should be made to determine the length of time receivables have been outstanding (aging of receivables), to determine the promptness of collections, and to facilitate follow-up actions, as deemed necessary, to collect delinquent accounts.

We found, however, that a large part of the accounts receivable recorded in the Trust Territory accounts were not supported by adequate documentation and had been outstanding for long periods of time. In our opinion, collection procedures were inadequate and many of the receivables were of questionable collectibility. We believe that appropriate accounting control has not existed over accounts receivable and that normal collection and accounting procedures have not been followed. There was no reliable record as to the actual amount of receivables due the Trust Territory.

Billed receivables

At March 31, 1969, the amount of billed receivables (sales and services) recorded in the general ledger totaled \$359,829.55 (excluding a receivable from an airline which is discussed separately below). Receivables totaling \$302,609.88, or about 84 percent of the total, were over 90 days old. Of the \$302,609.88, about 12 percent (\$36,693.55) was applicable to billings made prior to fiscal year 1967, some of which dated as far back as calendar year 1961. We were advised that these billings may be difficult to collect because copies of invoices, which contained information showing the basis for the billings, had been sent to storage and subsequently destroyed by a typhoon.

We were advised that receivables were not aged periodically to ascertain the length of time they had been

outstanding and that, even though forms existed which were designed to be used for follow-up action on delinquent accounts, the forms were not being used and no follow-up action had been taken. The billing clerk informed us that he had not received instructions as to how or under what conditions such forms should be used.

We noted several instances where receivables were past due from Trust Territory personnel who were still employed at the time of our field review. For example, information in the records indicated that a consultant had incurred a liability to the Trust Territory covered by a series of seven billings between December 1966 and March 1968 totaling \$688.75 for which there was no record of payment or evidence of attempts to collect the amounts due.

Also, as shown below, the data recorded in the accounting records as of March 31, 1969, showed that a number of receivables were due from individuals and local business firms which had incurred debts over extended periods and had not made payments on their accounts.

<u>Debtor</u>	<u>Period over which debt was incurred</u>	<u>Balance at March 31, 1969</u>	<u>Number of trans- actions</u>
A	3/67 to 1/68	\$ 1,673.12	13
B	11/67 to 3/69	5,931.84	32 ^a
C	2/64 to 7/65	627.00	6
D	4/66 to 1/67	595.00	3
E	4/66 to 12/66	9,235.82	9
F	9/64 to 3/65	779.00	7
G	12/64 to 3/67	261.00	8
H	5/67 to 9/68	1,768.70	5 ^b
I	5/67 to 11/68	2,896.08	6
J	6/68 to 3/69	22,295.87	16
K	3/68 to 9/68	3,076.50	6
L	8/64 to 3/68	3,405.94	9
M	3/65 to 5/68	806.39	6
N	10/63 to 4/65	952.00	5
		<u>\$54,304.26</u>	

^aThe last payment recorded was made on March 8, 1968, and covered debts incurred prior to November 1967.

^bOne billing for \$8.35 was paid on June 19, 1968.

Receivables from an airline

We were advised by a Trust Territory consultant that a contract with an airline for the operation of the Trust Territory Airline was terminated on May 15, 1968. He indicated that, under the terms of the contract, the Trust Territory paid for fuel and other supplies furnished to the contractor by the U.S. Navy and others and the Trust Territory was to be reimbursed by the contractor. Because of uncertainty as to the accuracy of its records--resulting from accounting inadequacies and the loss of some supporting documentation during a typhoon--the Trust Territory requested the airline to prepare a listing of all unpaid items as of May 15, 1968, based on the airline's records. The airline furnished a listing of unpaid items totaling \$299,753.60.

The consultant to the Trust Territory reviewed the airline's listing of unpaid items for the purpose of negotiating a settlement. The consultant advised us in April 1969 that the Trust Territory accounting records for both billed and unbilled receivables, after adjustments to correct errors, would support only about \$145,000 of the \$299,753.60 reported as unpaid by the airline as of May 15, 1968, of which \$116,654.92 had been paid through April 21, 1969. He stated that many items furnished to the airline were not recorded as receivables in the Trust Territory accounts but, instead, were recorded as expenses (estimated to amount to about \$120,000) of the Trust Territory. He indicated that the records of the Trust Territory were so incomplete that in many cases it was impossible to verify the amounts reported by the airline.

He stated further that in many cases the Trust Territory billing documents (1) contained mathematical or pricing errors, (2) did not furnish a complete description of the items being billed, and (3) went to the wrong parties. The amount to be eventually collected from the airline had not been finally determined at the time our field review was completed.

Receivables for use of a guesthouse

Part of the billed receivables were due from individuals staying at a guesthouse in Guam (Perez House) which was leased to the Trust Territory in January 1968 at a cost of \$1,200 a month. We were advised that these quarters were needed because of a lack of commercial accommodations, available on a consistent basis, which could be used by Trust Territory personnel transiting Guam.

Our review indicated that the names and addresses of individuals staying at the guesthouse and the times of their arrivals and departures were required to be recorded on sign-in sheets. Subsequently, the sign-in sheets should have been sent to the Trust Territory's Voucher Examination Section, Fiscal Services Branch, which had the responsibility for seeing that appropriate charges for the use of the guesthouse were billed or, where applicable, were offset against claims submitted by Trust Territory employees for reimbursement of travel expenses.

We examined the file containing the sign-in sheets and found that, although the file covered the period January 8, 1968, through March 16, 1969, sign-in sheets were not on file applicable to the periods February 5 to 20 and May 29 to August 2, 1968. The Chief, Voucher Examination Section, stated that he did not remember having received the missing sign-in sheets. Also, in March 1969, the Chief advised us that he had not had an opportunity to bill anyone since May 1968. In reviewing the sign-in sheets, we found that information was not always shown as to the departure date, length of stay, number in the party, and the guests' addresses.

Receivables for property leased to others

We noted that controls were not adequate to provide reasonable assurance that billings and collections were made for property which the Trust Territory leased to others or to ensure that the rental charges were reasonable.

The Trust Territory's Director, Land Management, advised us that from 50 to 60 percent of all land in the

Trust Territory was public land, some of which was leased to individuals or to commercial firms. Lease agreements, entered into by the Trust Territory, allowed such land to be used for grazing and farming and for residential, commercial, and industrial sites.

Pursuant to authority contained in Trust Territory regulations, lease agreements were entered into by officials in the district offices and by officials in the Headquarters office. We were advised by an official in the Budget and Finance office that no policy had been established concerning the assignment of responsibility for billing and collecting lease payments and that the district offices, in some cases, would perform these responsibilities and, in other cases, would forward the leases to the Headquarters office for administration. He stated that the Budget and Finance office did not maintain a listing of lease agreements, and we were unable to locate such a listing at the Headquarters office.

In April 1969 we met with a consultant employed by the Trust Territory who was establishing a current listing of leases in each of the district offices. At that time the consultant had completed a listing for only the Marianas District. The consultant told us that he had difficulty developing the listing because he had to piece information together from six separate offices. He found that, in many cases, rental payments were delinquent, leases had expired, and management controls and administrative practices were deficient. He stated that many payments under the lease agreements probably were not being collected but that, because of the poor condition of the records, it was difficult to be conclusive.

In a letter dated March 18, 1969, the consultant advised the Marianas District Administrator of the results of his review of leases in that district and attached a report which listed each lease outstanding and presented information concerning the status of each such lease. The consultant advised the Administrator, in part, as follows:

"Briefly, the report shows that the status of leases generally, and that of grazing (farm) leases particularly, is intolerable.

"The preparation of the report has demonstrated that Mariana Islands District Office of Land Management files are incomplete and lack the information necessary to properly service leases, determine compliance of operators, condition of rental payments, and the status of leases generally.

"It has also shown that Mariana Islands District Finance Office files are in a poor state of organization and maintenance, and ill-adapted to the determination or verification of lease payments.

"It has shown a lack of coordination between District and Headquarters Offices of Land Management for the transmission of lease information.

"It has shown a scattering of functions and responsibility among District and Subcenter (Rota) Land Management Offices, District Finance Offices, Headquarters Land Management Office, Office of Commissioner for Administration, Headquarters Budget and Finance Office, and the Office of the Attorney General in the making, servicing and collecting of rentals of leases in a most confusing manner."

The consultant reported that, of the 145 leases in the Marianas District at January 1, 1969, 42 had expired and that rental payments totaling \$10,694.80 were delinquent on 105 of the leases.

Also, the Director, Land Management, advised us in April 1969 that the Trust Territory did not have an adequate basis for determining rental rates because the Trust Territory had never had a land appraiser. He stated that the rental rates were so low that he doubted that the rental income would cover the cost of administering the leases. In this connection, we noted that in July 1968 the Director, Land Management, had written to the District Administrator, Palau, questioning the validity of a lease agreement involving a bakery. He indicated, also, that the rental rate of \$12 a year, which was called for by the lease agreement, was not acceptable for a business lot.

Unbilled receivables

Under the Trust Territory's procedures, many of the amounts due from others for goods and services provided by the Trust Territory are initially recorded in the "unbilled receivable" account prior to billing. After billing, the amounts due are transferred from this account to the billed receivable account.

Our review showed that the general ledger balance for this account totaled \$304,351.22 at March 31, 1969, and included \$178,690.33 (59 percent) for unbilled receivables brought forward from prior years. The amount brought forward from prior years had not changed since October 1967. The billing clerk, who had been employed for about 2 months at the time of our visit, stated that his predecessor (who had terminated his employment with the Trust Territory) told him not to bother with billing these receivables. He stated that he did not know the reason for not billing the amounts due but he thought that most of the unbilled items lacked adequate documentation to support a billing.

District receivables

The district offices maintain an accounts receivable ledger which is used to record billings sent to individuals, business firms, and others for services furnished by the district offices involving such items as cablegrams, utilities, equipment rentals, and medical and dental care. The district offices are responsible for collecting the receivables recorded in the districts and for sending the Headquarters office a detailed listing for the accounts receivable outstanding (unpaid) at the end of each month.

We were advised that the Headquarter's general ledger account--"district receivables"--had been maintained through June 30, 1968, in a manner intended to show the total amount of accounts receivable outstanding in the district offices and that postings to the account were based on the listings received from each of the district offices showing accounts receivable outstanding at the end of each month.

At the time of our examination, however, only three entries had been recorded in the account since its establishment and the outstanding balance in the account at June 30, 1968, was \$407,706.34. An employee in the Budget and Finance Office told us in April 1969, that the general ledger account had not been posted since June 30, 1968, because he recognized that he was not receiving sufficiently complete and accurate information from the district offices to justify adjusting the general ledger account balance.

In April 1969, an employee of the Budget and Finance Office provided us a file and indicated that it contained the latest listings received from the district offices, showing the outstanding accounts receivable at the end of the month. The latest listings contained in the file for three districts were for March 1969; for one district the latest listing was for January 1969; for one district the latest listing was for December 1968; and for one district the latest listing was partially for October 1968 and partially for February 1969.

Although the general ledger account--which had not been posted since June 30, 1968--showed an outstanding district receivables balance of about \$407,706, the latest listings cited above from all the district offices showed an outstanding balance of only about \$209,022--a difference of about \$198,684. Of the total amount of outstanding accounts receivables shown on the listings submitted by the district offices, about \$164,357 (79 percent) had been outstanding for 60 days or over and some had been outstanding several years.

During the period February 26 to March 17, 1969, the Trust Territory's Internal Auditor reviewed the utilities' accounts receivable in one district office and found that some accounts had balances outstanding for services provided in 1966 and 1967. He reported that billings to customers for the then-current month's services did not include past due or delinquent amounts. He also noted that invoices had been prepared for services applicable to the months of November and December 1968 but, as of March 4, 1969, had not been delivered to the customers. The amounts, however, were shown on a summary of accounts receivable as being 30 days overdue.

The method used by the Headquarters office to record entries in the district receivables account resulted not only in the balance shown in that account being unreliable but also, as discussed below, in excessive amounts being recorded in the general ledger as an "allowance for uncollectible accounts."

Amounts should usually be entered in the allowance for uncollectible accounts from an estimate of that portion of the amounts recorded as receivables which may be uncollectible. However, each time the Headquarters office made an entry to the district receivables account, it made a contra entry to the uncollectible account for the amount of the receivables over 30 days old--which included most of the district receivables. Although, at the time of our review in April 1969, the latest listings from the district offices reported outstanding accounts receivable of about \$209,022, the amount recorded to cover possible losses on district receivables in the allowance for uncollectible accounts totaled about \$388,841--an excessive and meaningless allowance.

Travel Advances

The Headquarters and district offices advance cash to Trust Territory employees for planned travel based on applications submitted on a standard form (SF-1038). The standard form, when properly completed, provides a record indicating the amount of the advance applied for, the amount actually advanced, the amount repaid, and the balance outstanding. The amounts of the travel advances also should be recorded in the general ledger which is maintained at the Headquarters office.

Instructions issued by the Trust Territory provide that, "a card file of the active SF-1038 should be kept and reconciled monthly to the general ledger travel advance account."

We found, however, that no recent reconciliations had been made between the active travel advances shown on the standard forms (SF-1038s) and the amount of outstanding travel advances shown in the general ledger. A Trust

Territory official indicated that one reason why reconciliations had not been made was inadequate staffing.

We were advised in May 1969 that there had not been any reviews to determine the status of travel advances outstanding since September 1968. Information in the files in May 1969 showed that 145 advances totaling \$16,139.73 had been outstanding in excess of 120 days and some dated as far back as March, 1967.

The Chief, Voucher Examination Section, told us that many employees were slow in submitting travel claims. We found that one Trust Territory official had only recently submitted seven travel vouchers covering trips taken during the period August 18, 1967, to January 16, 1969, and totaling \$2,723.31.

Because of the conditions described above, we believe that, at the time of our field review, there was no reasonable assurance that (1) the general ledger account for travel advances accurately showed the amount of travel advances outstanding, (2) funds advanced were properly offset against travel vouchers, and (3) advances which exceeded allowable travel claims were returned promptly by the employees.

Improper accounting procedures resulted
in erroneous inventory accounts

Accurate and reliable financial and quantitative information on property resources, for use by internal management and for preparing external financial reports, can be obtained only from a properly designed and operated system of accounts and related procedures. We found, however, that inaccuracies existed in the Trust Territory's inventory records which decreased the usefulness of the financial information contained in the accounts. In our opinion, this situation can adversely affect management's ability to make informed decisions as to the efficient and effective procurement, use, and management of such property.

Our review showed that, although the Property and Supply Department maintained a record of the current inventory value of seven categories of supplies and reported these values to the accounting department, no attempt had been made to reconcile the large variances between the amounts shown in the inventory records and in the general ledger accounts. The following table shows the amount of such variances at June 30, 1968.

<u>Type of inventory</u>	Balance at June 30, 1968 <u>Inventory</u> <u>records</u>	General <u>ledger</u>	Ledger amount over or <u>under (-)</u>
Repair parts	\$263,427.06	\$153,729.79	-\$109,697.27
Medical supplies	61,518.52	159,345.60	97,827.08
General stores-Palau	16,977.25	28,111.01	11,133.76
General stores-Yap	20,335.43	38,677.86	18,342.43
General stores-Truk	27,655.25	10,976.45	-16,678.80
General stores-Ponape	3,787.05	6,479.27	2,692.22
General stores- Marshalls	23,321.54	2,813.68	-20,507.86

A physical inventory of supplies on hand had been taken in July 1967. Although a physical inventory planned for July 1968 had been canceled because of the disruption caused by Typhoon Jean in April 1968, another inventory was scheduled for the summer of 1969. We noted that, although inventory losses totaling about \$343,000 (including about \$119,000 applicable to the seven categories cited above)

were estimated as resulting from Typhoon Jean for the purpose of submitting a claim to the Office of Emergency Preparedness, the accounting records were not adjusted on the basis of such claimed losses. Therefore, inventory valuations were overstated to the extent these claimed losses were valid.

In view of the deficiencies cited above, we believe that reliable information was not available in the accounting records of the Trust Territory as to the value of inventories that should have been on hand or as to the value actually on hand.

Errors in recording financial obligations

When an agency obligates funds for the procurement of services or goods, it is important that such obligations be properly recorded in the accounting records in a manner that will ensure that obligations and expenditures do not exceed the amounts authorized by the Congress. We found, however, that the accounting records and reports on funds available for program purposes were inaccurate and, because of inadequacies in the accounts and supporting documentation, the correct fund status was not readily ascertainable.

Information obtained during our review indicated that the Trust Territory employees did not (1) systematically review the basis for recorded obligations to ascertain that they conformed to the criteria set forth in section 1311 of the Supplemental Appropriation Act, 1955, as amended (31 U.S.C. 200), or (2) periodically reconcile the amount of obligations shown on supporting documentation with the amount recorded in the related control accounts.

Section 1311 of the Supplemental Appropriation Act of 1955, as amended, states, in part:

"Hereafter, in connection with the submission of all requests for proposed appropriations to the Bureau of the Budget, the head of each Federal agency shall report that any statement of obligations furnished therewith consists of valid obligations as defined in subsection (a) of this section.

* * * * *

"Any statement of obligation of funds furnished by any agency of the Government to the Congress or any committee thereof shall include only such amounts as may be valid obligations as defined in subsection (a) of this section."

Subsection (a) of the act sets forth in detail the criteria that must be met for an obligation to be valid. For example, one of the criteria states that, to be valid, an obligation must be based on a binding agreement in writing between the parties, including Government agencies, in a manner and form and for a purpose authorized by law and must be executed before the expiration of the period of availability for obligation of the appropriation or fund concerned for specific goods to be delivered, real property to be purchased or leased, or work or services to be performed.

GAO's Policies and Procedures Manual for the Guidance of Federal Agencies states that each agency shall review its obligation documents as of June 30 of each fiscal year for the purpose of determining whether all obligations meet the criteria of valid obligations set forth in section 1311 of the Supplemental Appropriations Act of 1955. The GAO manual states, also, that each agency shall reconcile its obligation documents with the related control accounts periodically and as of June 30 of each fiscal year.

We found that the Trust Territory had not adopted procedures for determining that its recorded obligations complied with the requirements of section 1311 or for periodically reconciling obligating documents with the related control accounts. Amounts were recorded and reported as unliquidated obligations although they did not represent valid obligations; conversely valid obligations were not recorded, or were recorded but not reported, on the status of funds report required by the Bureau of the Budget on Standard Form 133.

For example, some obligations were recorded on the basis of a procedure which provided for prevalidating certain types of operating expenses anticipated by the district offices. Under this procedure, obligations were established,

usually for a quarterly period, on the basis of estimates of the amount of orders that would be placed during the quarter for goods or services. We were advised, however, that the procedure was not working properly and that, in many cases, obligations which had been recorded on the basis of the anticipated issuance of purchase orders were being recorded a second time when the purchase orders actually were issued--resulting in duplicate obligations. This problem was identified in a memorandum dated March 20, 1969, to the Commissioner for Administration from a Trust Territory consultant, as follows:

"There appears to be some confusion with respect to the liquidation of these *** prevalidations. The Districts often submit requisitions for Headquarters Supply stock issues and the requisitions do not cite the prevalidation document numbers, so General Accounting obligates these requisitions from unobligated funds. Also requisitions for blanket purchase orders (e.g. food for hospital operations) are being recorded as new obligations rather than being liquidated against prevalidations."

The consultant noted that, as a result of the procedures being followed, obligations based on prevalidations were not being properly liquidated. He recommended the withdrawal of fiscal year 1969 obligations estimated at between \$200,000 and \$300,000, which were based on prevalidations issued for the period ended December 31, 1968, and which were shown by the records as being unliquidated.

In other memorandums the Trust Territory consultant also reported the following situations which appeared to result from inadequate accounting procedures.

1. At January 31, 1969, about \$143,000 of recorded unliquidated obligations were based on travel authorizations applicable to fiscal years 1967 and 1968. A large part of this amount represented funds obligated for authorized travel on an airline that went out of existence on May 16, 1968. Any funds obligated for such travel should have been liquidated prior to that time.

2. About \$105,000 of the December 31, 1968, recorded unliquidated obligations applicable to construction projects were not valid. Among other things, payments had been made without properly showing the obligations as being liquidated and requisitions or purchase orders had been canceled without properly withdrawing the amount obligated.

Our review showed, also, that recorded obligations of about \$988,000, for inventory replenishment, were omitted by the Trust Territory from its status of funds reported at June 30, 1968. Beginning in fiscal year 1964, the Trust Territory maintained a separate stock revolving fund to account for its inventory operations. In March 1967 the Director, Budget and Finance, issued instructions that, effective July 1, 1967, the separate stock fund accounting would be eliminated.

The proper accounting entries were not made, however, transferring the balances in the stock fund account to the general ledger. During fiscal year 1968, for reasons we were unable to determine, the Trust Territory recorded its obligations for stock purchases in the stock fund accounts, which should have been closed out as of June 30, 1967, instead of in the general ledger. In reporting its status of funds as of June 30, 1968, the Trust Territory did not consider the unliquidated obligations of about \$988,000 for materials and supplies on order which were recorded in the stock fund accounts.

Trust Territory officials agreed that the recorded obligations for inventory replenishment were not considered in reporting the status of funds at June 30, 1968. It was their view, however, that a large proportion of invalid obligations was included in the recorded amount of \$988,000 in unliquidated obligations and that the amount was therefore overstated. Their position was based on their analysis of recorded obligations at March 31, 1969, which showed that about 40 percent of recorded obligations were not valid obligations.

Weaknesses in reporting

Responsible financial management of a Federal agency requires reliable and useful reports on operating and financial results and a systematic means for comparing such results with agency budgets approved by the Congress. Decisions regarding future operations can be made with greater confidence where it can be demonstrated through information produced by an accounting system whether past performance has been consistent with planned programs and has been accomplished within established financial limits.

However, reports to meet such requirements on Trust Territory operations frequently were not prepared; and, because of inadequate accounting practices, those reports which were prepared often either were inaccurate or were not prepared in sufficient time to be useful. Also, we found that programs were not carried out in accordance with the budget justifications submitted to the Congress and that a system did not exist for disclosing such situations to top management officials and to the Congress.

Some of the Trust Territory management officials told us that financial reports which they received were of limited usefulness, primarily because they were not timely, accurate, or pertinent. The financial reports consisted principally of reports on the status of funds. In our opinion, management had not taken effective action to identify the information it needed and to provide for its reporting.

The fund status report lacked timeliness and accuracy primarily, in our opinion, because of the (1) incorrect posting of source documents, (2) 3- to 4-week backlog of posting of source documents, and (3) omissions of some district transactions because of late reporting. Also, an official in the education department expressed the opinion that the report's worth was affected considerably by its failure to provide information on program fund status by district office.

Two of the program managers--education and land management--had established their own accounting records to obtain the fund information which they considered useful. Other managers indicated that they were considering similar

action. Such action results in a duplication of work that is being performed in the finance department but that is not being reported promptly or in a useful format.

Aside from their criticism of the reports, most of the program managers also expressed a need for other reports which were not being prepared. For example, the Commissioner for Administration said that he would like to receive reports matching the goals and results of all Trust Territory departments.

The Administrative Assistant, Public Works Department, told us in May 1969 that procedures had not been established to compare actual and budgeted costs of construction projects. That such comparisons were not made could be attributed, in part, to the fact that, since about 1966, completed construction projects had been carried in the work-in-progress account and the final costs of such projects had not been ascertained and capitalized in the fixed assets account.

Trust Territory officials estimated, at the time of our field review, that about \$5 million in capital improvement projects had been completed but the necessary actions had not been taken to ascertain the final cost of each project and to transfer such project costs to the fixed assets account. One of the officials indicated that this presented an unrealistic picture for budgetary purposes as to the property that must be maintained and, also, an unrealistic figure as to the work-in-progress.

In the past, many construction projects included in the budget justifications, for which funds had been received, were not built or were deferred; and the funds were used for other purposes not included in the budget justifications. In some instances, the same project had been used to justify funds in 2 different fiscal years; but, after funds were appropriated, the building of the project was deferred. Our prior review applicable to fiscal years 1957-60 indicated that, in some cases, this situation was caused by inadequate planning which resulted in funds' having been requested for construction projects that had not been soundly conceived or supported by reasonably firm cost estimates.

During our current review, we noted additional examples of inadequate planning and of the use of construction funds for other than the specific purposes originally cited by Trust Territory officials in justifying to the Congress the need for such funds. Information which would disclose this situation, however, was not systematically reported to management and to the Congress.

For example, the fiscal year 1968 appropriation requests submitted to the Congress showed that \$295,000 was budgeted for the construction of dispensaries (2- to 16-bed size, costing between \$2,000 and \$20,000 each) and for the renovation of subcenter hospitals. Because of a reduction in the construction budget, the actual funding available for these projects was only \$225,000; and this amount was allotted for the construction of the Kusaie Hospital. We were informed that the decision was made to use the funds, intended for the construction of dispensaries and renovation of subcenter hospitals, for the construction of the Kusaie Hospital because the High Commissioner believed that this project, although not originally budgeted, had number one priority. At the time of our review, in March 1969, construction was scheduled to begin on July 1, 1969, and to be completed by March 31, 1970.

An official in the Public Works Department advised us on May 1, 1969, that, with the amount of funding provided, the completed hospital would lack such basic facilities as power and adequate access roads and that he intended to request additional funding for construction of the project. Subsequently, in a memorandum dated May 2, 1969, requesting information from officials in his department concerning additional construction projects which could be justified, the Commissioner for Public Works cited the Kusaie Hospital as an example of a project where consideration conceivably could be given "to designing for a fully-completed facility of a greater magnitude in the neighborhood of \$400,000 ***."

Another example of the use of funds for a purpose other than the originally intended one involved the planned construction of housing for teachers at a vocational school, the Micronesian Occupational Center, which was under construction and was planned for completion in fiscal year 1969. The fiscal year 1969 budget, presented to the

Congress, requested \$400,000 for the construction of 20 houses for teachers and \$200,000 for the construction of 10 houses for medical personnel. An official in the Education Department and a Program Analyst in the Office of the High Commissioner advised us that the \$400,000 for the construction of 20 houses for teachers was included in the budget as estimated housing requirements for the Micronesian Occupational Center.

We were advised that, after Congress appropriated the fiscal year 1969 funds, the housing funds which had been budgeted for medical personnel and teachers (\$600,000) were allotted to a Trust Territory-wide housing account. The Commissioner for Administration told us that all fiscal year 1968 housing funds had been used to buy materials for 70 houses to meet various Trust Territory requirements and that the fiscal year 1969 housing funds would be used to construct the 70 houses. According to correspondence in the Trust Territory's files, none of the 70 houses were for the use of teachers at the Micronesian Occupational Center. The fiscal year 1970 budget presented to the Congress requested \$300,000 for the construction of 15 houses to be used by teachers at the Micronesian Occupational Center.

Although the budget presentations to the Congress requested housing funds by program areas (i.e., education, medical, etc.), in effect such funds were placed in a common pool and used by program areas in amounts which differed from the justifications presented to the Congress. This was pointed out by the Assistant Commissioner for Education in a memorandum dated May 8, 1968, to the High Commissioner. The Assistant Commissioner indicated that, because sufficient housing had not been assigned by the High Commissioner for use by teachers at the Micronesian Occupational Center, "*** you precluded the opening of the *** [Center] scheduled for September 1969." The Assistant Commissioner pointed out also that:

"*** although during the three year period [fiscal years 1967-69] education has justified 46% of the housing funds, we are receiving 21.5% of the housing. I believe we could be open to charges of reprogramming a substantial amount of money without clearance from BOB [Bureau of the Budget] or Congress."

Trust Territory officials have indicated in testimony before a congressional committee¹ that, because of inadequate planning, situations similar to those discussed above did exist and that the solution probably lay in the Congress appropriating planning funds one year and construction funds the next year. In our opinion, this approach might contribute to more orderly implementation of the construction program, although at the time of our field review the approach had not been implemented.

Regardless of the approach used, we believe that management and the Congress would have better tools for evaluating performance and for making decisions regarding future operations if the accounting system would produce cost information needed to compare actual program and construction performance with budget justifications and if such information were systematically reported.

At the time of our review the accounting records were in such poor condition that, in our opinion, accurate and meaningful financial information could not have been provided to Trust Territory officials. We believe that first priority should be given to establishing and maintaining the necessary financial controls over the Trust Territory's assets and financial obligations.

Recommendation to the Secretary of the Interior

We recommend that the High Commissioner of the Trust Territory of the Pacific Islands be instructed to take immediate steps to (1) establish effective control over the assets and financial obligations of the Trust Territory and (2) revise the Trust Territory's accounting and reporting systems to facilitate the accumulation of cost and performance information.

¹See p. 1051 of part 1 of the hearings before a subcommittee of the House Committee on Appropriations entitled "Department of The Interior And Related Agencies Appropriations For 1968" 90th Cong., 1st sess.

REQUIREMENTS FOR AN EFFECTIVE INTERNAL CONTROL SYSTEM WERE NOT MET

In devising an effective financial management system for a Federal agency, consideration must be given to establishing internal controls which are designed to provide positive assistance in carrying out all duties and responsibilities, including those controls needed to ensure the accuracy and reliability of financial and other reports. Weaknesses in any part of the internal control system tend to decrease the effectiveness of the financial management system.

In establishing a system of good internal controls, management must consider the following requirements.

1. Organization: A carefully planned organizational structure should be established, under which responsibility is clearly defined and specifically assigned and appropriate authority is delegated.
2. Procedures: Procedures adopted to carry out agency operations should be as simple and practicable as circumstances permit, and the availability and suitability of personnel must be considered in devising procedures.
3. Personnel and supervision: The qualifications of officials and other personnel as to education, training, experience, competence, and integrity must be appropriate for the responsibilities, duties, and functions assigned to them and must be under proper supervision.

On the basis of our review, we believe that the above-cited requirements for an effective internal control system were not adequately met in the Trust Territory and weaknesses in the financial management system were the result.

The High Commissioner of the Trust Territory established in September 1964 a Manual of Administration for the purpose of disseminating information relative to functions of the organizational units, delegations of authority, policies and certain procedures of general and more-or-less

permanent application affecting the operations of the Government of the Trust Territory.

Our review in February 1969 of the Trust Territory Manual of Administration showed that approximately half of the sections listed in the table of contents were not included in the manual. For example, sections of the manual providing for the description of fiscal and accounting policies and procedures did not contain the chapters listed in the table of contents on (1) accounting policies and procedures, (2) funds source and description, (3) general ledger, and (4) revenue accounting.

We inquired of the Trust Territory officials responsible for the financial and accounting functions about the application and implementation of the accounting manual which was approved for the Trust Territory by the General Accounting Office in 1954. We were informed by these officials that they were unaware of the existence of the 1954 accounting manual and were unable to locate a copy of it in their files.

Part 1 of the Manual of Administration, dealing with organization, indicated that there were five departments under the High Commissioner, although we found that the Trust Territory government actually was organized into seven departments. The Director, Budget and Finance, informed us that his department was not presently organized in accordance with the organizational plan shown in the Trust Territory Manual of Administration.

We noted that a section of the Manual of Administration dated July 25, 1966, provided for the development of a district administrative manual for each district of the Trust Territory. The manual was to provide, in detail, instructions and procedures implementing the various organizational, management, administrative, and program policies applicable to a district. Each district administrator was responsible for the preparation of the district administrative manual for his district.

We found, however, that sufficient action had not been taken in districts to implement the preparation of such administrative manuals. For example, in February 1969, we

reviewed the Truk District's Manual of Administration and found that over half the sections of the manual provided for in the table of contents had not been prepared.

During our review, the Acting Management Improvement Officer advised us that representatives of the National Archives and Records Service of the General Services Administration had made a survey during July and August 1968 in the Trust Territory's Headquarters offices, the Marianas District Office, and certain judiciary offices. According to the information provided us, these representatives concluded, among other things, that:

"Many Headquarters Departments have not issued operating manuals ***. Priority attention should be given to the development of procedural manuals that fully tell 'how to do it' in clear and simple terms. This becomes more and more important with the increasing use of indigenous personnel."

The lack of appropriate organizational and procedural manuals was particularly serious, in our opinion, for the finance and accounting function, which our review indicated was being performed with inadequately trained and supervised Micronesian personnel.

The accounting function in the Trust Territory was being performed primarily by Micronesian personnel. The Director, Budget and Finance, advised us that new employees were placed directly on the job without orientation or training and that no in-service training was provided. The training program for most new employees consisted of assistance from employees already in positions to which the new employees were assigned. Some of the Budget and Finance employees interviewed by us stated that they had received no orientation or training before starting work and indicated that they had received only minimum on-the-job instruction from their coworkers.

In our opinion, adequate supervision would have mitigated the effect of using untrained employees. The Director, Budget and Finance, advised us, however, that the ability to provide effective supervision was adversely

affected by the fact that there were five unfilled supervisory positions in his department.

Recommendation to the Secretary of the Interior

We recommend that the High Commissioner of the Trust Territory of the Pacific Islands be instructed to prepare and issue detailed organizational and procedural manuals and that priority consideration be given to preparing such manuals for the finance and accounting functions. We recommend, also, that training programs be devised and implemented which are appropriate for the responsibilities and duties assigned to Trust Territory personnel.

INADEQUATE IMPLEMENTATION OF
THE INTERNAL AUDIT FUNCTION

We believe that the internal audit function in the Trust Territory was not adequately implemented, primarily because of inadequate staffing. We found that not all major financial activities were covered and that follow-up procedures for ascertaining actions taken on audit findings were lacking.

Our review indicated that, after 1963, the size of the audit staff (with exception of the period when there was no auditor) had varied from one to six employees. The position of Internal Auditor was vacant between July 1967 and September 1968. At the time of our field review, the staff consisted of one auditor and a temporary assistant. In view of the problems identified in our review, we believe that such a staffing pattern is unequal to the needs of the Trust Territory.

Our review of the internal audit reports, dating from February 1964 to the time of our field review, indicated that the internal auditors devoted substantial emphasis to cash accountability reviews at the district offices and, in our opinion, did not devote adequate attention to the essential issue of the integrity of the accounting records and reports and to compliance with management policies, plans, and procedures for carrying out program operations in the Trust Territory. We believe that there is a need for establishing and implementing a broader internal audit program encompassing all activities of the Trust Territory.

A new Internal Auditor was appointed on September 1, 1968; and in November 1968 he was assigned to help the Budget and Finance Office to prepare reconciliations of the cash accounts. The Internal Auditor advised us that he expected his work in this area to continue for several months. The Director, Budget and Finance, indicated that he had no one in his office who had time to make the reconciliations and, therefore, the Deputy High Commissioner had authorized the use of the Internal Auditor to perform this accounting function.

As indicated on page 10, the lack of cash reconciliations is an urgent problem requiring immediate solution. The use of the internal auditor to perform this and other accounting functions, however, reduces the time available to the internal auditor for the performance of his review functions and could limit the independence of his later reviews of accounting operations.

We noted that the Trust Territory had not established procedures for reporting on the actions taken in response to the audit findings in the areas covered by the Internal Auditor. The need for a follow-up system was pointed out in a June 27, 1966, memorandum from the then Acting Assistant Commissioner for Administration to the Acting Deputy High Commissioner:

"My observation during the past months indicates a certain laxity on the part of our administration in the follow-up on the findings of the Audit Unit unless there are certain evidences of embezzlement or mishandling of funds, and even in these areas, there is often a failure to take immediate action.

* * * * *

"*** I wish to recommend that a follow-up system be established *** whereby procedures can be established to ensure that action is taken promptly by the officials concerned, and that corrective action, as may be required, is properly instituted."

No action was taken on this recommendation and the deficiencies pointed out in many audit findings were not corrected. Thus, we noted instances where reports on audits performed at different points in time contained many of the same recommendations. We discussed this situation with the Deputy High Commissioner, then acting as High Commissioner. He indicated that, at least since 1966, the practice had been to present the auditor's findings to the people concerned, without requiring any reporting on the corrective actions taken.

We believe that there is a need for a regular status report of actions taken on audit recommendations. Also, provision should be made for regular inquiry into whether proposed corrective actions have, in fact, been taken and whether an evaluation of their effectiveness has been made.

Recommendation to the Secretary of the Interior

We recommend that the High Commissioner of the Trust Territory of the Pacific Islands be instructed to take the necessary actions to improve the staffing, scope, and follow-up procedures of the internal audit function in the Trust Territory.

CHAPTER 3

NEED FOR IMPROVED SURVEILLANCE

AT THE DEPARTMENTAL LEVEL

In our opinion, the financial management system in the Trust Territory is so weak that neither top management officials nor the Congress can trust the system to provide essential and reliable information for management's use in achieving an efficient and economical operation and to satisfactorily report on the custody and use of resources. Although officials of the Trust Territory have been aware of defects in the system for a long period of time, and have taken certain corrective actions, the basic defects continue. We believe that there is a need for improvement in surveillance techniques at the departmental level to ensure correction of the defects in an orderly and timely manner.

In a memorandum dated May 8, 1969, the Commissioner for Administration, Trust Territory of the Pacific Islands, advised us that there was no question about the fact that recommendations for improving financial management, which were contained in GAO and departmental reports dating back to 1957, largely were not implemented in the intervening years. He indicated that the cause was, at least in part, the positive reliance that had to be placed on Micronesian employees in fiscal management, especially through fiscal year 1968.

The Commissioner stated that the inability to recruit qualified personnel in the area of Budget and Finance, as was true in all other areas, was the result of (1) a grade structure which is too low, (2) limitations on increasing the number of personnel employed, (3) lack of accredited schools for children of employees, (4) remoteness of the area, and (5) inadequacy of civil service registers to supply the requirements for financial personnel.

He indicated, however, that, for the past 2 years, there had been an awareness of the defects in the systems and procedures and that, recently, changes had been made in

procedures and a financial management capability had been developed.

In a memorandum dated May 7, 1969, the Trust Territory's Director, Budget and Finance, advised the Commissioner for Administration of various financial management improvements which either had been made or were planned, including plans to enter into a contract with a financial consulting firm to provide the Trust Territory with a financial management system and plans to request relief from the personnel ceiling in the area of accounting and auditing. He stated that none of these actions had been accomplished at that time and indicated that, unless such actions were taken, the progress desired would not be accomplished.

Although reports issued by the Department's Office of Survey and Review have identified the basic financial management problems in the Trust Territory and have made appropriate recommendations for improvement, we believe that the Department's surveillance over corrective actions taken has not been sufficiently aggressive and persistent.

In view of the seriousness of the situation in the Trust Territory, we believe that the Department should establish, in writing, a plan of action which lists each item in the financial management area needing improvement and, for each item listed, should show the official responsible for corrective action and the required date for completion of such action. We believe in addition that monthly progress reports should be required showing the status of each item listed on the plan of action and the effort devoted to each such item during the month.

We believe that the items listed on the plan of action should be in sufficient detail to avoid any misunderstanding about the corrective action required.

RECOMMENDATION TO THE SECRETARY OF THE INTERIOR

We recommend that appropriate surveillance techniques, designed to ensure that corrective actions are taken, be established at the departmental level. These should include the preparation of a written plan of action listing each item in the financial management area needing improvement and the requirement for monthly progress reports to the Office of the Secretary.

CHAPTER 4

DEPARTMENTAL COMMENTS

In a letter dated January 20, 1970 (see app. I), the Acting Director of Survey and Review, Department of the Interior, in commenting on our draft report, advised us of several corrective actions which the Trust Territory had taken after our audit was performed. Primarily the reported corrective actions involved the reconciliation of general ledger cash accounts with bank balances or subsidiary records and the ascertainment of the validity of unpaid obligations.

He stated that the High Commissioner of the Trust Territory of the Pacific Islands had assured him that positive action was being taken (1) to obtain adequate control over assets and financial obligations and (2) to make monthly reviews to ensure correction of all inadequacies pointed out in the GAO report. In this connection, he indicated that the Trust Territory's Director of Finance had been instructed to use the GAO report as a guideline for making significant improvements in financial management.

The Acting Director advised us further that negotiations were under way to hire a financial consulting firm to (1) conduct a systematic and comprehensive analysis of the total organization and program as it related to the requirements for a unified financial management system and (2) design and implement an accounting system that met the requirements of the territorial managers, the GAO, other regulatory agencies, and the Department. Our review of information in the Department's files showed that departmental officials were aware that an essential element for success of the new financial management system would be the ability of the Trust Territory personnel to operate and maintain the system and that this element was being considered in the design and implementation of the system.

We believe that the actions taken or planned by the Trust Territory, as set forth above, will be of assistance in correcting the weaknesses in financial management which are discussed in this report. Also, as pointed out in

chapter 3 of this report, we believe that appropriate surveillance techniques should be instituted at the departmental level, which would be designed to ensure that timely corrective actions are taken. A departmental official advised us that the Department did not believe it was necessary to institute the type and level of surveillance recommended by us.

CHAPTER 5

SCOPE OF REVIEW

Our review of financial management activities of the Trust Territory of the Pacific Islands included an examination of pertinent legislation and congressional hearings and reports relating to Trust Territory operations. We reviewed policies and procedures applicable to financial management activities and examined selective accounting records, reports, and transactions to the extent we considered necessary to evaluate the adequacy of management controls and the reliability of financial data. In addition, we conducted interviews with officials responsible for financial management in the Trust Territory.

Our review was made primarily at the Trust Territory Headquarters, Saipan, Mariana Islands, and at district offices in the Mariana, Palau, and Yap Districts.

APPENDIXES



United States Department of the Interior

OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20240

Mr. Allen R. Voss
Associate Director, Civil Division
General Accounting Office
Washington, D. C. 20548

JAN 20 1970

Dear Mr. Voss:

We have reviewed with interest your draft report "Improvements Needed in the Financial Management System of the Trust Territory of the Pacific Islands." The Honorable Edward E. Johnston, High Commissioner, has discussed this report with me personally. He has assured me that positive action is now being taken to, first, obtain adequate control over assets and liabilities, and, secondly, to implement monthly reviews which will insure correction of all inadequacies pointed out in the GAO report. The Trust Territory's Director of Finance has been instructed to utilize the report as a guideline for significant improvements in the financial management of the Trust Territory.

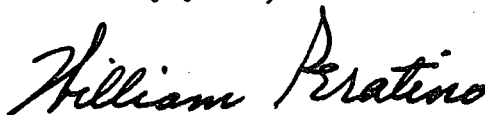
Further, we are informed that the following corrective action has taken place since the audit was performed:

- 1) All bank balances are reconciled with the exception of one District payroll account. This exception should be corrected in the near future.
- 2) Cash in Districts has now been reconciled with the General Ledger maintained in Headquarters.
- 3) Accounts with U.S. Treasury (Appropriated Funds) are now reconciled.
- 4) A system has been devised to analyze the unpaid obligations and insure validity.
- 5) The Appropriated Funds Report (Form 133) is now accurate.
- 6) Deficiencies relating to accrued Vouchers Payable have been corrected.

Even though these corrections have been made, we believe that the entire system needs modernizing. Negotiations are currently under way, and proposals have been received from reputable financial consulting firms, to conduct a systematic and comprehensive analysis of the total organization and program as it relates to the requirements for a unified financial management system; and to design and implement an accounting system that meets the requirements of the Territorial managers, the GAO, other regulatory agencies and the Department. We intend to submit this system for review and approval by the General Accounting Office within a time frame, geared to the contract, which you will be provided.

We appreciate the opportunity to review the draft report, and have found its recommendations useful as the basis for current and future plans and corrective action.

Sincerely yours,

A handwritten signature in black ink, reading "William Aratino". The signature is written in a cursive style with a large initial "W".

Acting Director of Survey and Review

PRINCIPAL OFFICIALS
 OF THE DEPARTMENT OF THE INTERIOR
 RESPONSIBLE FOR ADMINISTRATION
 OF THE ACTIVITIES
 DISCUSSED IN THIS REPORT

	<u>Tenure of office</u>	
	<u>From</u>	<u>To</u>
SECRETARY OF THE INTERIOR:		
Stewart L. Udall	Jan. 1961	Jan. 1969
Walter J. Hickel	Jan. 1969	Present
DIRECTOR, OFFICE OF TERRITORIES:		
Ruth G. Van Cleve	Mar. 1964	Jan. 1969
Elizabeth P. Farrington	Jan. 1969	Present
HIGH COMMISSIONER, TRUST TERRITORY OF THE PACIFIC ISLANDS:		
William R. Norwood	July 1969	Feb. 1969
Edward E. Johnston	May 1969	Present