COOK ISLANDS
GOVERNMENT

Cook Islands Audit Office

Excellence in Public Sector Auditing

Management Report for 30 June 2009 Financial Statements

Aid Management Division (AMD) Ministry of Finance & Economic Management

To:

Jim Armistead, Aid Manager

Distribution List:

Hon Henry Puna, Prime Minister
Hon Tom Marsters, Deputy Prime Minister
Hon Mark Brown, Minister for Finance and Audit
Richard Neves, Financial Secretary
Navy Epati, PSC Commissioner
Marie Francis, Chairperson of PERC

Date of Report: 26 August 2011

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1 Introduction

This report has been prepared to present to the management of the Aid Management Division, the report details the anomalies emerging from our audit procedures conducted on the systems and processes underlying the significant balances and transactions reported through the 30 June 2009 financial statements. This report provides a summary of:

- our audit opinion, and
- the significant issues arising from the audit.

The matters raised in this report are only those which came to our attention during the course of our audit and are not necessarily a comprehensive statement of all the weaknesses that exist or all improvements that might be made.

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

Management is responsible for implementing an internal control structure to maintain the reliability of the financial statements, safeguard assets and to mitigate risks in the entity. Because of the test nature and other limitations of an audit, it cannot provide an <u>absolute assurance</u> that there are no misstatements whether arising from fraud or error.

We must emphasise that:

- we did not examine internal controls other than to the extent necessary to determine the nature, extent and timing of our audit procedures;
- this report does not include all matters that came to our attention, but only those we regard as sufficiently important that they require management's attention;
- except as specifically stated, this report covers only the period of the financial statements and will not be updated to take into account any subsequent information or circumstances unless we are requested to do so.

AUDIT OPINION

We have issued a qualified opinion on the Aid Management Division's financial statements for the 30 June 2009 financial year.

Our qualification is issued in respect of prior period errors reported in equity at $313,556. This is made up of various corrections processed as part of the AMD's financial reporting improvement project. The corrections were however not processed retrospectively as required by IPSAS 3 – *Accounting Policies, Changes in Accounting Estimates and Errors* but rather corrected directly to equity in the current year.

2 Audit Findings

Following the recommendations contained in previous audit reports, AMD recruited the services of consultant Elizabeth Tommy in May 2011 to improve the internal controls, financial records and financial reporting systems around donor aid funds managed by AMD.

The resulting financial statements and supporting audit documentation submitted for audit showed a considerable improvement over previous years. Even more noteworthy is that eight of the previous year's nine significant audit findings have been completely cleared.

AMD are to be commended for their initiative in implementing the improvement project and the Audit Office encourages them to ensure that all improved internal controls, reporting processes and knowledge are embedded in the division following the completion of the project.

The Audit office would like to thank the division staff for the assistance provided during the course of the audit.

2.1 Prior period errors -non compliance with generally accepted accounting practice

Audit Findings

Prior period errors reported in equity at $313,556 relate to the corrections processed as part of the AMD's financial reporting improvement project. As a result of the project, entries were passed to clear stale cheques, unreconciled bank items and the redistribution of interest liabilities to the relevant Aid liability accounts. Aid assets and aid liabilities were also reconciled. These corrections were however not processed retrospectively as required by IPSAS 3 – *Accounting Policies, Changes in Accounting Estimates and Errors* but rather corrected directly to equity in the current year. Consequently this balance has been qualified due to non compliance with generally accepted accounting practise.

2.2 Cut off considerations – IPSAS 23 *Revenue from Non-Exchange Transactions*

Audit Findings

AMD receives the majority of its funding on a monthly basis from NZAID for specific projects that have been approved for completion. Currently, an asset is recognised when the cash is received and a corresponding liability is recognised until the funding is actually spent.

The subsequent release of the liability to revenue in accordance with IPSAS 23 should occur as the obligations under the funding agreement are fulfilled. AMD actually recognise income as the funding is spent on the project. However, consideration should be given to situations when spending does not equate to the fulfilment of the obligations under the funding arrangement. In which case, despite funds having been spent, the liability would not be extinguished.

Conversely, AMD should consider if at year end a project has been completed (i.e. obligations under the funding agreement have been fulfilled) but all suppliers have not yet been paid. In terms of the current accounting treatment, the project liability will remain until all suppliers have been paid. However, if at year end the project is complete as envisaged by the funding agreement, AMD has no aid liability but rather normal accounts payable to the suppliers. For example, if a project was funded to deliver an education project and at year end the project had been delivered but certain suppliers were still to be paid, revenue and a corresponding expense should be recognised along with a payable and the reduction in the aid liability.

These scenarios relate specifically to cut-off procedures and would only need to be considered at year end.

Risk Level	High
Recommendation	At year end AMD should consider the liabilities recognised and determine whether there is a performance obligation outstanding on the project to ensure the recognition of a liability is in accordance with IPSAS 23. If there is no further performance obligation then revenue should be recognised.
Ministry / Head of Ministry Response	

2.3 Recognition of Aid assets - IPSAS 23 *Revenue from Non-Exchange Transactions*

Audit Findings

In terms of IPSAS 23 an asset should be recognised when it is probable that the future economic benefits or service potential associated with the asset will flow to the entity. Currently AMD recognise the asset (cash from donors) on a cash basis i.e. when funding is received.

We interpret IPSAS 23 envisages the recognition of aid funding (assets) once the project is approved, which precedes the receipt of funds. Based on our discussions with management we understand the Forward Aid Programme (FAP) spans a 3 year period and we agree it would not be prudent to recognise revenue at this stage of approval. However it is our view that as the FAP is rolled down into smaller programmes and projects (yearly basis) the inflow of economic benefits becomes probable and that revenue should be recognised at this point.

Risk Level	High
Recommendation	At year end, AMD should consider whether there are any projects that have been approved in principal but for which funding has not yet been received. and that should be recognised as an asset in accordance with IPSAS 23
Ministry / Head of Ministry Response	

2.4 Bank reconciliations

Audit Findings

Our audit of bank reconciliations revealed the following anomalies:

- Bank reconciliation were not signed by the preparer and reviewer as required under the Cook Islands Government Financial Policies and Procedures Manual (CIGFPPM), Part B, Section 6.
- Some outstanding cheques per the year end bank reconciliations became stale in the subsequent period. However, we noted these cheques were cleared in subsequent periods.

We commend AMD's efforts to clear old reconciling items from bank reconciliations and for reconciling bank accounts and term deposits to bank statements, bank confirmations and aid project liability accounts.

Risk Level	Medium
Recommendation	The AMD Manager should review all bank account reconciliations and ensure that: • these are appropriately reconciled, outstanding items are supported by appropriate evidence and signed off by the preparer and reviewer in compliance with Part B, Section 6 of the CIGPPFM; • outstanding issues are followed up and cleared on a timely basis.
Ministry / Head of Ministry Response	

3 Conclusion

I would like to thank you and your staff for the assistance received during the audit.

The Public Expenditure Review Committee and Audit (PERCA) Act 1995-96, Section 32, paragraph 2, requires you to reply in writing within **14 days** to report your planned action to implement the recommendations contained in this report. Accordingly, we look forward to receiving your comments by **9 September 2011.** Forward all responses to:

The Director of Audit
PO Box 659
Avarua
Rarotonga
Fax: (682) 25 231
Email: perca@auditoffice.gov.ck

To conclude, the Cook Islands Audit Office is always looking at ways of improving our service and would appreciate any feedback you and your staff may wish to make. Please ensure that you complete and return the client survey questionnaire upon the completion of this audit.

Yours sincerely

Paul Allsworth
Director of Audit.

4 Definitions – Audit Opinion and Risk Rating

The definitions used to rate the risks of audit issues has been adopted from the Cook Islands Audit Office's risk criteria.

Risk Rating	Definition
High	Potential for unfavourable or noticeable negative impact on the organisation's objectives, income, expenditure, human resources and/or reputation. Management attention is required to ensure that the risk is managed in line with the organisation's objectives.
Medium	Potential for unfavourable or negative impact on the organisation's objectives, income, expenditure, human resources and/or reputation. Management needs to establish controls to address risk identified.
Low	Potential minor impact on the organisation's objectives, income, expenditure, human resources and/or reputation. Management needs to identify if there is a cost benefit in establishing increased controls.

Audit Opinion	Definition
Unqualified	An unqualified opinion is expressed when the auditor is satisfied in all material respects with the matters on which an overall conclusion is required to be drawn.
Qualified	A qualified opinion is expressed when either of the following circumstances exists: (a) there is a limitation on the scope of the auditor's examination; or (b) the auditor disagrees with the treatment or disclosure of a matter in the written assertion or set of assertions; and, in the auditor's judgement, the effect of the matter is or may be material. In order of severity (most to least), qualified audit opinions may take the following form: • Disclaimer – expressed when there is a limitation on the auditor's work as a result of the lack of audit evidence • Adverse – expressed when the results of a disagreement with management or a conflict between applicable financial reporting frameworks is significant and pervasive • Except For – expressed when an unqualified opinion is inappropriate because of a disagreement with management or a conflict between applicable financial reporting frameworks is not so significant and pervasive

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