

August 12, 2011

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Mr. Amon Tibon  
Managing Director  
Marshall Islands Development Bank

Dear Mr. Tibon:

In planning and performing our audit of the financial statements of the Marshall Islands Development Bank (MIDB) as of and for the year ended September 30, 2010 (on which we have issued our report dated August 12, 2011), in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, we considered MIDB's internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of MIDB's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of MIDB's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting. However, in connection with our audit, we identified, and included in the attached Appendix I, deficiencies related to MIDB's internal control over financial reporting and other matters as of September 30, 2010 that we wish to bring to your attention. Although we have included management's written responses to our comments contained therein, such responses have not been subjected to the auditing procedures applied in our audit of the basic financial statements and, accordingly, we do not express an opinion or provide any form of assurance on the appropriateness of the responses or the effectiveness of any corrective actions described therein.

We have also issued a separate report to the Board of Directors, also dated August 12, 2011, on our consideration of MIDB's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters.

The definition of a deficiency is also set forth in the attached Appendix I.

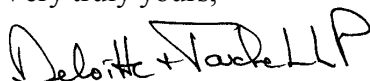
A description of the responsibility of management for establishing and maintaining internal control over financial reporting and of the objectives of and inherent limitations of internal control over financial reporting, is set forth in the attached Appendix II and should be read in conjunction with this report.

This report is intended solely for the information and use of the Office of the Auditor-General, management, others within the organization, and is not intended to be and should not be used by anyone other than these specified parties.

We will be pleased to discuss the attached comments with you and, if desired, to assist you in implementing any of the suggestions.

We wish to thank the staff and management of MIDB for their cooperation and assistance during the course of this engagement.

Very truly yours,



## SECTION I – CONTROL DEFICIENCIES

We identified, and have included below, control deficiencies involving MIDB's internal control over financial reporting as of September 30, 2010 that we wish to bring to your attention:

### 1. Lease Agreements

Comment: Existing lease agreements for two RMI Government tenants (the Office of Environmental Planning and Policy Coordination and the Immigration Division) are not signed while copies of another two lease agreements were not maintained on file.

Recommendation: We recommend that approved and signed lease agreements be timely executed and filed to validate supporting lease rental transactions.

### 2. Lease Income

Comment: We noted per a sublease agreement was not accrued from a tenant that there was an outstanding liability of \$97,300 for a prior year unpaid lease to be paid through quarterly installments of \$3,500. An audit adjustment was proposed to recognize a receivable and related lease rental income.

Recommendation: We recommend proper review, monitoring and recording of lease income based on underlying lease agreements.

### 3. Reconciliation of Opening Net Assets

Comment: Ending balance for net assets from the prior year audited financial statements did not agree to the opening balance in the amount of \$2,533. An audit adjustment was proposed to correct this unreconciled variance.

Recommendation: We recommend reconciliation of opening balances to prior year audited financial statements.

### 4. Written Agreement on Sample House

Comment: MIDB was able to provide a copy of the agreement relating to the sample house receivable of \$52,145 at September 30, 2010; however, we noted insufficient information on the agreement, i.e. agreed interest rate, amount of total receivable, etc. This matter was discussed in our previous letters for the audit of fiscal years 2008 and 2009.

Recommendation: We recommend that management require that all lending arrangements be supported by executed agreements detailing all pertinent information.

### 5. Deposits Pledged

Comment: Of four pledged deposit balances tested, we noted one item in the amount of \$11,212 where the deposit was established through a loan drawdown; however, no funds were actually disbursed or received. Furthermore, one item in the amount of \$6,351 returned a confirmed balance from the counterparty of \$nil. The recorded amount apparently resulted from erroneous postings. As the amount was considered immaterial to the financial statements, no audit adjustment was proposed.

Recommendation: We recommend that management require that all recorded pledged deposits are valid and represent deposits established through actual funds received.

## 6. Late filing of tax returns

Comment: We noted one instance of late filing for income taxes withheld whereby the withholding tax report for PPE 3/12/10 was not filed until 4/20/10, which resulted in a late penalty of \$138.

Recommendation: We recommend that timely remittance of taxes withheld to regulatory authorities occur.

## 7. Late Posting of Cash Receipts

Comment: Of eleven interest income cash receipts tested, we noted one cash receipt for Loan # 23040, dated 11/13/2009, that was not posted until 11/16/2009, and which resulted in the inaccurate calculation of loan interest.

Recommendation: We recommend timely posting of cash receipts for accurate calculation of interest income.

## 8. Construction-in-progress report

Comment: MIDB is currently in the process of constructing a satellite office in Wotje. A progress report for the Wotje building indicating the stage of completion could not be provided.

Recommendation: We recommend completion and filing of progress reports to properly document monitoring procedures and results at a specified period to provide a reliable basis for recorded expenditures.

## 9. Enhancement of IT Department

Comment: MIDB has an IT department staffed by two employees who also perform other functions in other departments. As MIDB does not have its own set of technically-equipped IT staff, the overall management of IT is highly dependent on assistance provided by an affiliate.

Certain reports may not be prepared timely due to MIDB's dependency on the availability of affiliate staff. Also, immediate corrective action may not be possible due to limited knowledge of MIDB IT staff.

The IT environment is a key area that MIDB should consider investing in but it appears that due to limited human technical resources, MIDB is maximizing the use of its employees in such a way that IT is not full-time task. This matter was discussed in our previous letters for the audit of fiscal years 2008 and 2009.

Recommendation: Management should assess the need to strengthen the IT department by either hiring additional staff or investing in education programs for existing staff.

## 10. Capitalization of Major Repairs

Comment: MIDB does not have a formal policy for capitalization of major repairs as fixed assets. This matter was discussed in our previous letters for the audit of fiscal years 2008 and 2009.

Recommendation: Management should consider formulating a policy relative to the capitalization of the cost of major repairs.

**APPENDIX I, CONTINUED**

**11. Loan files**

Comment: Our tests of loans receivable resulted in the following exceptions.

- a. Loan folders for the following loans cannot be located.

	Note	Date	Amount	9/30/10
#	#	<u>Opened</u>	<u>Borrowed</u>	<u>Balance</u>
1.	20670	05/12/05	\$ 5,097.00	\$ 0.01
2.	35224	11/06/09	\$ 4,082.00	\$ 2,173.64
3.	23737	03/31/09	\$ 25,460.00	\$ 5,162.03
4.	14704	08/29/01	\$ 14,904.73	\$ 819.19
5.	33565	05/09/08	\$ 75,000.00	\$ 67,720.71
6.	33828	06/13/08	\$ 30,498.00	\$ 16,925.37
7.	32416	01/10/08	\$ 30,497.98	\$ 4,686.81
8.	13305	08/21/00	\$ 7,202.83	\$ 6,965.74
9.	18999	11/14/03	\$ 13,789.00	\$ 8,880.65
10.	11674	03/25/99	\$ 27,810.57	\$ 15,516.88
11.	37772	06/02/10	\$ 3,065.00	\$ 2,850.53
12.	11167	12/31/99	\$ 5,966.59	\$ 5,927.18
13.	11166	12/31/99	\$ 3,763.93	\$ 3,402.13
14.	11073	12/31/99	\$ 7,474.83	\$ 7,474.83
15.	17572	09/25/03	\$ 510.00	\$ 84.19
16.	10960	12/31/99	\$ 3,875.86	\$ 414.48
17.	12478	02/02/00	\$ 3,544.68	\$ 3,159.32
18.	13982	05/28/01	\$ 15,268.80	\$ 13,059.46
19.	36746	03/11/10	\$ 1,026.00	\$ 718.31
20.	39305	08/04/10	\$ 3,053.00	\$ 2,727.87
21.	31064	05/21/07	\$ 22,040.00	\$ 7,627.50
22.	34597	09/29/08	\$ 15,604.00	\$ 14,336.35
23.	22449	11/07/08	\$ 24,408.00	\$ 19,236.34
24.	34183	08/08/08	\$ 75,000.00	\$ 65,282.88
25.	11033	12/31/99	\$ 65,474.24	\$ 65,474.24
26.	12838	12/31/99	\$ 26,428.03	\$ 16,227.72
27.	11035	12/31/99	\$ 97,281.25	\$ 97,281.25
28.	37186	04/22/10	\$ 10,183.00	\$ 8,486.59
29.	23732	03/31/09	\$ 25,346.00	\$ 6,971.72
30.	23337	02/12/09	\$ 35,181.74	\$ 32,388.26
31.	33629	05/16/08	\$ 15,040.00	\$ 15,040.00
32.	14459	08/07/00	\$1,800,000.00	\$ 24,972.62
33.	11013	12/31/99	\$ 109,368.72	\$ 109,368.72
34.	34171	08/01/08	\$ 116,150.00	\$ 116,150.00
35.	14988	01/02/02	\$ 50,000.00	\$ 36,848.70
36.	10621	12/31/99	\$ 17,154.20	\$ 3,284.37
37.	23864	04/09/09	\$ 75,000.00	\$ 73,277.00

**APPENDIX I, CONTINUED**

b. Inconsistent data per loan system against the loan folder details were noted as follows.

<u>#</u>	<u>Note #</u>	<u>Open Date</u>	<u>Loan Documentation Exceptions</u>
1.	17109	08/27/03	Request for loan drawdown is not available on file. Amount per loan agreement and promissory note is \$4,064.18 but shown as \$4,020 per loan system and amortization.
2.	29633	11/10/05	Loan date per loan agreement and promissory note is 10/18/05.
3.	22213	12/05/01	Request for loan drawdown is not available on file.
4.	14429	08/23/02	Request for loan drawdown is not available on file.
5.	27577	12/09/04	Loan dates per loan agreement and promissory note is 11/13/03. Request for loan drawdown is not available on file. Interest rate per loan documents is 14% but only 10% per loan system.
6.	36595	02/26/10	Loan date per loan agreement and promissory note is 2/24/10.
7.	38232	07/16/10	Loan agreement and promissory note are not dated. Strikethrough and amounts were handwritten per loan documents but are not counter-signed for the corrections.
8.	38277	07/21/10	Open date per promissory note is 7/16/10.
9.	24592	06/19/09	Note # per loan drawdown request form is 24671.
10.	23904	04/16/09	Note # per loan drawdown request form is 23897.
11.	10615	12/31/99	Note # per loan drawdown request form is 25067.
12.	24750	06/25/09	Open date per loan agreement and promissory note is 6/10/09.
13.	33729	06/02/08	Open & maturity date per promissory note is 5/23/08 and 5/22/12, respectively.
14.	37341	05/05/10	Maturity date per promissory note is 11/30/12 which is wrong based on the 18 months loan term from open date.

c. Loan number is not documented in the loan agreement and promissory notes.

Recommendation: We recommend proper documentation, filing and maintenance of loan documents to support valid claims against borrowers. Loan data should be documented accurately and consistently in the loan documents and the loan system to support correct calculation of loan amortization. We also recommend that loan numbers be specified in the promissory note and loan agreement to facilitate identification and reference. Review and monitoring should be implemented to timely correct deficiencies.

**SECTION II – DEFINITIONS**

The definition of a deficiency that is established in AU 325, *Communicating Internal Control Related Matters Identified in an Audit*, is as follows:

A *deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A deficiency in design exists when (a) a control necessary to meet the control objective is missing or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective would not be met. A deficiency in operation exists when (a) a properly designed control does not operate as designed, or (b) the person performing the control does not possess the necessary authority or competence to perform the control effectively.

## **MANAGEMENT'S RESPONSIBILITY FOR, AND THE OBJECTIVES AND LIMITATIONS OF, INTERNAL CONTROL OVER FINANCIAL REPORTING**

The following comments concerning management's responsibility for internal control over financial reporting and the objectives and inherent limitations of internal control over financial reporting are adapted from auditing standards generally accepted in the United States of America.

### **Management's Responsibility**

MIDB's management is responsible for the overall accuracy of the financial statements and their conformity with generally accepted accounting principles. In this regard, management is also responsible for establishing and maintaining effective internal control over financial reporting.

### **Objectives of Internal Control over Financial Reporting**

Internal control over financial reporting is a process affected by those charged with governance, management, and other personnel and designed to provide reasonable assurance about the achievement of the entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. Internal control over the safeguarding of assets against unauthorized acquisition, use, or disposition may include controls related to financial reporting and operations objectives. Generally, controls that are relevant to an audit of financial statements are those that pertain to the entity's objective of reliable financial reporting (i.e., the preparation of reliable financial statements that are fairly presented in conformity with generally accepted accounting principles).

### **Inherent Limitations of Internal Control over Financial Reporting**

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.