MARSHALL ISLANDS NATIONAL TELECOMMUNICATIONS AUTHORITY

(A COMPONENT UNIT OF THE REPUBLIC OF THE MARSHALL ISLANDS)

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH ASPECTS OF CONTRACTUAL AGREEMENTS AND REGULATORY REQUIREMENTS

YEAR ENDED SEPTEMBER 30, 2016

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INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH ASPECTS OF CONTRACTUAL AGREEMENTS AND REGUALTORY REQUIREMENTS

Board of Directors
Marshall Islands National Telecommunications Authority:

We have audited, 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, the financial statements of the Marshall Islands National Telecommunications Authority (NTA), which comprise the statement of net position as of September 30, 2016, the related statements of revenue, expenses and changes in net position, and of cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated June 5, 2017. In accordance with *Government Auditing Standards*, we have also issued our report dated June 5, 2017, on our consideration of NTA'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. No reports other than the reports referred to above and our Schedule of Findings and Responses related to our audit have been furnished to management.

In connection with our audit, we noted that NTA failed to comply with the terms, covenants, provisions, or conditions of their loan, grant, and security instruments as set forth in 7 CFR Part 1773, *Policy on Audits of Rural Utilities Service Borrowers*, §1773.33 and clarified in the Rural Utilities Service (RUS) policy memorandum dated February 7, 2014, insofar as they relate to accounting matters as enumerated below:

<u>Finding No. 1</u>

<u>Criteria:</u> Section 5.12, *TIER Requirement*, of the RUS Loan Agreements stipulates that NTA shall maintain a TIER rate of 1.5 from December 31, 2012 until maturity of the loans.

<u>Condition:</u> For the year ended September 30, 2016, NTA achieved a 0.89 average TIER ratio.

<u>Auditee Response:</u> Management agrees as to the reasons for noncompliance with the RUS loan TIER requirements. The problem of RUS loan obligations is not unique to NTA such that it has been raised on more than one occasion at the Micronesian President's Summit. The fact is that the market that NTA operates in is not only small, but it is also limited by the disposable income available to its customers to buy NTA's services. The fact is that over the last several years, the household debt in the RMI has increased substantially. The increased household debt has led to reduced consumer spending power, which has a direct adverse impact on NTA's ability to sell its services. While Management agrees as to the reasons for noncompliance with the RUS TIER requirements, it is the view of NTA Management that there is a real limitation on growth opportunities in the market unless the Company is able to sell its services outside of its traditional market. In the past NTA was able to provide satellite capacity to neighboring telecommunications companies that did not have fiber optic connectivity. As more countries in the region move to acquire fiber optic connectivity, NTA's opportunities have decreased. Management agrees that there is space to implement operating cost efficiencies but that it would still be difficult to achieve the 1.5 TIER rating requirement under the terms of the RUS loan.

Our audit was not directed primarily toward obtaining knowledge of such noncompliance. Accordingly, had we performed additional procedures, other matters may have come to our attention regarding NTA's noncompliance with the above-referenced terms, covenants, provisions, or conditions of the contractual agreements and regulatory requirements, insofar as they relate to accounting matters.

In connection with our audit, we noted certain matters regarding NTA's accounting and records to indicate that NTA did not:

- Maintain adequate and effective accounting procedures;
- Utilize adequate and fair methods for accumulating and recording labor, material, and overhead costs, arid the distribution of these costs to construction, retirement, and maintenance or other expense accounts;
- Reconcile continuing property records to the controlling general ledger plant accounts;
- Clear construction accounts and accrue depreciation on completed construction;
- Record and properly price the retirement of plant;
- Seek approval of the sale, lease or transfer of capital assets and disposition of proceeds for the sale or lease of plant, material, or scrap;
- Maintain adequate control over materials and supplies;
- Prepare accurate and timely Financial and Operating Reports;
- Obtain written RUS approval to enter into any contract for the management, operation, or maintenance of the borrower's system if the contract covers all or substantially all of the telecommunications system;
- Disclose material related party transactions in the financial statements, in accordance with requirements for related parties in generally accepted accounting principles;
- Record depreciation in accordance with RUS requirements (See RUS Bulletin 183-1, Depreciation Rates and Procedures);
- Comply with the requirements for the detailed schedule of deferred debits and deferred credits; and
- Comply with the requirements for the detailed schedule of investments.

These matters are enumerated below:

Finding No. 2

Criteria: Financial reporting necessitates adequate internal control in review and timely performance of bank reconciliations.

Condition:

1. Monthly bank reconciliations were not timely performed. The September 2016 BOG savings account reconciliation indicated $502,832 of invalid reconciling items that were corrected during the audit process. Of the total amount, $20,447 of employee advances were recorded twice and were improperly charged against an expense account.

Condition, Continued:

2. A September 2016 bank reconciliation indicated reconciling items that represented unrecorded expenses of $7,707; expenses of $10,935 improperly classified to a different expense account; and expenses of $6,182 improperly recorded as an expense instead of a reduction of accounts payable. These misstatements were corrected during the audit process.

3. A June 30 2016 bank reconciliation indicated reconciling items that represented expenses of $42,779 improperly classified to a different expense account; expenses of $29,224 improperly recorded as an expense instead of capital assets; and expenses of $13,616 improperly recorded as an expense instead of a reduction of accounts payable. These misstatements were corrected during the audit process.

4. An $8,162 check (#40826) was voided yet included in a September 2016 bank reconciliation as an outstanding check.

5. An unreconciled $65,158 cash account was noted as of September 30, 2016. As this amount was not considered material to the financial statements, no audit adjustment was proposed.

6. Stale checks of $45,025 were included in the September 2016 bank reconciliations. As this amount was not considered material to the financial statements, no audit adjustment was proposed.

Auditee Response: Throughout most of NTA's history, the Company has not had qualified accounting staff, which has resulted in substandard accounting practices. Due to a lack of qualified accounting staff, the Company has struggled to maintain acceptable accounting practices, including timely bank reconciliations. Management agrees with the finding and will implement correction actions to mitigate this problem. These corrective actions would include the hiring of a second qualified accountant to assist the accounting staff in making timely bank reconciliations, as well as to require the Accounting Department to provide proof to Management that bank accounts are being reconciled in a timely manner.

Finding No. 3

Criteria: Effective internal control over financial reporting necessitates that general ledger balances agree to supporting sub ledgers and that reconciliations be timely performed and independently reviewed.

Condition: During the audit process, we noted the following:

- The September 2016 accounts receivable aging report was not available and was not reconciled with the general ledger balance.

- The September 2016 Fixed Asset Register was not reconciled with general ledger balances and depreciation expense for the year was not timely recorded. Management subsequently identified capital assets ready for disposal in the amount of $19,698,269; however, these capital assets were not retired until this matter was raised and corrected during the audit process.

- Outstanding projects recorded in the Plant under Construction account were not timely monitored and completed projects were not timely transferred to capital assets in service. This matter was corrected during the audit process.

- The September 2016 customer deposits report was not available and was not reconciled with the general ledger balance. This matter was corrected during the audit process that resulted in a $41,000 variance. As this amount was not considered material to the financial statements, no audit adjustment was proposed.

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Auditee Response: Management agrees with this finding. As provided for under Finding No. 2 above, NTA Management will implement corrective actions to facilitate timely recording, monitoring, and financial reporting.

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This report is intended solely for the information and use of the Board of Directors, management, and the RUS and supplemental lenders and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

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June 5, 2017