

July 3, 2018

Mayor James Matayoshi
Rongelap Atoll Local Government
Republic of the Marshall Islands

Dear Mayor Matayoshi:

In planning and performing our audit of the financial statements of the governmental activities and each major fund of the Rongelap Atoll Local Government (RALGOV) for the year ended September 30, 2015, which collectively comprise RALGOV's basic financial statements and on which we have issued our report dated July 3, 2018, 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 RALGOV'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 RALGOV's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of RALGOV'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 RALGOV's internal control over financial reporting and other matters as of September 30, 2015 that we wish to bring to your attention.

We have also issued a separate report to RALGOV, also dated July 3, 2018 on our consideration of RALGOV'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.

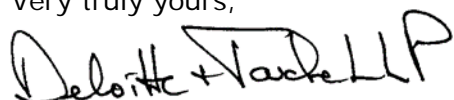
A description of the responsibility of management for establishing and maintaining internal control over financial reporting and of the objectives of and inherent limitations of internal control over financial reporting, is set forth in the attached Appendix II and should be read in conjunction with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

This report is intended solely for the information and use of management, the Council, others within the organization, and the Office of the Auditor-General 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 RALGOV 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 RALGOV's internal control over financial reporting as of September 30, 2015 that we wish to bring to your attention:

(1) Accounts Receivable - Others

Professional fees of \$18,000 for legal services were paid by RALGOV on behalf of a related party. Furthermore, RALGOV recognized a \$12,028 receivable from a related party for legal services in FY2014. These post-closing adjustments were recorded only when raised during the audit.

We recommend RALGOV perform timely reconciliation of intercompany balances.

(2) Capital Assets

Documentation supporting RALGOV performance of fixed asset inventories was not available. In addition, government-owned vehicles and equipment lack a RALGOV seal.

We recommend RALGOV perform periodic capital asset inventories and maintain documentation of such activity. RALGOV may consider tagging RALGOV seals on capital assets for appropriate identification.

(3) Interfund Balances

The interfund balance at December 31, 2014 resulted in a \$5,298 difference. Interfund balances were not timely reconciled. We recommend that interfund balances be periodically reconciled.

(4) Bank Reconciliation

Bank reconciliations included outstanding checks of \$140,248. Of that amount, 71% or \$99,680 was classified as stale checks.

<u>Fund</u>	<u>Outstanding Checks</u>	<u>Stale Checks</u>
General Fund	\$ 25,878	\$ 16,373
Payroll	15,472	8,701
Resettlement Project	40,731	19,401
Distribution	<u>58,167</u>	<u>55,205</u>
Total	\$ <u>140,248</u>	\$ <u>99,680</u>

Local Distribution Authority (LDA) bank reconciliation resulted in a difference of \$19,352. A post-closing adjustment was recorded by RALGOV when raised during the audit. Bank reconciliations were not timely reviewed to facilitate agreement with general ledger balances. Miscellaneous reconciling items of \$3,288 in the LDA account have been long outstanding without appropriate resolution.

We recommend management perform timely bank reconciliations and investigate long outstanding checks to determine an appropriate course of action.

SECTION I – CONTROL DEFICIENCIES, CONTINUED

(5) Expenditures

- General Fund:
 - a. Purchase Requisition no. 11753 covering nonresident workers tax of \$750 lacked a check and invoice on file.
 - b. Check no. 46679 issued for a death donation of \$3,000 lacked a copy of a death certificate to support the claim request.
 - c. The Mayor is entitled to an annual housing allowance of \$12,000. RMI Income Tax Act of 1989 Section 102h(iii) states that housing allowances in excess of \$9,000 are subject to tax. Documentation that supports RALGOV withheld and paid this was not on file.
 - d. JV2015-177 lacks a reviewer's signature to evidence independent review.
- Rongelap Bungalows:
 - a. Of 22 items tested, check nos. 1304 and 1329 with a total amount of \$5,878 lacked adequate quotations from qualified vendors to support compliance with the small purchase procurement requirement.
- Resettlement Phase One:
 - a. The following expenditures lack an independent reviewer's signature.

Purchase Requisition no. 10860	\$37,200
Purchase Requisition no. 11356	27,000
Purchase Requisition no. 11692	12,000
Purchase Requisition no. 11773	12,000
 - b. Check no. 08630 amounting to \$1,125 was paid to a RALGOV employee to be distributed to individual workers for stevedoring services. Acknowledgment from individual workers to support actual cash received was not on file.
 - c. An airfare expenditure of \$1,198 supported by TA 688 and check no. 8597 lacked a vendor invoice.
 - d. Check no. 08419 amounting to \$3,695 was recorded as travel expense for the purpose of canvassing and purchasing spare parts of equipment and RO units. The travel request lacks a signature from the appropriate Operations and Maintenance supervisor who is directly in charge of the department requiring the spare parts.
 - e. The following small purchases lack sufficient quotations from qualified vendors and adequate documentation justifying sole sourcing.

Check no. 08623	\$	3,313
Check no. 08648		3,040
Check no. 08404		2,373

SECTION I – CONTROL DEFICIENCIES, CONTINUED

(5) Expenditures, Continued

- f. JV2015-033 amounting to \$10,346 refers to settlement of spare parts purchases. Approved purchase requisitions and quotations from qualified vendors were not on file.

We recommend management provide adequate documents to support disbursement transactions.

(6) Payroll

The following were results of payroll test:

- a. One councilman was reclassified from a non-executive to an executive member resulted in increase of pay rate. Signed memo documenting this change was not available in the personnel permanent file.
- b. An employee salary was reduced by 50% while on leave. Signed documentation supporting approval of this action was not available on file.
- c. The pay rate of one employee did not agree with the signed personnel action form and payroll register. No written documentation was available on file to support the change.
- d. Three RALGOV employees were designated under the pearl farm project. However, these employees worked for a fish farming project operated by Aquaculture Technologies of the Marshall Islands (ATMI), an affiliated company. Adequate written agreement including terms and scope of RALGOV employees' participation with ATMI's operation were not available for examination.
- e. Salaries expense of \$7,416 was charged to a Federal grant under a subgrantee agreement but lacked timesheets. In addition, timesheets of several workers lack worker and supervisor signatures supporting independent review.

Written exception reports on job performance were not available. Thus, we were not able to verify appropriate monitoring of personnel working hours as an alternative basis for not preparing timesheets. Executive memo 2008-01 orders submission of exception reports on employee job performance on a monthly basis.

We recommend management revisit the payroll process and verify that payroll processing is adequately documented and properly filed.

(7) Allowance for Doubtful Accounts

Adequate documentation evidencing that RALGOV performs a periodic assessment of doubtful accounts was not on file. We recommend RALGOV perform assessments of doubtful accounts to determine the adequacy of allowance provision.

SECTION I – CONTROL DEFICIENCIES, CONTINUED

(8) Rongelap Bungalows

Miscellaneous revenues of Rongelap Bungalows include unidentified cash receipt. Revenues also include deposits of Rongelapese from Majuro addressed for their relatives in Rongelap atoll. However, adequate documentation supporting liquidation of deposits were not available.

Rongelap Bungalows did not record inventories at year-end. Cost of sales were not properly recognized. Store supplies were directly recognized as expenditure upon purchase without monitoring of unsold items at year-end.

We recommend RALGOV perform timely recording of cash receipts and reconciliation of bank accounts. In addition, we urge RALGOV adequately document and account deposits including liquidations for appropriate presentation in the financial statements. We also recommend RALGOV properly record inventories and recognition of cost of sales.

(9) Journal Entries

Manual journal entries lack preparer's and reviewer's signatures to support independent review. We recommend RALGOV adequately document preparation and review of journal entries.

(10) Distribution

Additional name was included in the original list of exposed Rongelapese. However, no adequate documentation was available to support approval of Executive Council to amend the original list. We recommend RALGOV adequately document approval process of any changes made on the original list of exposed Rongelapese.

(11) Investment

RALGOV investment in insurance policy of \$55,067 lacks documentation to support outstanding balance as of September 30, 2015. We were not able to verify the cash surrender value at September 30, 2015 and its possible impact in the financial statements. We recommend management obtain and file investment statements supporting cash surrender value of investment in insurance policy.

SECTION II - OTHER MATTERS

Our observations concerning other matters related to operations, compliance with laws and regulations, and best practices involving internal control over financial reporting that we wish to bring to your attention at this time are as follows:

(1) Segregation of Duties

RALGOV's current level of staffing limits the number of personnel available for accounting duties. Accordingly, appropriate segregation of duties is not always possible which may result in a weakness in internal controls, specifically in the role of the City Manager who has access to assets, has approving authority for disbursements, and also has full access to accounting records. To mitigate this weakness, a critical element in RALGOV's internal control system is the close

SECTION II - OTHER MATTERS, CONTINUED

(1) Segregation of Duties, Continued

involvement of management in the day-to-day operations and close review of accounting activities and financial reports.

Furthermore, certain duties of the Chief Accountant are incompatible such as processing checks for claims payments and distribution of such to payees. We recommend that management establish controls to require rotation of the check distribution function among RALGOV staff.

We encourage close involvement of management on a continuing basis and thorough review of accounting activities and financial reports as a means to maintain effective internal controls until a more structured control environment becomes cost effective.

(2) Sick Leave and Annual Leave Policy

There are currently no policies and procedures governing employee absences including sick leave and vacation leave. Employee paid time off is usually allowed by management. However, no policies are in place that establish limits and authorizations. Furthermore, mandatory vacation policy may be especially beneficial to RALGOV, being a small entity where certain employees may be handling incompatible duties. This would allow management to observe if there is any noticeable change while another person is performing the duties. We recommend that management establish vacation and sick leave policies.

(3) Amendments to Claims Trust Agreement

The original Trust Agreement was approved by the Government of the Marshall Islands (RepMar) through the Ministry of Finance and the Attorney General, as consistent with the Rongelap Agreed Minute, pursuant to Section 8 of the Article II of the Compact Section 177 Agreement. However, it appears that such approval was not obtained for the Amended Claims Trust Agreement. We recommend that management consult with its legal counsel as to the need to obtain approval of the Amended Trust from RepMar.

(4) Reporting

Management reports were not available. We recommend management consider preparing management reports that assist management and executive officers to monitor financial transactions and that support a relevant and well-informed decision making process.

(5) Local Noncompliance

RepMar Income Tax Code Section 105, requires employers to make a full, true and correct return within two (2) weeks following the preceding four (4) week period. RALGOV filed withholding taxes covering payperiod September 4 to 18, 2015 only on October 9, 2015, beyond the required deadline. This resulted in penalty of \$50 and interest charge of \$13.84.

We recommend RALGOV file withholding returns within the required date.

SECTION III – 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

RALGOV'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.