

**UTRIK ATOLL LOCAL GOVERNMENT**

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**INDEPENDENT AUDITORS' REPORTS ON  
INTERNAL CONTROL AND ON COMPLIANCE**

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**YEAR ENDED SEPTEMBER 30, 2004**

**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED UPON THE AUDIT PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

Mayor John Kaiko  
Utrik Atoll Local Government  
Republic of the Marshall Islands:

We have audited the financial statements of the governmental activities and each major fund of the Utrik Atoll Local Government (UALGOV) as of and for the year ended September 30, 2004, which collectively comprise UALGOV's basic financial statements, and have issued our report thereon dated November 14. We conducted our audit 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.

**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered UALGOV's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect UALGOV's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs (pages 8 through 15) as items 2004-1 through 2004-4.

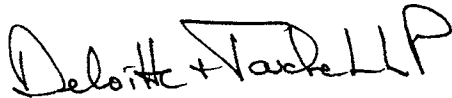
A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that the reportable conditions described above are material weaknesses.

## Compliance and Other Matters

As part of obtaining reasonable assurance about whether UALGOV's basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed one instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards* and which is described in the accompanying Schedule of Findings and Questioned costs as item 2004-5.

We also noted certain matters that we reported to management of UALGOV in a separate letter dated November 14, 2008.

This report is intended solely for the information and use of management, the Council, others within the entity, federal awarding agencies, and the cognizant audit and other federal agencies and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink that reads "Deloitte + Touche LLP". The signature is written in a cursive, stylized font.

November 14, 2008

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE APPLICABLE TO EACH MAJOR FEDERAL AWARD PROGRAM AND ON THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**

Mayor John Kaiko  
Utrik Atoll Local Government  
Republic of the Marshall Islands:

Compliance

We have audited the compliance of the Utrik Atoll Local Government (UALGOV) with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to its one major federal program for the year ended September 30, 2004. UALGOV's major federal program is identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs (pages 8 through 15). Compliance with the requirements of laws, regulations, contracts, and grants applicable to its one major federal program is the responsibility of UALGOV's management. Our responsibility is to express an opinion on UALGOV's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about UALGOV's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of UALGOV's compliance with those requirements.

In our opinion, UALGOV complied, in all material respects, with the requirements referred to above that are applicable to its Section 177 of the Compact of Free Association major program (CFDA # 15.875) for the year ended September 30, 2004. However, the results of our auditing procedures disclosed one instance of noncompliance with those requirements, which is required to be reported in accordance with OMB Circular A-133 and which is described in the accompanying Schedule of Findings and Questioned Costs as item 2004-6.

### Internal Control Over Compliance

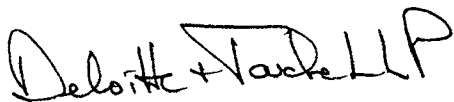
The management of UALGOV is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered UALGOV's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

### Schedule of Expenditures of Federal Awards

We have audited the financial statements of the governmental activities and each major fund of the Utrik Atoll Local Government (UALGOV) as of and for the year ended September 30, 2004, and have issued our report thereon dated November 14, 2008. Our audit was performed for the purpose of forming our opinions on the financial statements that collectively comprise UALGOV's basic financial statements. The accompanying Schedule of Expenditures of Federal Awards (pages 5 and 6) is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. This schedule is the responsibility of the management of UALGOV. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

This report is intended solely for the information and use of management, the Council, others within the entity, federal awarding agencies, and the cognizant audit and other federal agencies and is not intended to be and should not be used by anyone other than these specified parties.



November 14, 2008

**UTRIK ATOLL LOCAL GOVERNMENT**

Schedule of Expenditures of Federal Awards  
 Compact of Free Association, Public Law 99-239  
 Year Ended September 30, 2004

	<u>Total</u>	<u>Fund Balance</u>	<u>2004</u>	<u>Net</u>	<u>2004</u>	<u>Fund Balance</u>
	<u>Authorization</u>	<u>Beginning</u>	<u>Funds</u>	<u>Earnings</u>	<u>Funds</u>	<u>End of Year</u>
		<u>of Year</u>	<u>Received</u>	<u>on Funds</u>	<u>Expended</u>	
<u>U.S. Department of the Interior</u>						
<u>CFDA #15.875</u>						
Funds passed through the Republic of the Marshall Islands (RepMar):						
The Agreement between the Government of the United States and the Government of the Marshall Islands for the implementation of Section 177 of the Compact of Free Association	\$ 22,500,000	\$ 17,888,915	\$ -	\$ 1,968,834	\$ 2,289,795	\$ 17,567,954

Of funds received per the agreement between the Government of the United States and the Government of the Marshall Islands for the implementation of Section 177 of the Compact of Free Association, the cumulative amount of \$17,567,954 remains invested in the Utrik Claims Trust Fund, a permanent trust fund of UALGOV. Funds expended during the year ended September 30, 2004, are represented by fund manager fees of \$149,795, legal and consultancy fees of \$183,200, a transfer out to the General Fund of \$710,053 for general operations and a transfer out to the Utrik Local Distribution Authority of \$1,246,747 for distribution to the people of Utrik based on an approved distribution scheme.

See accompanying notes to schedule of expenditures of federal awards.

**UTRIK ATOLL LOCAL GOVERNMENT**

Schedule of Expenditures of Federal Awards  
Other U.S. Federal Grants  
Year Ended September 30, 2004

<u>CFDA#</u>	<u>Agency/Program</u>	Accrued (Deferred) Balance at October 1, 2003	Federal Cash Receipts and Adjustments	Federal Expenditures	Accrued (Deferred) Balance at September 30, 2004
	<u>U.S. Department of Agriculture</u>				
	Funds passed through RepMar:				
10.565	Commodity Supplemental Food Program	\$ -	\$ 98,979	\$ 98,979	\$ -
	Total U.S. Department of Agriculture	<u>-</u>	<u>98,979</u>	<u>98,979</u>	<u>-</u>
	<u>U.S. Department of the Interior</u>				
	Funds passed through RepMar:				
15.875	Local Finance Management Assistance Project	<u>5,948</u>	<u>5,948</u>	<u>-</u>	<u>-</u>
	Total U.S. Department of the Interior	<u>5,948</u>	<u>5,948</u>	<u>-</u>	<u>-</u>
		<u>\$ 5,948</u>	<u>\$ 104,927</u>	<u>\$ 98,979</u>	<u>\$ -</u>

The above federal expenditures are included within the expenditures of the General Fund of \$599,079.

See accompanying notes to schedule of expenditures of federal awards.

## UTRIK ATOLL LOCAL GOVERNMENT

Notes to Schedule of Expenditures of Federal Awards  
Year Ended September 30, 2004

### (1) Organization

The Utrik Atoll Local Government (UALGOV) is a governmental entity governed by its own Constitution. All significant operations of UALGOV are included in the scope of the OMB Circular A-133 audit (the "Single Audit"). The U.S. Department of the Interior has been designated as UALGOV's cognizant agency for the Single Audit. UALGOV is the subrecipient of funds received through Section 177 of the Compact of Free Association from the Republic of the Marshall Islands (RepMar). These funds must be distributed in accordance with the agreement concerning procedures for the implementation of United States economic assistance, programs and services provided in the Compact of Free Association between the Government of the United States and the Government of the Marshall Islands, dated July 31, 1986. It has been determined these funds are not subject to general U.S. federal requirements such as OMB's Circular A-87 and Circular A-102, but rather must be expended in compliance with local laws and regulations and Compact intent.

### (2) Summary of Significant Accounting Policies

#### Basis of Presentation

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of UALGOV and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.



**UTRIK ATOLL LOCAL GOVERNMENT**

Schedule of Findings and Questioned Costs  
Year Ended September 30, 2004

**Section I - Summary of Auditor's Results**

1. The Independent Auditors' Report on the financial statements of the governmental activities and each major fund expressed an unqualified opinion.
2. Reportable conditions in internal control over financial reporting were identified, all of which are considered to be material weaknesses.
3. One instance of noncompliance considered material to the basic financial statements was disclosed by the audit.
4. No reportable conditions in internal control over compliance with requirements applicable to the one major federal award program were identified.
5. The Independent Auditors' Report on compliance with requirements applicable to major federal award programs expressed an unqualified opinion.
6. The audit disclosed one finding required to be reported by OMB Circular A-133.
7. UALGOV's major program is as follows:

<u>Name of Federal Program or Cluster</u>	<u>CFDA Number</u>
Economic, Social and Political Development of the Territories and the Freely Associated States: Section 177 of the Compact of Free Association	15.875

8. A threshold of \$300,000 was used to distinguish between Type A and Type B programs as those terms are defined in OMB Circular A-133.
9. UALGOV did not qualify as a low-risk auditee as that term is defined in OMB Circular A-133.

**Section II - Financial Statement Findings**

<u>Reference Number</u>	<u>Findings</u>	<u>Refer Page #</u>
2004-1	Payroll Expenditures	9
2004-2	Non-payroll Expenditures	10
2004-3	Non-payroll Expenditures	12
2004-4	Non-payroll Expenditures	13
2004-5	Local Noncompliance	14

**Section III - Federal Award Findings and Questioned Costs**

<u>Reference Number</u>	<u>Findings</u>	<u>Refer Page #</u>
2004-6	Reporting	15

## UTRIK ATOLL LOCAL GOVERNMENT

### Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2004

#### Payroll Expenditures

##### Finding No. 2004-1

Criteria: Payroll processing should be established based upon internal control policies and procedures that would ensure accuracy of information and proper authorization of transactions.

Condition: UALGOV does not require personnel documentation. Employee data, including date of hiring, pay rate, job description and authorizations for hiring and salary upgrades, are not formally documented. Furthermore, there are no policies and procedures to ensure that employees actually work during the pay period. Timesheets, timecards or other means of reporting hours worked are not utilized. Instead, employees are paid a fixed rate of 80 hours bi-weekly. Furthermore, there are no policies and procedures governing compensated absences (sick and annual leave) nor a mechanism by which such can be monitored and reported.

Cause: The cause of the above condition is the lack of established internal control policies and procedures over payroll processing.

Effect: The lack of internal control policies and procedures over payroll processing, specifically on personnel documentation, employees work hours, sick leave or vacation leave, may result in abuse and misuse of government funds.

Recommendation: We recommend that management establish internal control policies and procedures over payroll processing to ensure that accurate payroll information is processed and authorized.

Prior Year Status: The lack of internal control policies and procedures over payroll processing was reported as a finding in the Single Audit of UALGOV for fiscal year 2003.

Auditee Response and Corrective Action Plan: Commencing October 1, 2008, all full-time employees are required to log-in on a payroll log sheet their time in and out on a daily basis. The secretary will do the summary of the two-week period covering a bi-weekly payroll. This will be the basis of hours worked for the said payroll. In case of employees in outer islands, the Acting Mayor is responsible to communicate to the Administration Office the hours worked of each employee for the payroll period.

**UTRIK ATOLL LOCAL GOVERNMENT**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

Non-payroll Expenditures

Finding No. 2004-2

**Criteria:** Expenditures should be supported by valid invoices, contracts, approved travel request forms for travel-related expenditures, and other relevant documentation.

**Condition:** Of \$470,692 in non-payroll expenditures of the General Fund, twenty-two (22) items were tested, totaling \$151,832, and the following were noted:

The following six (6) items were not supported by an invoice, contract or other relevant documentation to support the expenditure:

<u>Check#</u>	<u>Amount</u>
2869	\$ 9,000
3043	\$ 5,000
3057	\$ 14,030
3160	\$ 5,354
3198	\$ 2,085
3247	\$ 2,712

Furthermore, the following travel-related expenditures were not supported by approved travel authorizations:

<u>Check#</u>	<u>Amount</u>
3060	\$ 3,250
3061	\$ 3,250
3062	\$ 3,250
3101	\$ 3,750
3117	\$ 3,750
3186	\$ 6,750

Finally, UALGOV has not established a travel policy including applicable per diem rates.

**Cause:** The cause of the above condition is the lack of internal control policies and procedures over disbursements to ensure that payments are made for properly supported expenditures. Furthermore, UALGOV does not have an established policy governing travel-related expenditures.

**Effect:** The lack of internal control policies and procedures over processing of disbursements, including disbursements related to travel, may result in unauthorized expenditures and misappropriation of local government funds.

**Recommendation:** We recommend that management establish internal control policies and procedures over processing of disbursements to ensure that payments are made only for properly supported and authorized expenditures.

## UTRIK ATOLL LOCAL GOVERNMENT

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2004

### Non-payroll Expenditures

#### Finding No. 2004-2, Continued

Prior Year Status: The lack of internal control policies and procedures over disbursements was reported as a finding in the Single Audit of UALGOV for fiscal year 2003.

Auditee Response and Corrective Action Plan: Management is strictly implementing the procedure on processing of disbursements. All requests for payments have to be properly supported by purchase requisition, invoice, quotations and other pertinent documents. Also, all travel requests are to be supported by an approved travel authorization. Fiscal Officer ensures proper documentations are implemented.

## UTRIK ATOLL LOCAL GOVERNMENT

### Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2004

#### Non-payroll Expenditures

##### Finding No. 2004-3

Criteria: Expenditures should be supported by valid invoices, contracts, approved travel request forms for travel-related expenditures, and other relevant documentation.

Condition: Of \$332,995 in non-payroll expenditures of the Claims Trust Fund tested, the following exceptions were noted:

- 1) A \$43,200 payment to a consultant was not supported by an invoice or contract.
- 2) Liquidation of \$140,000 advance payments for legal fees were not monitored as no billings or invoices were available to support the payments.

Cause: The cause of the above condition is the lack of internal control policies and procedures over disbursements to ensure that payments are made only for supported expenditures.

Effect: The lack of internal control policies and procedures over processing of disbursements may result in unauthorized expenditures and misappropriation of local government funds.

Recommendation: We recommend that management establish internal control policies and procedures over processing of disbursements to ensure that payments are only made for supported and authorized expenditures.

Auditee Response and Corrective Action Plan: Management is strictly implementing the procedure on processing of disbursements. All requests for payments have to be properly supported by purchase requisition, invoice, quotations and other pertinent documents. Also, all travel requests are to be supported by an approved travel authorization. Fiscal Officer ensures proper documentations are implemented

## UTRIK ATOLL LOCAL GOVERNMENT

### Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2004

#### Non-payroll Expenditures

##### Finding No. 2004-4

Criteria: Distribution payments from the Local Distribution Authority (LDA) Fund should be made to the designated payee and be based on the number of eligible household members per approved Quarterly Distribution Listing.

Condition: Of seventy-six (76) distribution payments tested from the LDA Fund, the following exceptions were noted:

- 1) Forty-eight (48) payments (check #'s 1785, 1852, 1864, 1975, 2001, 2003, 2014, 2097, 2134, 2170, 2219, 2240, 2264, 2265, 2406, 2437, 2522, 2557, 2670, 2855, 2871, 2989, 3038, 3191, 3292, 3339, 3431, 3439, 3456, 3458, 3467, 3489, 3493, 3534, 3544, 3550, 3554, 3585, 3588, 3650, 3665, 3674, 3750, 3795, 3820, 3866, 3873 and 3885) showed no indication of the recipient signing as evidence of receipt of the check.
- 2) Five (5) payments (check #'s 2340, 2487, 2802, 2960, and 3227) were received by financial institutions or individuals other than the designated payee. An approved assignment agreement was not available to support these on-behalf payments.

Furthermore, we noted the absence of an updated Distribution Listing approved by the Council for twenty distribution payments tested.

Cause: The cause of the above condition is a lack of adequate controls over per capita distribution payments and the lack of an updated Quarterly Distribution Listing.

Effect: The effect of the above condition is the inability to determine whether the designated payee actually received their per capita distribution payments or whether the per capita distribution payments were processed in accordance with prescribed policies and procedures.

Recommendation: We recommend that management obtain written authorization and that such be kept on file before per capita distribution checks are released to other than the designated payee. In addition, we recommend that the designated payee, upon receipt, acknowledge all disbursements received in writing. Furthermore, we recommend that management update the Quarterly Distribution Listing prior to the calculation and issuance of per capita distribution payments.

Prior Year Status: The lack of adequate controls over the disbursement of per capita distribution payments was reported as a finding in the Single Audits of UALGOV for fiscal years 2002 and 2003.

Auditee Response and Corrective Action Plan: Corrective actions were made on this specific distribution finding. Management is implementing its policy on releasing of checks to the payee and to a representative. Written authorization and proper identification are required to be presented upon claiming of checks. Claimants are likewise required to sign on the distribution list and check stub as an acknowledgement. Distribution listings are also reviewed prior to printing of checks. The Secretary/Receptionist is responsible to release the checks and ensures that claimants signs on the check stub and distribution listings. She also files the authorization letters and other documents with the check stub to support the releasing of check to a representative.

## UTRIK ATOLL LOCAL GOVERNMENT

### Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2004

#### Local Noncompliance

##### Finding No. 2004-5

Criteria: Distributions from the Claims Trust Fund should be made in accordance with the underlying trust agreement. Specifically, section 4.2 (b) of the Claims Trust Fund agreement states that UALGOV shall retain not less than 30% but not more than 85% of the net income arising from the corpus of the Trust. Furthermore, section 5.2 of the Claims Trust Fund agreement states that an invasion of corpus shall not occur more frequently than once every three years.

Condition: During fiscal year 2004, net income of the Trust Fund was \$1,635,839, 70% of which amounts to \$1,145,087 (maximum amount available to be withdrawn from net income). However, total fiscal year 2004 draw downs amounted to \$1,956,800 which exceeded the allowable amount that may be drawn by \$811,713. Furthermore, as a result of the 2004 draw downs, the Claims Trust Fund reported an invasion of corpus in the amount of \$320,961. The previous invasion occurred in fiscal year 2002, which does not comply with the timeframe established per the trust agreement.

Cause: The cause of the above condition is the distribution of funds from the Claims Trust Fund in excess of the maximum amount allowed per the trust agreement and which ultimately resulted in an invasion of corpus.

Effect: The effect of the above condition is the possibility of noncompliance with the Claims Trust Fund agreement.

Recommendation: We recommend that UALGOV comply with the trust agreement concerning distributions made from the Claims Trust Fund.

Auditee Response and Corrective Action Plan: Management is reviewing the policies and procedures regarding this issue to come up with a sound solution so that the occurrence of this is minimized, if not totally, eradicated.

## UTRIK ATOLL LOCAL GOVERNMENT

### Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2004

#### Reporting

U.S. Department of the Interior  
Compact of Free Association Title I, Article VII, Section 177  
CFDA#15.875

#### Finding No. 2004-6

Criteria: In accordance with OMB Circular A-133, Subpart C, Auditee Responsibilities, Section 320, single audits shall be completed and the data collection form be submitted within the earlier of 30 days after receipt of auditors' report or nine months after the end of audit period, unless a longer period is agreed to in advance by the cognizant or oversight agency for audit.

Condition: UALGOV is not in compliance with the single audit nine-month deadline.

Cause: The cause of the above condition was the lack of adequate internal controls to ensure that financial reporting deadlines are complied with.

Effect: The effect of the above condition is the possibility of disallowed costs.

Recommendation: We recommend that UALGOV establish procedures to ensure compliance with OMB Circular A-133 reporting deadline.

Prior Year Status: The lack of compliance with the Single Audit reporting deadline was reported as a finding in the Single Audit of UALGOV for fiscal year 2003.

Auditee Response and Corrective Action Plan: Management is committed to comply with the audit deadline and implemented procedures to correct this finding. Fiscal Officer is designated to ensure submission of all audit requirements on deadline date.



## **UTRIK ATOLL LOCAL GOVERNMENT**

### **Unresolved Prior Year Findings and Questioned Costs Year Ended September 30, 2004**

#### Questioned Costs

There are no unresolved questioned costs from prior year Single Audits of UALGOV.

#### Unresolved Findings

The status of unresolved prior year findings is discussed within the Schedule of Findings and Questioned Costs section of this report (pages 8 through 15).