

November 18, 2016

Ms. Maybelline A. Bing
Secretary of Finance
Republic of the Marshall Islands

Dear Secretary Bing:

In planning and performing our audit of the financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Republic of the Marshall Islands (RepMar) as of and for the year ended September 30, 2015 (on which we have issued our report dated November 18, 2016), 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 RepMar'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 RepMar's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of RepMar'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 RepMar'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 Her Excellency Hilda C. Heine, also dated November 18, 2016 on our consideration of RepMar'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.

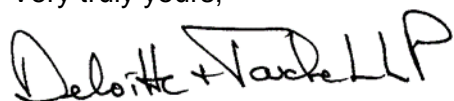
A description of the responsibility of management for establishing and maintaining internal control over financial reporting and of the objectives of and inherent limitations of internal control over financial reporting, is set forth in the attached Appendix II and should be read in conjunction with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

This report is intended solely for the information and use of management, the Honorable Members of the Nitijela, 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. However, this report is also a matter of public record.

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 RepMar for their cooperation and assistance during the course of this engagement.

Very truly yours,



SECTION I – DEFICIENCIES

We identified the following deficiencies involving RepMar’s internal control over financial reporting as of September 30, 2015 that we wish to bring to your attention:

Petty Cash Imprest Accounts

At September 30, 2015, the Ministry of Finance recorded twenty-nine petty cash imprest accounts aggregating \$24,995, including two non-existent accounts (G/L A/c # 950000-11044, Ebeye Thyroid, \$7,585 and G/L A/c # 950000-12040, Sea Patrol, \$4,100) identified in prior audits. As these two accounts total \$11,685, which is an amount not considered material to the financial statements, no audit adjustment was proposed. We recommend that the Ministry of Finance examine all recorded petty cash imprest accounts and assess their validity. This matter was discussed in our previous letters to management for the audits of fiscal years 2007 through 2014.

Embassy Imprest Accounts

At September 30, 2015, the Ministry of Finance recorded embassy imprest accounts, for which the September 2015 imprest account reconciliations reported unknown variances as follows:

<u>Embassy</u>	<u>GL A/c #</u>	<u>Imprest Fund</u>	<u>Unknown Shortage</u>
Fiji	950000-12010	\$ 69,700	\$ (33,172)
UN Mission	950000-12030	\$ 100,000	\$ (16,781)
Washington, D.C.	950000-12035	\$ 50,000	\$ (12,595)
Arkansas Consulate	950000-12045	\$ 20,000	\$ (1,335)
Korea	950000-12055	\$ 25,000	\$ (6,005)
Honolulu Consulate	950000-12070	\$ 10,000	\$ (1,089)

Additionally, the following exceptions were noted:

- The Fiji Embassy September 2015 reconciliation included the following reconciling items:
 - \$34,651 of disallowed amounts pertaining to fiscal years 2013 and 2014.
- The Japan Embassy September 2015 reconciliation included the following reconciling items:
 - \$18,983 unrecorded deposit from prior year.
 - \$79,582 unknown deposits.
 - \$106,159 disallowed amounts.
 - \$484,179 unknown withdrawals.
 - \$76,094 unknown advances to the embassy.
 - \$103,175 unknown variances.

Advances of \$170,000 to the Japan Embassy were not supported by a Cabinet Minute.

Embassy Imprest Accounts, Continued

- The UN Mission September 2015 reconciliation included \$140,947 in unrecorded grant receipts, including \$79,492 identified in prior years. Additionally, the reconciliation included the following reconciling items:
 - Four missing checks (#s 10286, 10400, 10406 and 10432) for \$5,525 each.
 - \$26,817 overpayment to the Mission in fiscal year 2011 (paid twice on June 30, 2011 and again on July 15, 2011), which has not been offset against subsequent reimbursement requests.
 - \$195,502 disallowed amounts, of which \$137,451 is over a year old.
- The Korea Embassy September 2015 reconciliation included \$20,455 in disallowed amounts.

We recommend that the Ministry of Finance require monthly reconciliations of the imprest accounts and documentation and resolution of reconciling items. We further recommend that unknown variances be timely investigated. This matter was discussed in our previous letters to management for the audits of fiscal years 2010 through 2014.

Bank of Marshall Islands (BOMI) Imprest Accounts

At September 30, 2015, the Ministry of Finance recorded cash of \$22,268 and \$5,042 for the Asian Development Bank Loan # 1791 Imprest Account (GL A/c # 800405-12062) and for the MOE/PEC Imprest Account (GL A/c # 950000-11081), respectively. Bank confirmation responses obtained in prior audits indicated that both accounts had been closed; however, we were unable to ascertain the final disposition of the remaining account balances. We recommend that the Ministry of Finance determine the final disposition of these account balances and verify whether such were deposited to RepMar's General Fund bank account. This matter was discussed in our previous letters to management for the audits of fiscal years 2008 through 2014.

Ministry of Education Maintenance Account

The Ministry of Education continues to maintain and use a checking account that is not recorded by RepMar. Fiscal year 2015 bank statements and account reconciliations for such were not available for examination. We recommend that the Ministry of Finance record and require reconciliation of all bank accounts of RepMar's ministries and agencies that are not authorized by enabling legislation to have separate financial reporting. This matter was discussed in our previous letters to management for the audits of fiscal years 2010 through 2014.

Miscellaneous Receivables

At September 30, 2015, the Ministry of Finance recorded the following receivables that were not supported by underlying subsidiary ledgers:

<u>G/L A/c #</u>	<u>G/L Balance</u>
100100-24100	\$ 401,497
950000-24100	\$ (1,566)

No audit adjustments were proposed for the above accounts as these receivables were offset by a corresponding allowance for uncollectible accounts. We recommend that the Ministry of Finance reconcile these receivables and determine their ultimate collectability. This matter was discussed in our previous letters to management for the audits of fiscal years 2007 through 2014.

Fixed Assets Register

The fixed assets register (FAR) as of September 30, 2015 included the following exceptions:

- Location of one item (Hitachi loader ZW250 270338) could not be determined by Ministry of Finance staff due to inadequate information in the FAR.
- \$289,500 acquisition cost for a purchased firetruck was not supported by a vendor invoice.
- Acquisition cost for one addition (oxygen generating equipment) is understated by \$1,243.

Additionally, an addition (IDMP # 90, hospital aircon unit) replaced an old asset; however, we were unable to verify that the FAR was updated for this disposal due to lack of asset disposal documentation.

Based on our observation and inquiry with accounting department personnel, we noted that asset useful lives used in depreciation are estimated without consultation with other RepMar personnel who may provide a more accurate estimate.

We recommend that management establish policies and procedures pertaining to timely and accurate update of the fixed assets register for additions and disposals. We further recommend that the accounting personnel consult, when appropriate, with Ministry of Public Works personnel when estimating asset useful life, which should be periodically re-assessed and adjusted as appropriate. This matter was discussed in our previous letters to management for the audits of fiscal years 2011 through 2014.

Accounts Payable

At September 30, 2015, accounts payable recorded by the grants fund included unknown balances of \$43,718 that have been carried forward from prior years. We recommend that management investigate and resolve these amounts.

Labor Bonds Payable

At September 30, 2015, the following labor bonds payable accounts had debit balances:

<u>GL A/c #</u>	<u>Debit Balance</u>
100100-50030	\$ 3,645
200319-50030	\$ 1,500

The debit balances appear to result from the issuance of labor bond refunds for which a corresponding payable could not be identified. No audit adjustment was proposed as the above amounts were not considered material to the financial statements. We recommend that the Ministry of Finance perform regular reconciliations of labor bonds payable accounts and require that refunds be issued based on valid labor bonds recorded. This matter was discussed in our previous letters to management for the audits of fiscal years 2010 through 2014.

Cancelled Checks

At September 30, 2015, unclaimed checks held at the Treasury Department included certain checks which had been cancelled and adjusted to general fund revenue in prior years. We recommend that the Accounting Department recall cancelled checks from the Treasury Department for review and proper disposition. This matter was discussed in our previous letters to management for the audits of fiscal years 2012 through 2014.

Unidentified Income

At September 30, 2015, the Ministry of Finance recorded a \$26,684 debit balance in unidentified income (G/L A/c # 100100-07225). We were informed that such pertained to processing errors in the 4gov Accounts Payable module. We recommend that management investigate the nature of this account and correct noted errors. This matter was discussed in our previous letter to management for the audit of fiscal year 2014.

Payroll Expenditures

Tests of payroll expenditures resulted in the following exceptions:

- For the pay period ended May 2, 2015, employee # 222072 was paid for leave hours taken February 23 to March 6, 2015. The associated leave application was approved over a month later on April 29, 2015.
- Personnel action form for employee # 42003 supporting hourly rate paid for the pay period ended July 25, 2015 was not available for examination.
- Approved timesheet for employee # 61372 for the pay period ended October 4, 2014 indicated 72 regular, 8 overtime and 8 holiday hours; however, 80 regular hours and double time for holiday were paid.
- Delays in processing personnel action forms (PAF) for employee #s 61206, 206848 and 210744 resulted in retroactive payments to these employees for the pay periods ended November 15, 2014, October 18, 2014 and February 7, 2015, respectively.
- The PAF for employee # 90517 was received by the payroll department seven pay periods after the effective date, resulting in a retroactive payment of \$9,997, which was understated by \$25 due to an erroneous calculation.
- PAFs authorized pay increases for the following employees, resulting in retroactive payments:

<u>Employee #</u>	<u>PAF Effective Date</u>	<u>PPE Paid</u>
65592	01/13/2014	04/18/2015
31017	10/01/2014	2/21/2015
47518	10/01/2014	6/27/2015

- The following employees were underpaid due to errors in retroactive pay calculations:

<u>Employee #</u>	<u>PPE</u>	<u>Error</u>
88191	04/18/2015	\$ 43
93087	07/11/2015	\$ 4,368

- Approved timesheet for employee # 55949 for the pay period ended December 27, 2014 erroneously indicated 16 holiday hours.
- Approved timesheet for employee # 62489 for the pay period ended December 27, 2014 indicated 64 regular and 16 holiday hours; however, 72 annual leave and 8 holiday hours were paid.

We recommend that management establish policies and procedures to facilitate: (1) the veracity of timesheets, payroll processing and the overall approval process; and (2) the timely processing of personnel action forms. This matter was discussed in our previous letters to management for the audits of fiscal years 2013 and 2014.

Gross Receipts Tax

No penalty was assessed for a quarter ended 12/31/2014 tax return that was filed and paid (cash receipt # 519604) in May 2015. We recommend that the Ministry of Finance assess penalties on delinquent tax returns, as required by 48 MIRC Chapter 1, Income Tax Act of 1989.

Verification of Daily Deposits

Section 4.7 of the Ministry of Finance's Standard Operating Procedures manual requires the Accounting Department to verify deposits against cash receipts on a daily basis, however, such is not being carried out.

SECTION II – OTHER MATTERS

We also identified, and have included below, other matters involving RepMar's internal control over financial reporting as of September 30, 2015 that we wish to bring to your attention:

Unclaimed Property

On November 28, 2002, the Secretary of Finance received \$93,737, representing unclaimed customer accounts, from Bank of Hawaii due to closure of its Majuro branch. Such is recorded as a liability within G/L Acct # 300430-50080. In accordance with Marshall Islands Revised Code, Title 30 Chapter 5, *Disposition of Unclaimed Business Interests*, any unclaimed property which escheats to RepMar under the provisions of the law, shall be deposited into an Abandoned Business Interests account within the Unclaimed Business Property Fund. The Secretary of Finance is required to publish the existence of such property within one year after receipt.

As of September 30, 2015, the Secretary of Finance had not published the existence of such property in the local newspaper. We recommend that the Ministry of Finance publish the existence of escheated property in accordance with the enabling legislation. This matter was discussed in our previous letters to management for the audits of fiscal years 2003 through 2015.

General Ledger Accounts

Supervisory review and approval of the creation of new general ledger accounts is not consistently documented. We recommend that the Ministry of Finance establish policies and procedures relative to creation of new general ledger accounts. This matter was discussed in our previous letters to management for the audits of fiscal years 2011 through 2013.

Additionally, RepMar's investment in the Pacific Islands Development Bank is recorded in GL A/c # 100100-15040 and the name of the account is "Trust Fund Acct D-FHB". We recommend that management consider updating the name of the account. This matter was discussed in our previous letters to management for the audits of fiscal years 2013 and 2014.

Cash Receipts

Cash receipts are not consistently issued for contributions received via check, resulting in inaccurate and untimely recording. We recommend that management establish policies and procedures requiring issuance of cash receipts for such contributions, to facilitate accurate and timely recording. This matter was discussed in our previous letter to management for the audit of fiscal year 2014.

Payroll Checks

There is no established policy with respect to minimum check amount and unclaimed payroll checks. Consequently, numerous payroll checks for nominal amounts have remained unclaimed for a number of years. Furthermore, payroll checks older than six months are not returned by the ministries/offices to the Treasury Department for proper disposition. We recommend that management consider establishing policies with respect to minimum check amount and unclaimed payroll checks. This matter was discussed in our previous letter to management for the audit of fiscal year 2014.

Annual Leave

Annual leave hours available at the end of payroll # 1, which is around mid-December, is the basis for rolling over employee leave hours each year. This is inconsistent with the December 31 cutoff date as per Part VI, paragraph 56(2) of the Public Service Regulations, which state that the maximum number of leave that can be accumulated at the end of the leave year, December 31, is 208 hours. Furthermore, fiscal year 2015 rollover of annual leave hours occurred after payroll # 2 (ended 12/27/2014) and as a result, all employees were allotted an additional 8 hours without documented approval.

We were also informed that application for annual leave of 24 hours or less was not required. This is inconsistent with Public Service Instruction No. 2010/01, which states that all annual and sick leave hours recorded in the time-clocks and timesheets without prior approval shall be treated as leave without pay or absence without leave.

We recommend that management require compliance with all Public Service Regulations.

Kwajalein Landowner Payments

Evidence of Secretary of Finance's review and approval of first quarter Kwajalein landowner payments was not available.

4gov Org and Account #s

Org and account #s were established in the 4gov accounting system which differentiate Compact, other federal and non-federal grant revenues. We noted incorrect use of such, resulting in inaccurate labeling/description of recorded grant revenues. We recommend that the Ministry of Finance verify the accuracy of the org and account #s used when recording grant revenues. This matter was discussed in our previous letter to management for the audit of fiscal year 2014.

Access Control of End-User

The Payroll Director is configured to be a super user in the Unix environment because he is also a backup staff of the IT department. The user is able to make unauthorized modifications to the data and system configurations, which will affect the consistency and integrity of the information system operation. We recommend a review of the activities logs of super users, including the Payroll Director, occur to monitor EDP environment activities. This matter was discussed in our previous letters to management for the audits of fiscal years 2009 through 2014.

Enhancement of Network Security

There is a lack of control of network activities resulting in a higher chance of data integrity and confidentiality issues. For example, hackers may be able to access the network and modify/view sensitive information. Therefore, network vulnerability testing and/or network penetration testing should be performed at least annually to identify control weaknesses. This matter was discussed in our previous letters to management for the audits of fiscal years 2009 through 2014.

IT Policies and Procedures

No information technology policies and procedures have been adopted with respect to use of information technology and general security, data ownership and access rights. We recommend that management consider adopting such policies and procedures. This matter was discussed in our previous letter to management for the audit of fiscal year 2014.

SECTION III – DEFINITIONS

The definition of a deficiency 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

RepMar'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.