

June 10, 2009

Mr. Jefferson Barton  
Secretary of Finance  
Republic of the Marshall Islands

Dear Secretary Barton:

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, 2008 (on which we have issued our report dated June 10, 2009), 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, 2008 that we wish to bring to your attention.

We have also issued a separate report to the President, His Excellency Litokwa Tomeing, also dated June 10, 2009, 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.

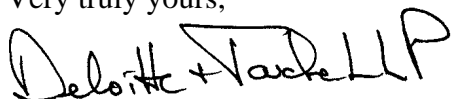
A description of the responsibility of management for establishing and maintaining internal control over financial reporting and of the objectives of and inherent limitations of internal control over financial reporting, is set forth in the attached Appendix II and should be read in conjunction with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

We identified the following control deficiencies involving RepMar's internal control over financial reporting as of September 30, 2008:

1. No offsite facility

Backup tapes are stored in the server room, which is located in the same building as the Ministry of Finance. Accordingly, historical data could be destroyed if a natural disaster (e.g. fire, flooding) occurred in the Capital Building and thus prevent RepMar from operating subsequent to a natural disaster. We recommend that the Ministry of Finance consider safeguarding of backup tapes including offsite storage.

2. Access Control of End-User

The current payroll director (employee # 205663) is configured to be a super user in the UNIX environment. The user is able to make unauthorized modifications to the payroll data and system configurations, which will affect the consistency and integrity of the information system operation. We recommend that the Ministry of Finance switch the payroll director's user profile from a super user to a regular user.

3. User Access Review

The User Access Profile is not reviewed regularly resulting in the possibility of access privileges being improperly assigned. For example, terminated employee accounts may not be deleted from the system thus allowing access to the system by these employees to modify and view sensitive data after they were terminated. In addition, user profiles of employees who have been transferred or promoted may not be up-to-date. As a result, these employees may have excess access privileges, which could allow them to have unauthorized access to other modules. We recommend that the Ministry of Finance establish policies and procedures to review user access profiles on a periodic basis to ensure access privileges are properly assigned.

## 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, 2008 that we wish to bring to your attention:

1. Petty Cash Imprest Accounts

At September 30, 2008, the Ministry of Finance recorded twenty-seven petty cash imprest accounts, aggregating \$23,995. We selected one item for testing (G/L Acct # 950000-11044, Ebeye Thyroid Petty Cash) in the amount of \$7,585; however, it was determined that this petty cash account no longer existed. As the amount of \$7,585 was 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 determine whether such represent valid petty cash accounts.

**APPENDIX I, CONTINUED**

2. Miscellaneous Receivables

At September 30, 2008, the Ministry of Finance recorded the following receivable balances that were not supported by underlying subledgers:

<u>G/L Acct #</u>	<u>G/L Balance</u>	<u>G/L Acct #</u>	<u>G/L Balance</u>	<u>G/L Acct #</u>	<u>G/L Balance</u>
100100-20200	\$ 32,543	100100-24012	\$ 2,367	100100-24060	\$ 13,875
100100-22005	\$ 33,419	100100-24020	\$ 12,053	100100-24090	\$ 15,467
100100-22020	\$ 18,956	100100-24027	\$ 1,298	100100-24100	\$ 216,677
				950000-24100	\$ (1,566)

No audit adjustments were proposed for the above items as these receivable balances were offset by an allowance for uncollectible accounts in the amount of \$398,392. We recommend that the Ministry of Finance reconcile these receivable accounts and determine their ultimate collectability.

3. Allotment Liabilities

At September 30, 2008, the Ministry of Finance recorded various payroll allotment liability accounts, totaling \$978,057, pertaining to the last payroll period of the fiscal year whereas the actual amount withheld and payable amounted to \$970,704, resulting in a variance of \$7,353. As this amount was not considered material to the financial statements, no audit adjustment was proposed; however, we recommend that the Ministry of Finance reconcile these payroll allotment liability accounts on a periodic basis.

4. MIDB Receivable

At September 30, 2008, the Ministry of Finance recorded a receivable from the Marshall Islands Development Bank (MIDB) in the amount of \$2,907,902, which was confirmed by MIDB at year end. However, upon examination of the accrued interest receivable calculation, it was determined that the accrued was overstated by \$5,382. As this amount was not considered material to the financial statements, no audit adjustment was proposed; however, we recommend that the Ministry of Finance recompute interest income pertaining to the MIDB receivable on a periodic basis.

5. Travel Advances

At September 30, 2008, the Ministry of Finance recorded travel advances within the general ledger that were not reconciled to the supporting DILOG subledger. Details of these are as follows:

<u>G/L Acct #</u>	<u>G/L Balance</u>	<u>Subledger Balance</u>	<u>G/L Balance</u>	<u>G/L Acct #</u>	<u>Subledger Balance</u>
100100-28010	\$ 14,100	\$ 38,298	410102-28010	\$ 2,691	\$ -
200090-28010	(340)	1,335	410110-28010	(17,141)	835
200330-28010	(302)	-	410150-28010	4,925	38,958
200332-28010	(614)	520	410170-28010	(358)	318
200340-28010	(320)	402	510100-28010	(122)	1,522
200515-28010	(710)	-	600350-28010	44,840	35,008
410100-28010	<u>(13,309)</u>	<u>-</u>	700360-28010	<u>(1,772)</u>	<u>1,700</u>
	\$ <u>(1,495)</u>	\$ <u>40,555</u>		\$ <u>33,063</u>	\$ <u>78,341</u>

## APPENDIX I, CONTINUED

As summarized above, the total general ledger balances for travel advances did not agree to the supporting DILOG subledger, resulting in an unreconciled variance of \$87,328. No audit adjustments were proposed as this amount was not considered material to the financial statements. We recommend that the Ministry of Finance reconcile travel advances to the supporting DILOG subledger on a monthly basis.

### 6. Accounts Payable

At September 30, 2008, the Ministry of Finance recorded accounts payable within the general ledger that was not reconciled to the supporting DILOG subledger. Details of these are as follows:

<u>G/L Acct #</u>	<u>Unadjusted G/L Balance</u>	<u>Proposed Adjustments</u>	<u>Adjusted G/L Balance</u>	<u>Subledger Balance</u>	<u>Variance</u>
100100-50010	\$ 538,934	\$ 56,447	\$ 595,381	\$ 553,959	\$ 41,422
410100-50010	(161,485)	313,545	152,060	144,193	7,867
410102-50010	22,950	59,030	81,980	64,201	17,779
410110-50010	(21,147)	46,388	25,241	18,583	6,658
410150-50010	(14,280)	27,519	13,239	13,470	(231)
510100-50010	(2,565,391)	2,827,274	261,883	223,714	38,169
510110-50010	229,080	28,981	258,061	259,362	(1,301)
600350-50010	445,207	4,335	449,542	448,705	837
700360-50010	1,142	-	1,142	1,139	3
700370-50010	(1,158,346)	1,424,470	266,124	236,929	29,195
200090-50010	1,011	-	1,011	1,089	(78)
200330-50010	(145)	-	(145)	-	(145)
200332-50010	(1,660)	-	(1,660)	3,763	(5,423)
200515-50010	<u>4,300</u>	<u>-</u>	<u>4,300</u>	<u>4,257</u>	<u>43</u>
	<u>\$ (2,679,830)</u>	<u>\$ 4,787,989</u>	<u>\$ 2,108,159</u>	<u>\$ 1,973,364</u>	<u>\$ 134,795</u>

The proposed audit adjustment of \$4,787,989 comprised of 2008 expenditures, totaling \$4,616,862, incorrectly recorded in 2007, \$121,127 that represented double posting of vendor check payments recorded as miscellaneous revenues, and \$50,000 that represented a check payment to a vendor that was incorrectly reversed. The remaining unreconciled variance of \$134,795 was not considered material to the financial, thus no audit adjustment was proposed. We recommend that the Ministry of Finance reconcile accounts payable to the supporting DILOG subledger on a monthly basis.

### 7. Bank of Marshall Islands (BOMI) Imprest Accounts

At September 30, 2008, the Ministry of Finance recorded a cash balance of \$22,268 for the Asian Development Bank Loan # 1791 Imprest Account and a cash balance of \$5,042 for the MOE/PEC Imprest Account. We obtained a confirmation from BOMI and were informed that both accounts were closed. 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 the remaining account balances and ensure that such was deposited to RepMar's General Fund bank account.

## APPENDIX I, CONTINUED

### 8. Payroll Clearing Account

At September 30, 2008, the Ministry of Finance recorded a credit balance within the payroll clearing account (G/L Acct # 100100-13025) in the amount of \$2,199 representing a payroll bank account with Bank of Marshall Islands that was closed in fiscal year 2004. We recommend that that Ministry of Finance determine the validity of this account balance and correct the general ledger for amounts no longer considered valid.

### 9. Ebeye General Fund Account

At September 30, 2008, the Ministry of Finance recorded a credit balance within the Ebeye General Fund account (G/L Acct # 950000-13015) in the amount of \$129,328, which did not articulate to the corresponding bank reconciliation balance of \$141,166. The variance of \$11,838 primarily represented unrecorded receivables for returned checks. As the amount was not considered material to the financial statements, no audit adjustment was proposed. We recommend that the Ministry of Finance ensure that all bank reconciliation adjustments are recorded to the general ledger.

### 10. Bank Errors

At September 30, 2008, the bank reconciliation for the General Account (G/L Acct # 950000-13010) and the Payroll Account (G/L Acct # 950000-13020) included bank errors in the amounts of \$32,858 and \$11,772, respectively, which date back as far as fiscal year 2003 without apparent follow-up with the financial institution. Given the aging of these balances, collectability from the financial institution may be doubtful. We recommend that the Ministry of Finance follow-up on all bank errors with the financial institution in a more timely manner.

### 11. Unrecorded Bank Transactions

At September 30, 2008, the General Account (G/L Acct # 950000-13010) bank reconciliation reported transactions in the net amount of \$132,481, which included various grant receipts from donor agencies of \$92,796 that were not recorded. Furthermore, the General Account-Ebeye (G/L Acct # 950000-13018) bank reconciliation reported transactions in the net amount of \$10,624, which primarily represented unrecorded check disbursements. These transactions represented activity that covered the entire fiscal year. We recommend that the Ministry of Finance determine the disposition of these unrecorded transactions in a timely manner.

### 12. First Hawaiian Bank (FHB) Credit Card

On September 15, 2008, FHB closed a time certificate of deposit (TCD) that collateralized a government credit card. At the time of closure, the credit card balance amounted to \$40,914; however, no supporting documentation was made available to support this balance. As the Ministry of Finance continued to carry the TCD balance of \$55,000 with the general ledger, an audit adjustment was proposed to reflect the closure of the account. We recommend that the Ministry of Finance determine the final disposition of credit card charges incurred prior to the closure of the credit card.

### 13. Bank of Marshall Islands (BOMI) Ebeye General Account

Based on scrutinization of the check register for checks issued from the BOMI Ebeye General Account, we noted that checks were not issued in a sequentially numbered order. For example, the last check issued for the year ended September 30, 2008 was check # 10364 yet the check # series 10181 through 10195 were issued in October 2008. We recommend that the Ministry of Finance ensure that checks are issued in sequential number order.

14. Embassy Imprest Accounts

At September 30, 2008, the Ministry of Finance recorded imprest accounts for the Taiwan Embassy, United Nations Mission and Honolulu Consulate in the amounts of \$40,000, \$50,000 and \$10,000, respectively, for which no bank reconciliations and related imprest account reconciliations were provided. Furthermore, the Ministry of Finance recorded an imprest account for the Washington Embassy in the amount of \$50,000 for which no imprest account reconciliation was provided. We recommend that the Ministry of Finance ensure that all Embassy imprest accounts are supported by bank reconciliations and imprest account reconciliations that are performed on a monthly basis.

15. Unclaimed Property

On November 28, 2002, the Secretary of Finance received \$93,737 from the Bank of Hawaii representing unclaimed customer accounts when the bank closed its branch, and recorded such as a liability within G/L Acct # 300430-50080. In accordance with Public Law No. 1999-89, 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, 2008, the Secretary of Finance has 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.

16. Tax Revenues

Of 125 General Fund tax revenue receipts tested, we noted the following exceptions:

- Three Ebeye cash receipts (CR #s 9009923, 9011810 and 9013190 in the amounts of \$437, \$10,080 and \$3,706, respectively) pertaining to import taxes were not supported by underlying vendor invoices verifying amounts itemized on the respective Form 725.
- One Majuro cash receipt (CR # 314777 in the amount of \$1,326) pertaining to import taxes was not supported by the underlying Form 725 and vendor invoice.
- One Ebeye cash receipt (CR # 9009430 in the amount of \$93,240) pertaining to employee withholding taxes was not supported by the underlying Withholding Tax return.
- One Ebeye cash receipt (CR # 9011841 in the amount of \$44,984) pertaining to business gross revenue taxes was not supported by the underlying Gross Receipts Tax return.

We recommend that the Ministry of Finance ensure that tax revenue receipts are supported by underlying documentation such as vendor invoices, Form 725s, Withholding Tax returns and Gross Receipts Tax returns.

17. Fiji Embassy Imprest Account

At September 30, 2008, the Ministry of Finance recorded an imprest account for the Fiji Embassy in the amount of \$19,700, for which the imprest account reconciliation included net unrecorded transactions of \$4,212 pertaining to unrecorded receipts and foreign exchange gain of \$9,673 and \$1,123 less unrecorded disbursements of \$6,584. We recommend that the Ministry of Finance ensure that all transactions pertaining to Embassy imprest accounts be recorded.

## APPENDIX I, CONTINUED

### 18. Japan Embassy Imprest Account

At September 30, 2008, the Ministry of Finance recorded an imprest account for the Japan Embassy in the amount of \$100,000, for which the imprest account reconciliation included net unrecorded transactions of \$16,987 pertaining to unrecorded disbursements and foreign exchange loss of \$43,239 and \$7,546, respectively, less unrecorded receipts of \$33,798. We recommend that the Ministry of Finance ensure that all transactions pertaining to Embassy imprest accounts be recorded.

### 19. Accounts Payable – Landowners

At September 30, 2008, the Ministry of Finance recorded an amount payable to landowners (G/L Acct # 100100-55040) in the amount of \$19,499, which represented amounts received from Mobil Oil Micronesia, Inc. (MOMI) for a land lease at the airport not yet paid to the landowners. However, all payments for fiscal year 2008 were paid to the landowners thus the recorded liability may no longer be valid. Of this amount, \$16,499 represented an amount carried over from fiscal year 2007. As the amount of \$16,499 was not considered material to the basic financial statements, no audit adjustment was proposed. We recommend that the Ministry of Finance determine the validity of amounts payable to landowners for the MOMI land lease at the airport.

### 20. Encumbrances

Of forty three encumbrances tested for the Grants Assistance Fund, we noted one item (PO # 2218501 for \$113,701) that was no longer considered valid. Furthermore, for one item tested for the Other Governmental Funds, PO # 2376101 for \$4,908 was not evidenced by an underlying purchase order or other evidential matter allowing us to verify the recorded encumbrance. We recommend that the Ministry of Finance periodically examine the encumbrance subledger and deobligate items no longer considered valid. Furthermore, we recommend that the Ministry of Finance ensure all recorded encumbrances are evidenced by underlying supporting documentation.

### 21. Payroll Expenditures

Of forty-nine General Fund payroll expenditures tested, totaling \$41,429, we noted the following exceptions:

- (i) For one employee (employee # 74341), the authorized Personnel Action Form was not made available supporting the rate of \$5.00 per hour.
- (ii) For one employee (employee # 207104), the employee was paid gross wages of \$487.88 based on 110 hours worked, which equated to \$4.44 per hour; however, the Personnel Action Form provided indicated an authorized rate of \$4.22 per hour. No explanation was made available for the difference of \$0.22 per hour.

We recommend that the Payroll Department ensure that pay rates are supported by authorized Personnel Action Forms.

## APPENDIX I, CONTINUED

Of eighty-five Grants Assistance Fund payroll expenditures tested, totaling \$53,260, we noted the following exception:

- (i) For two employees (employee #s 209862 and 229756), the Cost Center allocated were incorrect. Employee # 209862 was charged to CC # F73351 whereas employee # 229756 was charged to CC # F63350. Both Cost Centers were no longer valid under the grant award and both employees should have been charged to CC # F83350.

For internal accounting and reporting purposes, we recommend that the Payroll Department ensure that Cost Centers allocated to employees are valid and correct.

### 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**

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.