

October 30, 2014

Mr. Alfred Alfred, Jr.  
Secretary of Finance  
Republic of the Marshall Islands

Dear Secretary Alfred:

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, 2013 (on which we have issued our report dated October 30, 2014), 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, 2013 that we wish to bring to your attention.

We have also issued a separate report to the President, His Excellency Christopher J. Loeak, also dated October 30, 2014 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.

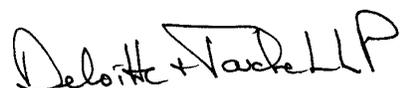
A description of the responsibility of management for establishing and maintaining internal control over financial reporting and of the objectives of and inherent limitations of internal control over financial reporting, is set forth in the attached Appendix II and should be read in conjunction with 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, 2013 that we wish to bring to your attention:

Petty Cash Imprest Accounts

At September 30, 2013, the Ministry of Finance recorded twenty-nine petty cash imprest accounts aggregating \$24,745, 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 2012.

Embassy Imprest Accounts

At September 30, 2013, the Ministry of Finance recorded the following embassy imprest accounts, for which the September 2013 imprest account reconciliations reported unknown variances:

<u>Embassy</u>	<u>GL A/c #</u>	<u>Imprest Fund</u>	<u>Unknown (Shortage) Overage</u>
Fiji	950000-12010	\$ 19,700	\$ (28,025)
Japan	950000-12020	\$ 100,000	\$ (51,309)
UN Mission	950000-12030	\$ 50,000	\$ (17,547)
Washington, D.C.	950000-12035	\$ 50,000	\$ 4,535
Arkansas Consulate	950000-12045	\$ 20,000	\$ (2,523)

Additionally, the following exceptions were noted:

- The Fiji Embassy September 2013 reconciliation included the following reconciling items:
  - An undated and unresolved disallowed amount of \$15,026.
  - An unresolved embassy staff duplicate reimbursement claim of \$500.
- The Japan Embassy September 2013 reconciliation included the November 2012 replenishment request of \$28,175; however, this request was not accrued as of September 30, 2013. Additionally, the reconciliation included the following reconciling items:
  - An unknown and undated withdrawal of \$4,677.
  - Advances to the embassy from unidentified sources amounting to \$23,488.
- The UN Mission September 2013 reconciliation included two unrecorded deposits of \$60,000 and \$9,492 representing grant receipts identified in prior years and one unrecorded deposit of \$10,000 in 2013. A third unrecorded deposit of \$27,846 from an unknown source, identified in a prior audit, was not included as a reconciling item in the reconciliation. No explanation was provided for the omission. Additionally, the reconciliation included the following reconciling items:

Embassy Imprest Accounts, Continued

- Two missing checks (#s 10400 and 10432) for \$5,525 each.
- \$26,817 overpayment to the Mission in fiscal year 2011 (the same reimbursement request was paid on 06/30/2011 and again on 07/15/2011), which has not been offset against subsequent reimbursement requests.
- \$1,000 variance in amount of a fiscal year 2012 Mission check # 10435 as compared with amount recorded per check register.
- Various disallowed amounts totaling \$107,965, some of which are over a year old.

The UN Mission September 2013 bank account reconciliation included an unidentified variance of \$1,342 which was over three months old. Additionally, outstanding check # 10680, dated 8/14/2013 was noted as missing.

- The Washington, DC Embassy September 2013 reconciliation included the following reconciling items:
  - Unknown deposits from April, June and August 2012 totaling \$2,609, which were not recorded.
  - A \$15,191 overpayment to the Embassy in fiscal year 2011 (the same reimbursement request was paid on 09/12/2011 and again on 09/20/2011), which has not been offset against subsequent reimbursement requests.
  - An unknown deposit of \$11,101 dated July 2013.
  - Various disallowed amounts totaling \$6,675 and prior years' shortages totaling \$6,822.
  - Unreimbursed and un-accrued expenditures totaling \$16,093.
  - Unsupported payment of \$2,450 to an embassy staff.

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 2012.

Errors in bank wire transfers and lack of subsequent offset of overpayments to RepMar embassies was reported as a finding in the Single Audits of RepMar for fiscal years 2010 and 2011.

At September 30, 2013, the Ministry of Finance recorded accrued liabilities (GL A/c # 100100-50010) totaling \$37,557 payable to the Fiji Embassy and the UN Mission. The corresponding September 2013 imprest account reconciliations for these two embassies do not include the above accruals as reconciling items. We recommend that the Ministry of Finance require monthly reconciliations of the imprest accounts and documentation and resolution of reconciling items.

Bank of Marshall Islands (BOMI) Imprest Accounts

At September 30, 2013, 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 2012.

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 2013 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 2012.

Miscellaneous Receivables

At September 30, 2013, the Ministry of Finance recorded the following receivable balances that were not supported by underlying subsidiary ledgers:

<u>G/L A/c #</u>	<u>G/L Balance</u>
100100-24100	\$ 245,097
950000-24100	\$ (1,566)

No audit adjustments were proposed for the above accounts as these receivable balances 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 2012.

Fixed Assets Register

The fixed assets register (FAR) as of September 30, 2013 included the following exceptions:

- A prior year addition (central aircon unit for Ebeye hospital) costing \$136,584 was not accurately described in the FAR. Such was noted in the FAR as an unknown difference in beginning capital asset cost.
- The location of one item (Hitachi loader ZW250 270338) could not be determined by Ministry of Finance staff due to inadequate information in the FAR.
- Acquisition cost for one addition (oxygen generating equipment) was understated by \$1,243. This item had initially been erroneously recorded as a fiscal year 2012 addition at a cost which was overstated by \$5,258. An adjustment was proposed in the prior year to remove this item from the FAR and the matter was raised in our letter to management for the prior year audit.

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.

Fixed Assets Register, Continued

Based on our observation and inquiry with accounting department personnel, we noted that asset useful life used in depreciating asset cost is estimated without consultation with other personnel within RepMar 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. This matter was discussed in our previous letters to management for the audits of fiscal years 2011 and 2012. We further recommend that the accounting personnel consult when appropriate with Ministry of Public Works personnel when estimating asset useful life.

Accounts Payable - Other

At September 30, 2013, the Ministry of Finance recorded accounts payable (GL A/c # 700370-50020) of \$6,037 that was not supported by an underlying subsidiary ledger. No audit adjustment was proposed as this amount was not considered material to the financial statements. We recommend that the Ministry of Finance reconcile accounts payable to supporting subsidiary ledgers on a monthly basis. This matter was discussed in our previous letters to management for the audits of fiscal years 2011 and 2012.

Labor Bonds Payable

At September 30, 2013, 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

It appears that the debit balances resulted 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 the labor bonds payable accounts and ensure that refunds are 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 2012.

Cancelled Checks

At September 30, 2013, the Ministry of Finance recorded preliminary general and payroll fund cancelled checks liabilities (G/L A/c #s 100100-50060 and 100100-55020, respectively) of \$473,153 and \$57,422, respectively, which were not supported by reconciled subsidiary ledgers. Alternative audit procedures were performed to verify the account balances, which resulted in audit adjustments proposed to reconcile such with the correct balances of \$267,185 and \$67,336, respectively. We recommend that the Ministry of Finance monitor and reconcile stale checks in accordance with the Financial Management Act 1990, Section 150. This matter was discussed in our previous letters to management for the audits of fiscal years 2011 and 2012.

Additionally, at September 30, 2013, 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 letter to management for the audit of fiscal year 2012.

General Fund Payroll Expenditures

Of \$15,987,457 in payroll expenditures, sixty-seven (67) items totaling \$58,973 were tested, with the following exceptions noted:

- Personnel action forms (PAF) provided for the following employees indicated their status as probationary despite having been employed for over two years as of the pay period tested:

<u>Employee #</u>	<u>Pay Period Ended</u>
200731	10/06/2012
215105	03/09/2013

- Employee # 216661 was overpaid by 40 hours or \$220 for pay period ended 06/01/2013.
- Employee # 002932 was underpaid by 8 hours or \$44 for pay period ended 02/09/2013.
- For employee # 201739, a personnel action form supporting hourly rate paid for the pay period ended 03/09/2013 was not available for examination.
- For the following employees, 60 overtime (OT) hours as per the approved timesheet were paid as night differential as the hours were not supported by approved OT forms:

<u>Employee #</u>	<u>Pay Period Ended</u>
64208	05/04/2013
14910	06/15/2013
55554	06/29/2013

For employee # 14910, an additional 45 regular hours (or \$167) for the same pay period was not paid.

- Supervisory approval of timesheet hours for the following employees was not documented:

<u>Employee #</u>	<u>Pay Period Ended</u>
47947	05/04/2013
41479	05/18/2013
57779	05/18/2013
07088	06/29/2013

- Approved annual leave forms for the following employees were not available for examination:

<u>Employee #</u>	<u>Pay Period Ended</u>
066284	10/06/2012
200731	10/06/2012
209996	11/03/2012
023175	01/26/2013
050479	03/23/2013
063599	03/23/2013
040954	04/06/2013
200377	04/20/2013
200724	04/20/2013
041479	05/18/2013
007088	06/29/2013
032641	07/27/2013
089439	08/10/2013

General Fund Payroll Expenditures, Continued

We recommend that management establish policies and procedures to ensure that current PAFs are maintained on file and to facilitate accurate payroll processing. This matter was discussed in our previous letter to management for the audit of fiscal year 2012.

Grants Fund Payroll Expenditures

The following exceptions were noted in grants fund payroll expenditures tested:

- Employee # 210215 was underpaid by 16 stand-by hours and 30 night differential hours or a total of \$63 for pay period ended 03/10/2013. No questioned cost results as this was an underpayment.
- For the following samples, timesheet approval dates either were not documented or predate the pay period end dates:

<u>Fund</u>	<u>Employee #</u>	<u>Pay Period Ended</u>
410110	220060	06/01/2013
410150	36953	10/20/2012
600350	74138	12/29/2012
600350	216718	03/23/2013
600350	74138	04/06/2013
600350	216083	05/18/2013
600350	55671	06/15/2013
600350	41449	07/27/2013
600350	92154	09/07/2013
700370	64709	12/15/2012

No questioned costs result as supervisory review of the above timesheets was documented.

- For employee # 25941, the org # per approved timesheet for the pay period ended 05/18/2013 was GG7510 instead of the correct org # CD7530, which was the org # charged for this payroll expenditure.
- For employee # 70507, org # 2759 as per approved timesheet for pay period ended 01/26/2013 should have been charged instead of org # 2510. Additionally, the employee's retroactive pay included in this pay period was understated by \$433. No questioned cost results as both org #s are chargeable to the same grant and the error is an underpayment.
- Approved leave forms for the following employees were not available for examination:

<u>Employee #</u>	<u>Pay Period Ended</u>
205735	01/12/2013
215483	01/12/2013
070443	03/09/2013
210215	03/09/2013
090918	08/10/2013

Alternative audit procedures were performed to verify supervisory approval of leave hours paid; therefore, no amounts are questioned.

We recommend that management establish policies and procedures to facilitate adequate documentation of approvals and of accurate payroll processing.

General Fund Non-payroll Expenditures

Of \$17,167,940 General Fund non-payroll expenditures, seventy-two (72) items totaling \$3,954,444 were tested and the following exceptions were noted:

- Vendor invoices were not available for the following checks paid to three different vendors for the school lunch program:

<u>Check #</u>	<u>APV #</u>	<u>Amount</u>	<u>Contract Amount</u>
105430	198243	\$ 4,120	\$ 4,247
106440	200306	\$ 3,169	\$ 3,267
107392	202140	\$ 1,585	\$ 1,634

Instead, we were provided with one contract executed with several vendors for various amounts, which did not agree with the check amounts tested. Furthermore, there was no documentation on file to verify that amounts paid were for actual food items received.

- Supporting documentation was not available for the following checks:

<u>Account #</u>	<u>Check #</u>	<u>APV #</u>	<u>Amount</u>	<u>Documentation Lacking</u>
02215	107530	202538	\$ 190,447	Vendor invoice
02021	107862	203156	\$ 5,450	Travel authorization
02330	109727	206730	\$ 44,582	Vendor invoice
02615	90000222	90000222	\$ 2,910	Vendor invoice
03133	90000995	90000995	\$ 742	Invoices/receipts
02750	90001002	90001002	\$ 50,000	Authorization of increase in embassy imprest fund

Management subsequently reclassified the above increase in embassy imprest fund to cash.

We recommend that the Ministry of Finance establish policies and procedures requiring that payments to vendors are adequately supported by vendor invoices, contracts, and other appropriate documentation. This matter was discussed in our previous letters to management for the audits of fiscal years 2010 through 2012.

Grants Fund Non-payroll Expenditures

The following exceptions were noted in grants fund non-payroll expenditures tested:

There was no evidence on file to verify an employee's attendance at a seminar for which the employee received a \$1,120 stipend (check # 17635). Alternative audit procedures were performed to confirm the employee's attendance; however, we recommend that documentation be retained on file for such expenditures.

Additionally, a \$15,000 item (check # 101763, APV # 189331) was supported by a vendor invoice describing services provided which differed from the type of expenditure recorded. Alternative audit procedures were performed to verify the service received and expenditure recorded; however, we recommend that expenditures are supported by proper documentation.

Grants Fund Non-payroll Expenditures, Continued

Check # 106849 (APV # 201094, \$18,594) was issued to an affiliate of the vendor, at the vendor's request. We were informed that such was verbally approved by management. The originally issued check # 106836 was issued to the vendor and was then voided; however, it was included in the September 2013 bank reconciliation as an outstanding check. An audit adjustment was proposed to correct this error.

A receiving report or a similar document for check # 102082 (non-US federal assistance) was not available.

We recommend that the Ministry of Finance establish policies and procedures requiring that expenditures are adequately supported by vendor invoices, contracts, and other appropriate documentation.

Other Governmental Funds Non-payroll Expenditures

Of three other governmental funds non-payroll expenditures tested, supporting documentation for one \$47,800 item (check # 105570) was not available for examination.

**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, 2013 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, 2013, 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 2012.

### General Ledger Accounts

There is a lack of control over creation of new general ledger accounts. We were informed during the FY2012 audit process that GL A/c # 950000-12055 had been assigned to an unrecorded cash-in-bank account discovered through the audit process. Supervisory approval of the creation of such account was not evident.

During our FY 2013 audit fieldwork, we were informed that the above GL A/c # had been assigned to a new embassy imprest account. Further inquiry revealed that the cash-in-bank account for which the A/c # was created, remained unrecorded in the general ledger.

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 and 2012.

Additionally, RepMar's investment in the Pacific Islands Development Bank is recorded in GL A/c # 100100-15040; however, the name of the account has not been changed from its original name of "Trust Fund Acct D-FHB". We recommend that management consider updating the name of the account.

### Overtime Hours

Public Service Commission *Instruction No. 2010/02* states that employee hours in excess of the regular 80 each biweekly period must be pre-approved by the respective ministries/agencies. We noted various instances where the excess hours are approved per timesheet; however, such hours are not supported by a separate pre-approval by the respective ministries/agencies, as stipulated in the PSC regulations. We recommend that management ensure that PSC regulations are followed.

### QuickBooks Disbursements

During the year, the Ministry of Finance utilized the QuickBooks accounting software to disburse non-federal funds from checking accounts that were separate from RepMar's general bank account. Disbursements from these accounts were recorded in the 4gov DILOG accounting system through manual journal entries at year end. We were informed during the prior year audit process that the intent of such practice was to expedite payments on critical time-sensitive purchases.

We recommend that management ensure that disbursements from such accounts are in compliance with RepMar's Procurement Code and that such are accurately captured in the 4gov DILOG accounting system. This matter was discussed in our previous letter to management for the audit of fiscal year 2012.

### Voided Checks

Check # 104864 was voided; however, the original voided check could not be located. We recommend that original voided checks be retained on file. This matter was discussed in our previous letter to management for the audit of fiscal year 2012.

### 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 2012.

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 2012.

**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.