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February 23, 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, 2014 (on which we have issued our report dated February 23, 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, 2014 that we wish to bring to your attention.

We have also issued a separate report to Her Excellency Hilda C. Heine, also dated February 23, 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, 2014 that we wish to bring to your attention:

### Petty Cash Imprest Accounts

At September 30, 2014, the Ministry of Finance recorded twenty-nine petty cash imprest accounts aggregating \$24,845, 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 2013.

### Embassy Imprest Accounts

At September 30, 2014, the Ministry of Finance recorded embassy imprest accounts, for which the September 2014 imprest account reconciliations reported unknown variances as follows:

<u>Embassy</u>	<u>GL A/c #</u>	<u>Imprest Fund</u>	<u>Unknown (Shortage) Overage</u>
Fiji	950000-12010	\$ 69,700	\$ 7,162
Japan	950000-12020	\$ 150,000	\$ (92,745)
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	\$ (3,636)
Honolulu Consulate	950000-12070	\$ 10,000	\$ (1,143)

Additionally, the following exceptions were noted:

- The Fiji Embassy September 2014 reconciliation included the following reconciling items:
  - \$62,203 in disallowed amounts, of which \$54,524 pertains to fiscal year 2013.
- The Japan Embassy September 2014 reconciliation included a \$20,910 replenishment request; however, this request was not accrued as of September 30, 2014. As this amount was not considered material to the financial statements, no audit adjustment was proposed. Additionally, the reconciliation included the following reconciling items:
  - An unrecorded \$18,983 deposit.
  - \$27,073 in unknown deposits.
  - \$43,050 in disallowed amounts.
  - \$132,256 in unknown withdrawals.

Embassy Imprest Accounts, Continued

- The UN Mission September 2014 reconciliation, which was provided in January 2016, included \$79,492 in unrecorded deposits identified in prior years as grant receipts. An 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:
  - Four missing checks (#s 10286, 10400, 10406 and 10432) for \$5,525 each.
  - \$26,817 overpayment to the Mission in fiscal year 2011 (the same reimbursement request was paid on June 30, 2011 and again on July 15, 2011), which has not been offset against subsequent reimbursement requests.
  - Various disallowed amounts totaling \$137,451, of which \$98,251 is over a year old.
- The Korea Embassy September 2014 reconciliation included \$4,819 in disallowed amounts.
- A \$19,985 bank wire transfer (# 9000958) for the Washington DC embassy dated October 18, 2012 was never processed. Such is a reconciling item in the September 2014 general bank account reconciliation.

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 2013.

Bank of Marshall Islands (BOMI) Imprest Accounts

At September 30, 2014, 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 2013.

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 2014 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 2013.

NOAA Grant Receivables/Revenue

NOAA grant receivable account was not reconciled during the year. For grant receipts totaling \$97,924 received on 10/30/2013, the Ministry of Finance's billings to the grantor for \$25,185 were not available for examination. We recommend that the Ministry of Finance timely reconcile NOAA grant receivables.

Miscellaneous Receivables

At September 30, 2014, 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	\$ 245,097
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 2013.

Fixed Assets Register

The fixed assets register (FAR) as of September 30, 2014 included the following exceptions:

- Location of two items (Hitachi loader ZW250 270338 and Hitachi excavator 270288) could not be determined by Ministry of Finance staff due to inadequate information in the FAR.
- The *MV Landrik* vessel has an estimated net book value of \$506,880 and remaining useful life of eleven (11) years; however, the vessel is not being utilized and is not in good working condition. We were informed that no decision has been made whether to repair or dispose of the vessel.
- \$135,000 acquisition cost for a donated firetruck was not supported by grant award documents or vendor invoice.
- \$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 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. 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 2013.

Accounts Payable - Other

At September 30, 2014, the Ministry of Finance recorded \$6,037 of accounts payable (GL A/c # 700370-50020) that were 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 through 2013.

Labor Bonds Payable

At September 30, 2014, 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 the labor bonds payable accounts and require 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 2013.

Cancelled Checks

At September 30, 2014, 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 \$267,185 and \$67,336, 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 \$188,842 and \$63,843, 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 through 2013.

Additionally, at September 30, 2014, 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 and 2013.

Unidentified Income

At September 30, 2014, the Ministry of Finance recorded \$125,608 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.

Grants Fund Revenue

The following grants were erroneously recorded in fund 700360:

- A \$71,508 federal grant receipt (cash receipt # 478269, deposited on January 21, 2014), which should have been recorded in fund 600350.
- A \$94,075 European Union grant receipt (JV # G14-428P), which should have been recorded in fund 700100. Additionally, the associated grant agreement was not available for examination.

We recommend that the Ministry of Finance require that grants be recorded in the correct governmental funds.

General Fund Payroll Expenditures

Of \$15,784,408 in payroll expenditures, twenty-four items totaling \$30,772 were tested, with the following exceptions noted:

- Employee # 20964 was overpaid \$1,029 in night and standby differential hours, as per approved timesheets, for pay periods ended October 5, 2013 through July 12, 2014. The employee was not entitled to such benefits until July 1, 2014, as per the personnel action form.
- Personnel action form for employee # 70546 supporting hourly rate paid for the pay period ended May 31, 2014 was not available for examination.
- Approved timesheet for employee # 87792 for the pay period ended March 8, 2014 indicated 80 regular hours; however, only 40 hours were paid, as stipulated by the employment contract.
- Employee # 201125 was underpaid \$58 for retroactive pay included in pay period ended November 2, 2013.

We recommend that management establish policies and procedures to require that current personnel action forms are maintained on file and to facilitate accurate payroll processing. This matter was discussed in our previous letters to management for the audits of fiscal years 2012 and 2013. We further recommend that management require that timesheets are verified for accuracy.

Grants Fund Payroll Expenditures

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

- Approved timesheet for employee # 37586 for pay period ended October 19, 2013 indicated 40 regular and 40 sick leave hours; however, the sick leave hours were not paid due to lack of an approved sick leave form.
- 40 annual leave hours were paid for employee # 47612 for pay period ended December 28, 2013; however, the approved leave form was not available for examination. Alternative audit procedures were performed to verify supervisory approval of leave hours paid.
- Standby differential (SD) hours for employee # 71577 of 80 per approved timesheet for pay period ended December 14, 2013 were incorrect; however, the correct SD hours of 31 were paid. Furthermore, the 10% night differential rate per personnel action form was incorrect; the correct rate per Public Service Commission regulations of 15% was paid.
- Approved timesheet for employee # 89679 for pay period ended July 12, 2014 indicated 80 regular, 80 standby and 8 holiday hours; however, double time for the holiday hours was not paid due to lack of the required pre-approval to work such hours.

We recommend that management establish policies and procedures to facilitate adequate documentation of approvals and of accurate payroll processing. This matter was discussed in our previous letter to management for the audit of fiscal year 2013. We further recommend that management require that personnel action forms and timesheets are verified for accuracy.

Other Governmental Funds Revenue

A \$7,094 cash receipt (CR # 486502) pertained to payroll withholding tax, however, such was recorded as non-resident workers fee. We recommend that the Ministry of Finance require accurate recording of cash receipts.

Gross Receipts Tax

Gross receipts tax withheld from a vendor payment (check # 120842) had yet to be paid into Treasury eight months later. We recommend that the Ministry of Finance verify that withheld taxes are paid into Treasury.

**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, 2014 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, 2014, 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 2013.

General Ledger Accounts

There is a lack of control over creation of new general ledger accounts. We were informed during the fiscal year 2012 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.

The above GL A/c # has been assigned in fiscal year 2014 to the Korea embassy imprest account and the cash-in-bank account for which the A/c # was created remained unrecorded in the general ledger. Management proposed an adjustment to record the cash account.

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; 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. This matter was discussed in our previous letter to management for the audit of fiscal year 2013.

Kwajalein Range Services Revolving Fund

Replenishment (check # 111944) of RepMar’s \$75,000 revolving fund with Kwajalein Range Services, as per agreement, was recorded as a subsidy rather than as the actual types of expenditures incurred. We recommend that the Ministry of Finance require that disbursements from the revolving fund are accurately recorded.

### Cash Receipts

Cash receipts are not consistently issued for contributions received via check, resulting in inaccurate and untimely recording of such. We recommend that management establish policies and procedures requiring issuance of cash receipts for such contributions, to facilitate accurate and timely recording.

### 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 at the Treasury Department for 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.

### Ebeye Travel Advance Checks

For various travel advance checks processed by Ministry of Finance-Ebeye, the check amounts per the 4gov accounting system differed from the actual check amounts, resulting in variances totaling \$53,814 in the August and September monthly bank account reconciliations. We recommend that the Ministry of Finance investigate and rectify the travel advance check errors.

### 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.

### Check #s 112061 and 112233

A \$23,830 check (# 112061) was payable to a Ministry of Finance staff, who cashed the check and paid for purchases related to President's Day celebrations and the christening of the *MV Majuro* vessel in November 2013. A second \$6,000 check (# 112233) was payable to an Assistant Secretary, who also cashed the check and paid for purchases related to christening of the *MV Kwajalein* vessel, also in November 2013. We examined the supporting vendor invoices, noting an unspent balance totaling \$2,275, which had not been re-deposited into the Treasury Fund. Due to our inquiries, \$1,970 and \$77 were re-deposited on April 7 and May 21, 2015, respectively, with the remaining difference of \$228 being unaccounted for.

We were informed that the method of payment described above was approved by Cabinet. Associated procurement documents for purchases pertaining to the above events were not available for examination.

### 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 2013.

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 2013.

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.

**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.