

June 29, 2018

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, 2017 (on which we have issued our report dated June 29, 2018), 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, 2017 that we wish to bring to your attention.

We have also issued a separate report to Her Excellency Dr. Hilda C. Heine, also dated June 29, 2018 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.

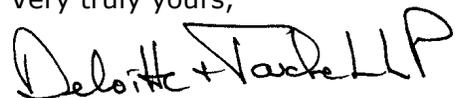
A description of the responsibility of management for establishing and maintaining internal control over financial reporting and of the objectives of and inherent limitations of internal control over financial reporting, is set forth in the attached Appendix II and should be read in conjunction with 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, 2017 that we wish to bring to your attention:

Petty Cash Imprest Accounts

At September 30, 2017, 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 the Ministry of Finance examine all recorded petty cash imprest accounts and assess their validity. This matter was discussed in previous letters to management for the audits of fiscal years 2007 through 2016.

Closed Bank Accounts

At September 30, 2017, the Ministry of Finance recorded cash of \$22,268 for Asian Development Bank Loan # 1791 Imprest Account (GL A/c # 800405-12062). The associated bank account was confirmed closed during a prior audit; however, final disposition of the account balance is unknown. We recommend the Ministry of Finance investigate such, including verification of whether the account balance was deposited to RepMar’s General Fund bank account. This matter was discussed in previous letters to management for the audits of fiscal years 2008 through 2016.

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 2017 bank statements and account reconciliations for such were not available. We recommend 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 previous letters to management for the audits of fiscal years 2010 through 2016.

Miscellaneous Receivables

At September 30, 2017, 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	\$ 643,243
950000-24100	\$ (1,566)

No audit adjustments were proposed as these receivables were partially offset by a corresponding allowance for uncollectible accounts and the net balance is not considered material to the financial statements. We recommend the Ministry of Finance reconcile these receivables and determine their ultimate collectability. This matter was discussed in previous letters to management for the audits of fiscal years 2007 through 2016.

Unidentified Income

At September 30, 2017, the Ministry of Finance recorded a \$38,871 debit balance in unidentified income (G/L A/c # 100100-07225). Management attributes this occurrence to processing errors in the 4gov Accounts Payable module. We recommend management investigate the nature of this account and correct noted errors. This matter was discussed in previous letters to management for the audits of fiscal years 2014 through 2016.

**SECTION I – DEFICIENCIES, CONTINUED**

Capital Assets

Condition # 1: The following exceptions were noted:

- One item (Hitachi loader ZW120-G 270283) was relocated to Kwajalein Atoll; however, transfer documentation and an image of the asset at its new location was not available;
- One item (safety loader truck 274304) displayed a tag # which differed from the fixed asset register; and
- Construction of one item (MOH Pre-Fabricated Warehouse, contract # C12048) was supposed to have been completed by March 2, 2018; however, based upon construction site inspection on March 15, 2018, work had yet to commence. Furthermore, the contract authorized a 30% prepayment, with subsequent monthly payments to be approved based on accomplished work. As of September 30, 2017, 53% of the \$647,338 contract price had already been paid to the contractor.

We recommend management establish policies and procedures requiring documentation of capital assets locations, condition and maintenance, and identification tag #s. Furthermore, we recommend management require adherence with contract terms and conditions.

Condition # 2: Capital asset useful lives for depreciation purposes are estimated without consultation with other RepMar personnel who may provide more accurate estimates. We recommend accounting personnel consult, where appropriate, with Ministry of Public Works personnel when estimating asset useful lives, which should be periodically re-assessed and adjusted as appropriate.

These above matters were discussed in previous letters to management for the audits of fiscal years 2011 through 2016.

Condition # 3: Impairment conditions have not been ascertained for the following inoperable equipment, which are recorded in the fixed assets register:

<u>Funding Source</u>	<u>Asset Description</u>	<u>Department</u>	<u>Net Book Value</u>
General Fund	Health Admin Email/Information System	Health	\$ 157,981
General Fund	Caterpillar 730 Rock/Articulated Truck	Public Works	\$ 199,600
Japan Grant	Hitachi Excavator 270288	Public Works	\$ 105,673
Japan Grant	Hitachi Excavator 270290	Public Works	\$ 105,673

We recommend management establish policies and procedures requiring regular assessment of possible asset impairment.

The above matter was previously reported in the prior audit within Finding 2016-004.

Encumbrances

Encumbrances are not timely reviewed and reconciled. We recommend management periodically review encumbrance subsidiary ledgers for continuing validity and timely reconcile the general ledger to such. This matter was previously reported in prior audits within Finding Nos. 2013-013, 2014-012 and 2015-008 and in our previous letter to management for the audit of fiscal year 2016.

**SECTION I – DEFICIENCIES, CONTINUED**

Payroll Expenditures

Tests of payroll expenditures resulted in the following exceptions:

- An approved timesheet for employee # 220514 for the pay period ended December 10, 2016 erroneously indicated 12 sick leave hours; the correct 3.69 sick leave hours were paid.
- An approved timesheet for employee # 239004 for the pay period ended April 15, 2017 erroneously indicated 24 overtime hours rather than the correct 24 night differential hours which were paid.

We recommend management establish policies and procedures to facilitate the veracity of timesheets, payroll processing and the overall approval process. This matter was discussed in previous letters to management for the audits of fiscal years 2013 through 2016.

**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, 2017 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 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; however, such has yet to be published. We recommend the Ministry of Finance publish the existence of escheated property in accordance with the enabling legislation. This matter was discussed in previous letters to management for the audits of fiscal years 2003 through 2016.

Verification of Daily Deposits

Section 4.7 of the Ministry of Finance, Banking and Postal Services' Standard Operating Procedures manual requires the Accounting Department to verify deposits against cash receipts on a daily basis; however, such is not being performed. This matter was discussed in previous letters to management for the audits of fiscal years 2015 and 2016.

Payroll Checks

There is no established policy with respect to minimum check amounts and unclaimed payroll checks. Consequently, payroll checks for nominal amounts remain unclaimed each year. Furthermore, payroll checks older than six months are not returned by the ministries/offices to the Treasury Department for proper disposition. We recommend management consider establishing policies with respect to minimum check amounts and unclaimed payroll checks. This matter was discussed in previous letters to management for the audits of fiscal years 2014 through 2016.

Journal Vouchers

Independent review and approval of JV #s G17-78A, G17-489H, and G17-02P were not evident. We recommend management require that all journal vouchers are adequately supported and independently reviewed and approved. This matter was previously reported in prior audits within Finding Nos. 2009-12, 2010-10, 2011-14, 2012-11, 2013-014, 2014-013 and 2015-019 and discussed in our previous letter to management for the audit of fiscal year 2016.

**SECTION II – OTHER MATTERS, CONTINUED**

RMI Procurement Code

Condition # 1: Records of procurement for the following general fund expenditures were not available for examination:

<u>Check #</u>	<u>APV #</u>	<u>Amount</u>
145650	282643	\$4,026
146263	284279	\$6,750
149327	290211	\$8,059

Condition # 2: Procurement for one general fund expenditure (check # 146256, APV # 284204, \$32,995) was conducted in a manner inconsistent with the RMI Procurement Code. Specifically, it appears that the small purchase method was employed rather than the competitive sealed bid method required by Section 125 of the RMI Procurement Code for procurement of goods or services exceeding \$25,000.

We recommend that management require adherence to the RMI Procurement Code and that procurement documentation be retained on file.

Leave Hours

We noted the following inconsistencies with Public Service Regulations (PSR):

- The Ministry of Finance rolls over employee annual leave hours each year based on leave hours available at the end of payroll # 1, which is around mid-December. Such is inconsistent with PSR Part VI, paragraph 56(2) which states that 208 leave hours is the maximum that can be accumulated and rolled over at the end of the leave year, December 31.
- Approved forms for annual leave of 24 hours or less are not being required, which is not consistent with PSR Instruction No. 2010/01 which states that all annual and sick leave hours recorded in time-clocks and timesheets without prior approval shall be treated as leave without pay or absence without leave.

We recommend management require compliance with all Public Service Regulations, including documented pre-approval of leave. This matter was discussed in previous letters to management for the audits of fiscal years 2015 and 2016.

4gov Org, Cost Center and Account #s

Org, cost center and account #s established in the 4gov accounting system differentiate revenues and expenditures by funding source, purpose and department. We noted incorrect use of such, resulting in inaccurate reporting of revenues and expenditures. We recommend the Ministry of Finance verify the accuracy of org, cost center and account #s used. This matter was discussed in previous letters to management for the audits of fiscal years 2014 through 2016.

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 could 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 previous letters to management for the audits of fiscal years 2009 through 2016.

**SECTION II – OTHER MATTERS, CONTINUED**

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 previous letters to management for the audits of fiscal years 2009 through 2016.

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 management consider adopting such policies and procedures. This matter was discussed in previous letters to management for the audits of fiscal years 2014 through 2016.

Bank Wire Transfers

At September 30, 2017, the Ministry of Finance recorded receivables of \$230,121 (included within G/L A/c #s 100100-24020 and 100100-24080) representing overpayments through bank wire transfers to vendors and embassies. We recommend management verify bank wire transfers prior to processing.

Public School System Education Fund

The following exceptions were noted:

- The preliminary trial balance provided for audit recorded the following:
  - A \$140,000 debit balance in account # 1230 Prior Year Liability which represented expenditures not recorded in proper accounts. Such was subsequently corrected.
  - A \$554,000 credit balance in account # 2002 Encumbrances which represented liabilities as of September 30, 2017. Such was subsequently corrected.
  - A variance of \$15,000 with the accounts payable subsidiary ledger.
  - Fiscal year 2018 expenditures of \$12,883.
- For check # 10679, one associated invoice for \$12,215 was not provided for examination.
- For check # 10680, the associated receiving report was not provided for examination.

We recommend management require that financial records of the Public School System Education Fund be accurate and adequately supported by source documentation.

**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.