

May 10, 2018

Mr. Amon Tibon  
Managing Director  
Marshall Islands Development Bank

Dear Mr. Tibon:

In planning and performing our audit of the financial statements of the Marshall Islands Development Bank (MIDB) as of and for the year ended September 30, 2017 (on which we have issued our report dated May 10, 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 MIDB'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 MIDB's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of MIDB'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 MIDB'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 the Board of Directors, also dated May 10, 2018, on our consideration of MIDB'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.

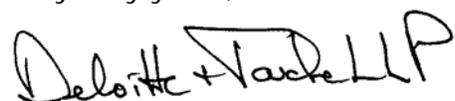
A description of the responsibility of management for establishing and maintaining internal control over financial reporting and of the objectives of and inherent limitations of internal control over financial reporting, is set forth in the attached Appendix II and should be read in conjunction with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

This report is intended solely for the information and use of the Office of the Auditor-General, management, others within the organization, and is not intended to be and should not be used by anyone other than these specified parties.

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

Very truly yours,

A handwritten signature in black ink that reads "Deloitte + Touche LLP". The signature is written in a cursive, stylized font.

## SECTION I – CONTROL DEFICIENCIES

We have not identified deficiencies involving MIDB's internal control over financial reporting as of September 30, 2017 that we wish to bring to your attention.

## SECTION II – OTHER MATTERS

Our observations concerning other matters related to operations, compliance with laws and regulations, and best practices involving internal control over financial reporting that we wish to bring to your attention are as follows:

### 1. Written Agreement on Sample House

Comment: MIDB was able to provide a copy of the agreement relating to the sample house receivable of \$52,145 at September 30, 2017; however, we noted insufficient information in the agreement, i.e. agreed interest rate, amount of total receivable, etc. This matter was discussed in our previous letters for the audit of fiscal years 2008 to 2016.

Recommendation: We recommend that management require that all lending arrangements be supported by executed agreements detailing pertinent information.

### 2. Policy on Accounts Receivable Allowance for Credit Losses

Comment: MIDB does not have a formal policy for establishing an allowance for uncollectible accounts receivable. This matter was discussed in our previous letters for the audit of fiscal years 2014 to 2016.

Recommendation: Management should consider formulating a policy relative to establishing an allowance for uncollectible accounts receivable.

### 3. Negative Balances in Deposit Accounts

Comment: As of September 30, 2017, there were 219 savings deposit accounts with negative balances totaling \$44,482. Savings deposits generally pertain to loan overpayments resulting from dated records and withdrawals made through customer refunds. Therefore, it appears that the Bank refunded certain customers in excess of related deposit balances or this matter could be attributed to dated records.

Recommendation: Management should revisit the cited accounts and consider adding these amounts to existing loans. Otherwise, management should decide whether these balances should be charged-off or an applicable allowance for doubtful accounts be provided as appropriate.

### 4. Inadequate Monitoring of Rental Receivables

Comment: MIDB monitors rent collections and calculates rent receivable and related rent income at year-end. Hence, the accrued rent receivable and the corresponding accrued income at month-ends are understated.

Recommendation: Rental activities are a major revenue generating source. Therefore, management should consider accruing rent receivable on a monthly basis.

### 5. Valuation of Collateral

Comment: MIDB accepts collateral for loans but the collateral is not appraised. Furthermore, MIDB does not perform internal appraisals or valuations of collateral.

Recommendation: MIDB should perform internal appraisals of collateral.

**SECTION II – OTHER MATTERS, CONTINUED****6. Interest Income on Delinquent Loans**

Comment: MIDB recognizes and accrues interest for loans less than 90 days per GAAP. However, upon discontinuance of accrual of interest after being past due for more than 90 days, all unpaid accrued interest is not reversed and subsequent collections are applied to interest then to principal. Per GAAP, upon such discontinuance, all unpaid accrued interest is reversed and thereafter interest is recognized only to the extent of cash payments are received after the principal is recovered. In FY17, application to principal for payments of delinquent loans have been applied for loans more than 270 days; however, application did not occur for loans more than 90 days but less than 270 days.

Recommendation: We recommend that management continue to address application of payments for delinquent loans in accordance with GAAP. In addition, management should maintain separate recording of loans for internal monitoring purposes for loans written-off in the books when borrower contractual obligations are not legally extinguished.

**7. Loan Processing Fees**

Comment: MIDB recognizes at the loan opening date the full amount of loan processing fees regardless of the fact that it is included as part of loan receivable balance and not collected in cash.

Recommendation: We recommend that management collects in cash loan processing fees at the opening of the loan for MIDB to fully recognize such fees as income at loan inception.

**8. Employee Pension Plan**

Comment: MIDB has a retirement plan for employees wherein MIDB employees who elect to be members of the plan contribute \$30/pay period and MIDB will match the full amount of employee contribution.

Recommendation: We recommend that management establishes its employee pension plan outside of MIDB books to be administered by a pension plan trustee to clearly determine pension plan assets and liabilities for the security of its plan members.

**SECTION III – DEFINITION**

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**

MIDB'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 effected 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.