

July 3, 2018

Mayor James Matayoshi  
Rongelap Atoll Local Government  
Republic of the Marshall Islands

Dear Mayor Matayoshi:

In planning and performing our audit of the financial statements of the governmental activities and each major fund of the Rongelap Atoll Local Government (RALGOV) for the year ended September 30, 2014, which collectively comprise RALGOV's basic financial statements and on which we have issued our report dated July 3, 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 RALGOV'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 RALGOV's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of RALGOV'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 RALGOV'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 RALGOV, also dated July 3, 2018 on our consideration of RALGOV'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.

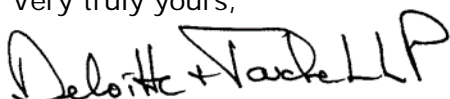
A description of the responsibility of management for establishing and maintaining internal control over financial reporting and of the objectives of and inherent limitations of internal control over financial reporting, is set forth in the attached Appendix II and should be read in conjunction with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

This report is intended solely for the information and use of management, the Council, others within the organization, 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.

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

Very truly yours,



**SECTION I – CONTROL DEFICIENCIES**

We identified, and have included below, control deficiencies involving RALGOV’s internal control over financial reporting as of September 30, 2014 that we wish to bring to your attention:

(1) Rongelap Bungalows

Rongelap Bungalow Inc.’s store credit sales were not timely recorded. Cash collections and deposits were recorded as miscellaneous revenue. Furthermore, inventories are not accounted for at year-end. Thus, no recognition of cost of sales occurred during the year.

We recommend that the US GAAP modified accounting method should be adopted.

(2) Capital Asset

A physical capital asset inventory is not performed. RALGOV-owned vehicles lack city government seal.

Inventories of capital assets should be periodically performed. RALGOV may consider attaching city government seals to its vehicles to facilitate monitoring.

(3) Interfund Balances

Interfund balances were not periodically reconciled. As an example, the period ending December 31, 2013 interfund balances noted a \$51,743 difference.

RALGOV recorded a post-closing journal entry of \$54,188 to reconcile the Rongelap Bungalow interfund account. Reconciliations were due to unrecorded interfund transactions arising in prior years. We recommend that interfund reconciliations be periodically performed.

(4) Bank Reconciliation

Bank reconciliations included outstanding checks of \$140,830, 67% or \$94,498 which was classified as stale checks.

<u>Fund</u>	<u>Outstanding Checks</u>	<u>Stale Checks</u>
General Fund	\$ 20,039	\$ 14,803
Payroll	14,821	10,415
Resettlement Project	29,827	11,208
Rongelap Bungalows	10,288	10,288
Distribution	<u>65,855</u>	<u>47,784</u>
Total	\$ <u>140,830</u>	\$ <u>94,498</u>

In addition, suspense reconciling items have been long outstanding without appropriate resolution.

Distribution	\$2,768
General Fund	352
Resettlement Phase One	1,015

**SECTION I – CONTROL DEFICIENCIES, CONTINUED**(4) Bank Reconciliation, Continued

Check number 103600 amounting to \$9,000 was withdrawn from Local Distribution Authority (LDA) fund as an employee advance. The transaction does not fall within the purpose of the fund.

We recommend management investigate long outstanding checks and determine an appropriate course of action. We also recommend management comply with the approved policies of LDA.

(5) Expenditures

The following instances were noted during expenditure tests:

- General Fund
  - a. Check numbers 45705, 45651 and 45745 were drawn for death donations but lacked death certificates on file.
  - b. Check number 46030 amounting to \$1,723 as payment for vehicle maintenance lacks adequate quotations from qualified vendors to support competitive that a procurement process occurred.
  - c. A journal entry with document number PR622 amounting to \$660 recognizing airfare tickets lacked an invoice, checks, and approved travel forms to support, recorded transactions.
- Rongelap Bungalows
  - a. Check number 8305 amounting to \$4,054 as partial payment of labor and materials for repair of a tourism boat lacked adequate quotations from qualified vendors to support that the competitive procurement occurred.
- Resettlement Phase One
  - a. Check number 08046 amounting to \$60 was named under a RALGOV employee as payment for helper's wages. No documentation was on file to support acknowledgment of the actual receipt by the helper.
  - b. Check numbers 08048, 08230, 08296, 08043 and 08075 with a total amount of \$17,478 as payment for professional fees incurred by an affiliate company were not properly recorded as a receivable at year-end.
  - c. Check number 07947 amounting to \$15,878 as payment for consultant's reimbursements lacked actual invoices. A written consultancy agreement was not available on file.
  - d. Check number 08075 amounting to \$280 lacked a supporting invoice.
  - e. Check number 08048 amounting to \$6,250 as payment of professional fees lacked evidence that the competitive procurement process occurred.

We recommend that payments be supported by vendor invoices. In addition, we recommend that purchases be supported by documentation that competitive procurement process has occurred.

**SECTION I – CONTROL DEFICIENCIES, CONTINUED**

(6) Receivables and Allowance for Doubtful Accounts

- a. A receivable from RepMar Finance of \$25,600 has been outstanding for over a year and subsequent collection has not occurred.
- b. A receivable amount of \$6,600 was improperly presented.
- c. Accrued interest receivable of \$2,000 arose from an affiliate company's cash advance. However, the principal amount is in dispute.
- d. RALGOV liquidated \$6,059 of receivables from an affiliate company. Of the total balance, \$2,200 lacked a signed lease agreement and actual invoices to support the offset.
- e. No documentation available on file to support RALGOV performs allowance assessment.

We recommend that RALGOV investigate long outstanding receivables. Accrual and liquidation of receivables should be supported by invoices. Periodic assessments of the allowance is recommended.

(7) Journal Entries

Tests of journal entries noted the following instances:

- a. JV2014-175, JV2014-173, JV2014-031, JV2014-155, JV2014-171f, JV2014-169, JV2014-170c, JV2014-032, JV2014-152, JV2014-005, JV2014-154, JV2014-002, JV2014-032, JV2014-167, JV2014-153, JV2014-122, JV2014-019 lacked a signature of the reviewer supporting that independent review took place.
- b. Journal entries with document numbers PR9292, PR9856, 100392 and PR9291 showed that the purchase requisition lacked a preparer and reviewer signature supporting that independent review of the transaction took place.
- c. JV2014-168a showed recognition of RALGOV expenditures paid by an affiliated company. However, invoices were not on file to support the recorded expenditures.

We recommend that independent review of journal entries be performed and be properly documented. Journal entries recorded should be adequately supported by appropriate documentation and invoices.

(8) Investment

An investment in savings plan balance at September 30, 2014 lacked supporting investment statements. Monthly statements of an investment in savings plan were not on file. Insured individuals covered by the related insurance policy have resigned but no change has been made with the insurance policy. Inadequate documentation for the approval and assignment of insured employees exists.

We recommend RALGOV maintain adequate documentation ensuring that significant documents are properly filed. RALGOV should also determine an appropriate course of action for its investment in savings plan.

**SECTION I – CONTROL DEFICIENCIES, CONTINUED**

(9) Distribution

Check no. 100774 amounting to \$452 lacks acknowledgment to support actual receipt. An additional name was added to the original list of exposed individuals. No written documentation was on file to support authorization and approval of the Executive Council. We recommend that management adhere to financial management policies and adequately document approval process for any significant changes in the distribution list.

(10) Payroll

Timesheets are not kept for employees. However, supervisors are required to submit exception reports for employee absences and other employee matters. Exception reports were not available for examination.

One employee with a designation of alap lacked a signed personnel action form on file. One councilman changed from non-executive to an executive member which resulted in an increase in salary and lacked written documentation. Another employee with a designation of alap died during the year but lacked a death certificate on file.

Three RALGOV employees with total annual salaries of \$32,250 work for an affiliated company. A written agreement documenting a sharing of services was not on file.

We recommend that management adopt a policy of requiring timesheets to monitor employee attendance. Furthermore, we recommend that management timely update permanent employee files. RALGOV should also produce written documentation on sharing of services with an affiliated company.

(11) Receivables

General fund receivables from RMI Finance of \$25,600 have been outstanding for over a year. Invoices and communications related to collection were not available on file.

A receivable of \$6,600 reported in the General Fund was presented as incorrectly.

In addition, another \$2,000 was recognized as receivable for interest earned on a cash advance to an affiliated company. However, the principal amount is currently in dispute as debtor asserts that such advance has been utilized for RALGOV's domestic airfare tickets.

An amount of \$6,059 was liquidated from an outstanding receivable of \$7,088 in the Resettlement Phase One. However, \$2,200 of that related to a lease payment and monthly feed cost and lacks a signed lease agreement and actual invoices of purchased fish feed meal.

We recommend that management perform reviews of outstanding receivables, adequately document liquidation, and determine collectability of outstanding receivables.

(12) Account Reconciliations

RALGOV recorded twelve post-closing adjusting entries during the audit. We recommend that management perform periodic reconciliation of accounts and timely update general ledger accounts.

## 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 at this time are as follows:

### (1) Segregation of Duties

RALGOV's current level of staffing limits the number of personnel available for accounting duties. Accordingly, appropriate segregation of duties is not always possible which may result in a weakness in internal control, specifically in the role of the City Manager who has access to assets, has approving authority for disbursements, and also has full access to accounting records. To mitigate this weakness, a critical element in RALGOV's internal control system is the involvement of management in the day-to-day operations and the review of accounting activities and financial reports.

Furthermore, certain duties of the Accounts Payable clerk are incompatible such as processing checks for claims payments and distribution of such to payees. We recommend that management establish controls to require rotation of the check distribution function among RALGOV staff.

We encourage involvement of management on a continuing basis and a thorough review of accounting activities and financial reports as a means to maintain effective internal control until a more structured control environment becomes cost effective.

### (2) Sick Leave and Annual Leave Policy

There are currently no policies and procedures governing employee absences including sick and vacation leave. Employee paid time off is usually allowed by management. However, no policies are in place that establish limits and authorizations. Furthermore, a mandatory vacation policy may be especially beneficial to RALGOV, being a small entity, where certain employees may be handling incompatible duties. This could allow management to observe if there is a noticeable change while another person is performing the duties. We recommend that management establish vacation and sick leave policies.

### (3) Amendments to Claims Trust Agreement

The original Trust Agreement was approved by the Government of the Marshall Islands (RepMar) through the Ministry of Finance and the Attorney General, as consistent with the Rongelap Agreed Minute, pursuant to Section 8 of the Article II of the Compact Section 177 Agreement. However, it appears that such approval was not obtained for the Amended Claims Trust Agreement. We recommend that management consult with legal counsel as to the need to obtain approval of the Amended Trust from RepMar.

### (4) Reporting

Management reports were not available. We recommend management consider preparing management reports that assist management and executive officers to monitor financial transactions and that support a relevant and well-informed decision making process.

**SECTION II - OTHER MATTERS, CONTINUED**

(5) Resettlement Housing Project

The resettlement housing project has been completed since FY2014. Adequate documentation was not provided to support formal assignment and distribution of built houses for occupancy. To date, 40 housing units are left unoccupied and have not been distributed.

We recommend that the Executive Council adopt rules and procedures to facilitate distribution and occupancy of the Resettlement Project houses.

**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**

RALGOV'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.