

June 25, 2010

Mr. Jefferson Barton
Secretary of Finance
Republic of the Marshall Islands

Dear Secretary Barton:

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, 2009 (on which we have issued our report dated June 25, 2010), 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, 2009 that we wish to bring to your attention.

We have also issued a separate report to the President, His Excellency Jurelang Zedkaia, also dated June 25, 2010, 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.

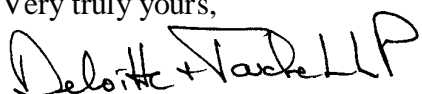
A description of the responsibility of management for establishing and maintaining internal control over financial reporting and of the objectives of and inherent limitations of internal control over financial reporting, is set forth in the attached Appendix II and should be read in conjunction with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

We identified the following control deficiencies involving RepMar's internal control over financial reporting as of September 30, 2009:

Petty Cash Imprest Accounts

At September 30, 2009, the Ministry of Finance recorded twenty-seven (27) petty cash imprest accounts in the aggregate amount of \$23,995. We selected one item for testing (G/L Acct # 950000-11044, Ebeye Thyroid Petty Cash) in the amount of \$7,585; however, it was determined that this petty cash account no longer existed. As the amount of \$7,585 was 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 determine whether such represent valid petty cash accounts.

Miscellaneous Receivables

At September 30, 2009, the Ministry of Finance recorded the following receivable balances that were not supported by underlying subledgers:

<u>G/L Acct #</u>	<u>G/L Balance</u>	<u>G/L Acct #</u>	<u>G/L Balance</u>	<u>G/L Acct #</u>	<u>G/L Balance</u>
100100-20200	\$ 59,499	100100-24012	\$ 2,367	100100-24060	\$ 13,875
100100-22005	\$ 33,419	100100-24020	\$ 12,053	100100-24090	\$ 15,467
100100-22020	\$ 18,956	100100-24027	\$ 1,298	100100-24100	\$ 226,557
				950000-24100	\$ (1,566)

No audit adjustments were proposed for the above items as these receivable balances were offset by an allowance for uncollectible accounts in the amount of \$381,925. We recommend that the Ministry of Finance reconcile these receivable accounts and determine their ultimate collectability.

Furthermore, at September 30, 2009, the Ministry of Finance recorded reimbursable travel from the Asian Development Bank, totaling \$27,941, pertaining to Travel Advance Voucher #s 120742 and 120740, which had not been collected to date (over 6 months from date of travel). We recommend that management require timely collection of receivables.

Payroll Allotment Liabilities

At September 30, 2009, the Ministry of Finance recorded various payroll allotment liabilities totaling \$987,056 pertaining to the last payroll period of fiscal year 2009 whereas the actual amount withheld and payable amounted to \$979,733, resulting in a variance of \$7,323. As this amount was not considered material to the financial statements, no audit adjustment was proposed; however, we recommend that the Ministry of Finance reconcile payroll allotment liability accounts on a bi-weekly basis.

APPENDIX I, CONTINUED

Travel Advances

At September 30, 2009, the Ministry of Finance recorded travel advances within the general ledger that were not reconciled to the supporting DILOG subledger. Details are as follows:

<u>G/L Acct #</u>	<u>G/L Balance</u>	<u>Subledger Balance</u>	<u>G/L Balance</u>	<u>G/L Acct #</u>	<u>Subledger Balance</u>
100100-28010	\$ 53,043	\$ 64,947	410102-28010	\$ (3,365)	\$ (6,056)
200090-28010	\$ (1,685)	\$ 1,455	410150-28010	\$ 19,344	\$ 18,504
200330-28010	\$ (302)	\$ -	600350-28010	\$ 40,664	\$ 30,831
200332-28010	\$ (614)	\$ 3,524	700360-28010	\$ 1,488	\$ 1,200
200340-28010	\$ 1,404	\$ 804			
200515-28010	\$ (710)	\$ -			

Total general ledger balances for travel advances did not agree to the supporting DILOG subledger, resulting in a net unreconciled variance of \$5,942. No audit adjustment was proposed as this amount was not considered material to the financial statements. In addition, a total of \$113,137 in credit balances was included in the above net variance, which appears to relate to erroneous recordings of travel advance liquidations.

We recommend that the Ministry of Finance reconcile travel advances to the supporting DILOG subledger on a monthly basis.

Accounts Payable

At September 30, 2009, the Ministry of Finance recorded accounts payable within the general ledger that was not reconciled to the supporting DILOG subledger. Details of these are as follows:

<u>G/L Acct #</u>	<u>Unadjusted G/L Balance</u>	<u>Subledger Balance</u>	<u>Variance</u>	<u>Adjustments G/L Balance</u>	<u>Adjusted G/L Balance</u>
100100-50010	\$ 257,404	\$ 327,013	\$ (69,609)	\$ (131,889)	\$ 125,515
410100-50010	401,851	397,380	4,471	-	401,851
410102-50010	97,953	99,675	(1,722)	-	97,953
410110-50010	77,498	116,566	(39,068)	(43,232)	34,266
410150-50010	1,555,547	1,555,777	(230)	(1,422,599)	132,948
410170-50010	4,089	(4,089)	8,178	-	4,089
510100-50010	344,487	353,044	(8,557)	(15,954)	328,533
600350-50010	630,020	633,518	(3,498)	(82,923)	547,097
700370-50010	52,583	52,387	196		52,583
200090-50010	537	459	78		537
200330-50010	(145)	-	(145)		(145)
200515-50010	43	-	43	-	43
	<u>\$ 3,421,867</u>	<u>\$ 3,531,730</u>	<u>\$ (109,863)</u>	<u>\$ (1,696,597)</u>	<u>\$ 1,725,270</u>

We proposed audit adjustments to correct the overstatement of accounts payable and expenditures, totaling \$1,696,597, which was a result of duplicate entries for certain transactions from the Ministry of Finance Ebeye Office. The remaining unreconciled variance of \$109,863 was not considered material to the financial statements, thus no audit adjustment was proposed. In addition, the Ministry of Finance was not able to generate the DILOG A/P by Fund or Subledger reports as of September 30, 2009; however, we performed alternative procedures to verify and support year-end accounts payable balances.

We recommend that the Ministry of Finance reconcile accounts payable to the supporting DILOG subledger on a monthly basis.

APPENDIX I, CONTINUED

Bank of Marshall Islands (BOMI) Imprest Accounts

At September 30, 2009, the Ministry of Finance recorded cash of \$22,268 for the Asian Development Bank Loan # 1791 Imprest Account and cash of \$5,042 for the MOE/PEC Imprest Account. We obtained bank confirmations from BOMI and were informed that both accounts were 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 the remaining account balances and ensure that such was deposited to RepMar's General Fund bank account.

Ebeye General Fund Account

At September 30, 2009, the Ministry of Finance recorded a credit balance within the Ebeye General Fund account (G/L Acct # 950000-13015) in the amount of \$215,913, which did not articulate to the corresponding bank reconciliation balance of \$214,673. The variance of \$1,280 primarily represented unrecorded receivables for returned checks. As the amount was not considered material to the financial statements, no audit adjustment was proposed. We recommend that the Ministry of Finance ensure that all bank reconciliation adjustments are recorded to the general ledger.

Bank Errors

At September 30, 2009, the bank reconciliation for the General Account (G/L Acct # 950000-13010) and the Payroll Account (G/L Acct # 950000-13020) included bank errors in the amounts of \$41,414 and \$11,772, respectively, which date back as far as fiscal year 2003 without apparent follow-up with the financial institution. Given the aging of these balances, collectability from the financial institution may be doubtful. We recommend that the Ministry of Finance follow-up on all bank errors with the financial institution in a more timely manner.

Unrecorded Bank Transactions

At September 30, 2009, the General Account (G/L Acct # 950000-13010) bank reconciliation reported transactions totaling \$113,849 that represent various grant receipts from donor agencies that were not recorded. We recommend that the Ministry of Finance determine the disposition of these unrecorded transactions in a timely manner.

Unclaimed Property

On November 28, 2002, the Secretary of Finance received \$93,737 from the Bank of Hawaii representing unclaimed customer accounts when the bank closed its branch, and recorded such as a liability within G/L Acct # 300430-50080. In accordance with Public Law No. 1999-89, 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, 2009, the Secretary of Finance has 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.

APPENDIX I, CONTINUED

Tax Revenues

Of seventy-five (75) General Fund tax revenue receipts tested, we noted the following exceptions:

- Supporting tax forms/ calculations for the following tax payments have not been provided:
Fuel Tax - \$56,741 (Ref # G09-186G)
Fuel Tax - \$56,701 (Ref # G09-263G)
Income Tax - \$2,481 (Ref # G10-016G)
- Cash receipt # 355555 in the amount of \$746 pertaining to import taxes was not supported by Form 725 and underlying vendor invoices.
- Ebeye Cash receipt #s 9013769, 9014800 and 9015185 in the amounts of \$1,465, \$343 and \$1,838, respectively, pertaining to import taxes were not supported by underlying vendor invoices verifying amounts itemized on the respective Form 725.
- Majuro Cash receipt # 346503 in the amount of \$2,924 was not supported by underlying vendor invoices verifying amounts itemized on the respective Form 725.
- Majuro Cash receipt # 346503 in the amount of \$2,924 pertaining to business gross revenues taxes were not supported by the underlying Gross Receipts Tax return.
- Per examination of Majuro Cash receipt # 356217 in the amount of \$15,000, pertaining to an installment payment of total tax due of \$65,152, penalty and interest of approximately \$23,002 were not charged for deficiency in Gross Receipts taxes due from a local business for fiscal year 2006 through 2008.

We recommend that the Ministry of Finance ensure that tax revenue receipts are supported by underlying documentation such as vendor invoices, Form 725s, Withholding Tax returns and Gross Receipts Tax returns.

Fiji Embassy Imprest Account

At September 30, 2009, the Ministry of Finance recorded an imprest account for the Fiji Embassy in the amount of \$19,700, for which the imprest account reconciliation included net unrecorded transactions of \$4,382 pertaining to unrecorded receipts and foreign exchange gain of \$10,550 and \$1,151, respectively, less unrecorded disbursements of \$7,319. We recommend that the Ministry of Finance ensure that all transactions pertaining to the Fiji Embassy imprest account be recorded.

Japan Embassy Imprest Account

At September 30, 2009, the Ministry of Finance recorded an imprest account for the Japan Embassy in the amount of \$100,000, for which the imprest account reconciliation included net unrecorded transactions of \$44,891 pertaining to unrecorded disbursements of \$74,564 less unrecorded receipts of \$20,530 and foreign exchange gain of \$9,143. We recommend that the Ministry of Finance ensure that all transactions pertaining to the Japan Embassy imprest account be recorded.

Washington Embassy Imprest Account

At September 30, 2009, the Ministry of Finance recorded an imprest account for the Washington Embassy in the amount of \$50,000, for which the imprest account reconciliation included net unrecorded transactions of \$19,567 pertaining to unrecorded receipts of \$20,063 less unrecorded disbursements of \$496. We recommend that the Ministry of Finance ensure that all transactions pertaining to the Washington Embassy imprest account be recorded.

APPENDIX I, CONTINUED

Honolulu Consulate Imprest Account

At September 30, 2009, the Ministry of Finance recorded an imprest account for the Honolulu Consulate in the amount of \$10,000, for which the imprest account reconciliation reported net variance of \$4,228. In addition, the related bank reconciliation included outstanding checks of \$4,367, which appears to be stale-dated as the checks were 6 months to over 3 years old. We recommend that the Ministry of Finance ensure that all transactions pertaining to Honolulu Consulate imprest account be recorded.

Arkansas Consulate Imprest Account

At September 30, 2009, the Ministry of Finance recorded an imprest account for the Arkansas Consulate in the amount of \$20,000, for which the imprest account reconciliation reported a reconciling item of \$4,000 that was not adequately documented as to details. We recommend that the Ministry of Finance ensure that all transactions pertaining to Arkansas Consulate imprest account be recorded.

United Nation Mission Imprest Account

At September 30, 2009, the Ministry of Finance recorded an imprest account for the Mission to the United Nations in the amount of \$50,000, for which the imprest account has not been reconciled. The September 30, 2009 reconciliation shows a total imprest fund of \$7,588 while the recorded imprest account is \$50,000. The variance was not accounted for. Additionally, several reconciling items that date back in fiscal year 2006, totaling to \$5,936, have not been resolved.

Additionally, the Ministry of Finance has not recorded a grant amounting to \$60,000 that the UN Mission received in March 2006. Such funds are deposited in an account in the name of the UN Mission. We recommend that the Ministry of Finance require monthly reconciliations of the imprest account and proper documentation of reconciling items.

Accounts Payable – Landowners

At September 30, 2009, the Ministry of Finance recorded an amount payable to landowners (G/L Acct # 100100-55040) in the amount of \$22,857, which represented amounts received from Mobil Oil Micronesia, Inc. (MOMI) for a land lease at the airport not yet paid to the landowners. Of this amount, \$16,499 represented an amount carried over from fiscal year 2007. As the amount of \$16,499 was not considered material to the basic financial statements, no audit adjustment was proposed. We recommend that the Ministry of Finance determine the validity of amounts payable to landowners for the MOMI land lease at the airport.

Encumbrances

Of thirty one encumbrances tested for the Grants Assistance Fund, we noted one item (PO # 2218501) in the amount of \$113,701 that was no longer considered valid. Furthermore, two items tested for the Grants Assistance Funds (contract # T8049701) in the amount of \$627 were not evidenced by underlying travel authorizations verifying the recorded encumbrance. We recommend that the Ministry of Finance periodically examine the encumbrance subledger and deobligate items no longer considered valid. Furthermore, we recommend that the Ministry of Finance ensure all recorded encumbrances are evidenced by underlying supporting documentation.

APPENDIX I, CONTINUED

Net Assets

At September 30, 2009, opening fund balances on the following accounts did not agree with the audited closing balances at September 30, 2008:

<u>Fund Code</u>	<u>GL account #</u>	<u>Opening Balance per</u> <u>GL</u>	<u>Closing Balance per</u> <u>2008 Audited F/S</u>	<u>Variance</u>
100100	92040	\$ (2,879,416)	\$ (2,582,746)	\$ (296,670)
410150	92040	\$ 28,594	\$ 28,909	\$ (315)
600350	92040	\$ (2,825)	\$ (2,272)	\$ (553)
700360	92040	\$ (73,538)	\$ (80,014)	\$ 6,476
700370	92040	\$ 281,445	\$ -	\$ 281,445

We recommend that appropriate financial closing and reconciliation procedures, including related reversal of closing balances in the subsequent period, be implemented.

Prepayment

At September 30, 2009, the Ministry of Finance recorded prepayment of \$322,843 representing advances for utility expenditures for December 2008 and January 2009. As such has been utilized as of September 30, 2009, an audit adjustment was proposed to record expenditures and to eliminate the prepayment. We recommend that the Ministry of Finance reconcile prepayments on a monthly basis.

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, 2009 that we wish to bring to your attention:

Access Control of End-User

The Payroll Director is configured to be a superuser 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 superusers, including the Payroll Director, to monitor their activities in the EDP environment.

Strengthen Logical Access Control

User Access Profile is not reviewed regularly thus access privileges will be assigned improperly. Some terminated employees' accounts may not be deleted from the system. They can access the system to modify and view sensitive data after termination. Also, the user profiles of employees that were transferred or promoted may not be updated. As a result, they may have excess access privileges, which allow them unauthorized access to other modules. We recommend manual forms of access authorization be created in order to establish a basis of user access review. The forms, which will be completed by department heads, should specify who can enter which modules and systems at what time. The department heads should also sign off and date the form when users' accesses are terminated. The system administrator should file these manual forms in the IT department. The forms will assist the IT administrator with performing access review, which should be performed at least quarterly.

Enhancement of Network Security

There is a lack of control on network activities resulting in a higher chance of data integrity and confidentiality issues. For example, hackers can easily go to the network and modify/view sensitive information. We recommend the network violation report be reviewed regularly. Also, network vulnerability testing and/or network penetration testing should be performed at least annually to identify control weaknesses.

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.