

June 28, 2017

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, 2016 (on which we have issued our report dated June 28, 2017), 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, 2016 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 28, 2017 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.

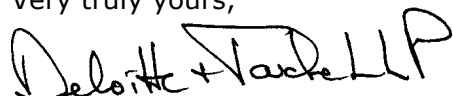
A description of the responsibility of management for establishing and maintaining internal control over financial reporting and of the objectives of and inherent limitations of internal control over financial reporting, is set forth in the attached Appendix II and should be read in conjunction with 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, 2016 that we wish to bring to your attention:

Petty Cash Imprest Accounts

At September 30, 2016, 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 2015.

Embassy Imprest Accounts

At September 30, 2016, the Ministry of Finance recorded embassy imprest accounts, for which the September 2016 imprest account reconciliations reported unknown variances as follows:

<u>Embassy</u>	<u>GL A/c #</u>	<u>Imprest Fund</u>	<u>Unknown Shortage</u>
Fiji	950000-12010	\$ 89,700	\$ (38,284)
Japan	950000-12020	\$ 200,000	\$ (97,313)
UN Mission	950000-12030	\$ 125,000	\$ (16,781)
Washington, D.C.	950000-12035	\$ 50,000	\$ (12,595)
Arkansas Consulate	950000-12045	\$ 20,000	\$ (1,335)
Honolulu Consulate	950000-12070	\$ 25,000	\$ (1,089)

Additionally, the following exceptions were noted:

- The Fiji Embassy September 2016 reconciliation included the following reconciling items:
 - \$64,278 disallowed amounts, of which \$35,427 is from prior year.
 - \$3,244 due from embassy staff from prior year.
- The Japan Embassy September 2016 reconciliation included the following reconciling items:
 - \$18,983 unrecorded deposit from prior year.
 - \$80,980 unknown deposits from prior year.
 - \$221,006 disallowed amounts, of which \$106,159 are from prior year.
 - \$859,481 unknown withdrawals, of which \$545,681 are from prior year.
 - \$126,094 advances to the embassy from various sources, of which \$76,094 are from prior year.
- The Taiwan Embassy September 2016 reconciliation included \$23,337 in disallowed amounts.
- The UN Mission September 2016 reconciliation included the following reconciling items:
 - \$148,547 unrecorded receipts, of which \$147,762 are from prior year.
 - Four missing checks (#s 10286, 10400, 10406 and 10432) for \$5,525 each.
 - \$26,817 overpayment to the Mission in 2011 (initially paid on June 30, 2011 and paid again on July 15, 2011), which has not been offset against subsequent reimbursement requests.
 - \$214,555 disallowed amounts, of which \$193,589 are from prior year.

Embassy Imprest Accounts, Continued

- The Washington, D.C. Embassy September 2016 reconciliation included \$1,502 in disallowed amounts.
- The Korea Embassy \$25,000 imprest fund was not supported by a September 2016 reconciliation or associated bank statements.
- The Honolulu Consulate September 2016 reconciliation included \$10,502 in disallowed amounts.

We recommend the Ministry of Finance require monthly reconciliations of the imprest accounts and documentation and resolution of reconciling items. We further recommend unknown variances be timely investigated. This matter was discussed in previous letters to management for the audits of fiscal years 2010 through 2015.

Closed Bank Accounts

At September 30, 2016, the Ministry of Finance recorded cash of \$22,268 for the Asian Development Bank Loan # 1791 Imprest Account (GL A/c # 800405-12062). A bank confirmation obtained in a prior audit indicated that the account had been closed; however, we were unable to ascertain the final disposition of the remaining account balance. We recommend the Ministry of Finance determine the final account balance disposition and verify whether such 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 2015.

Moreover, bank confirmations indicated that the associated accounts had been closed for NCT Investments (GL A/c # 300614-19060) and Micro President/Chief Summit (GL A/c # 950000-15086). This matter was reported in previous audits within Finding Nos. 2013-010, 2014-008 and 2015-014.

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 2016 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 2015.

Miscellaneous Receivables

At September 30, 2016, 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	\$ 420,973
950000-24100	\$ (1,566)

No audit adjustments were proposed as these receivables were offset by a corresponding allowance for uncollectible accounts. 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 2015.

Capital Assets

The following exceptions were noted:

- One item (Caterpillar 730 Rock/Articulated Truck-2005) is with a local contractor for repairs; however, there is no documentation of the required repairs and authorization of such or evidence that custody of the asset is being monitored.
- One item (Hitachi loader ZW120-G 270283) was relocated to Jaluit Atoll; however, transfer documentation and an image of the asset at its new location were not available.
- One item (Hitachi excavator 270280) was relocated to Ebeye island; however, no transfer documentation was available for examination. An image of the asset at its new location was provided, however, such did not display a tag # for verification.
- One item (safety loader truck 274304) displayed a tag # which differed from the fixed asset register

We recommend management establish policies and procedures requiring documentation of capital assets locations, condition and maintenance, and identification tag #s.

Moreover, 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, when appropriate, with Ministry of Public Works personnel when estimating asset useful lives, which should be periodically re-assessed and adjusted as appropriate.

These matters were discussed in previous letters to management for the audits of fiscal years 2011 through 2015.

Labor Bonds Payable

At September 30, 2016, 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 the Ministry of Finance perform regular reconciliations of labor bonds payable accounts and require refunds be issued based on valid labor bonds recorded. This matter was discussed in previous letters to management for the audits of fiscal years 2010 through 2015.

Cancelled Checks

At September 30, 2016, unclaimed checks held at the Treasury Department included certain checks which had been cancelled and adjusted to general fund liabilities. We recommend the Accounting Department recall cancelled checks from the Treasury Department for review and proper disposition. This matter was discussed in previous letters to management for the audits of fiscal years 2012 through 2015.

Unidentified Income

At September 30, 2016, the Ministry of Finance recorded a \$41,801 debit balance 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 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 and 2015.

Payroll Expenditures

Tests of payroll expenditures resulted in the following exceptions:

- A personnel action form or salary memo for employee # 52831 supporting the hourly rate paid for the pay period ended October 31, 2015 was not available.
- Approved timesheets for the following employees erroneously indicated 60 overtime hours (paid at time and a half) rather than 60 night differential hours (paid at 15%):

<u>Employee #</u>	<u>PPE Date</u>
76782	01/23/2016
238498	02/06/2016
70518	08/06/2016

The employees were correctly paid night differential hours.

- An approved timesheet for employee # 236442 for the pay period ended August 20, 2016 erroneously indicated 13.09 overtime hours; the correct 18.64 overtime hours were paid.
- A personnel action form for employee # 216448 erroneously indicated a night differential rate of 10% rather than the correct rate of 15%.
- Delays in processing an employment contract for employee # 89754 resulted in a retroactive payment on the pay period ended July 23, 2016, which was understated by \$1,288 due to an erroneous calculation.
- An approved timesheet for employee #s 55591, 209107 and 215063 for the pay period ended November 28, 2015 indicated 16 holiday hours; however, 8 holiday hours were paid as only one holiday occurred that pay period.
- A calculation error resulted in employee # 220605 being underpaid for seventy-eight pay periods by a total of \$2,400, of which \$560 was paid in the pay period ended June 25, 2016. A balance of \$1,840 remains unpaid to the employee.

We recommend management establish policies and procedures to facilitate: (1) the veracity of timesheets, payroll processing and the overall approval process; and (2) the timely processing of personnel action forms. This matter was discussed in previous letters to management for the audits of fiscal years 2013 through 2015.

Non-Payroll Expenditures

Check # 141155 (APV # 272213) was for a vehicle purchase wherein an additional \$3,250 was charged to the General Fund because of user preference instead of purchasing a less expensive vehicle from another vendor.

Encumbrances

Encumbrances were not reviewed and reconciled throughout fiscal year 2016. Reconciled encumbrance subsidiary ledgers provided on March 20, 2017 included undated encumbrances totaling \$538,045. We recommend management periodically review encumbrance subsidiary ledgers for invalid encumbrances and timely reconcile the general ledger to subsidiary ledgers. This matter was previously reported in prior audits within Finding Nos. 2013-013, 2014-012 and 2015-008.

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, 2016 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; 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 2015.

Cash Receipts

Cash receipts are not consistently issued for contributions received via check, resulting in inaccurate and untimely recording. We recommend management establish policies and procedures requiring the issuance of cash receipts for such contributions and to facilitate accurate and timely recording. This matter was discussed in previous letters to management for the audits of fiscal years 2014 and 2015.

Verification of Daily Deposits

Section 4.7 of the Ministry of Finance’s 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 a previous letter to management for the audit of fiscal year 2015.

Payroll Checks

There is no established policy with respect to minimum check amounts and unclaimed payroll checks. Consequently, numerous payroll checks for nominal amounts have remained unclaimed for a number of years. 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 and 2015.

Journal Vouchers

The following exceptions were noted:

- Documentation supporting JV #s G16-89P, G16-145P and G16-147P were not available.
- Independent review and approval of JV #s G16-29C, G16-43D and G16-46M were not evident.

We recommend management require all journal vouchers be adequately supported and be 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 and 2014-013.

Annual Leave

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

- Annual leave hours available at the end of payroll # 1, which is around mid-December, is the basis for rolling over employee leave hours each year. However, PSR Part VI, paragraph 56(2) 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 required. However, PSR Instruction No. 2010/01 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 a previous letter to management for the audit of fiscal year 2015.

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 the org, cost center and account #s used. This matter was discussed in previous letters to management for the audits of fiscal years 2014 and 2015.

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 previous letters to management for the audits of fiscal years 2009 through 2015.

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 2015.

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 and 2015.

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.