

REPUBLIC OF THE MARSHALL ISLANDS

**INDEPENDENT AUDITORS' REPORTS ON
INTERNAL CONTROL AND ON COMPLIANCE**

YEAR ENDED SEPTEMBER 30, 2012

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

His Excellency Christopher J. Loeak
President
Republic of the Marshall Islands:

We have audited 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, 2012, which collectively comprise RepMar's basic financial statements and have issued our report thereon dated July 29, 2013. Our report includes a reference to other auditors and an explanatory paragraph concerning collectability of receivables federal agencies. We conducted our audit 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. Other auditors audited the financial statements of the Marshall Islands National Telecommunications Authority, as described in our report on RepMar's financial statements. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that is reported on separately by those other auditors.

For purposes of this report, our consideration of internal control over financial reporting and our tests of compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters did not include the Marshall Islands Scholarship, Grant and Loan Board, the Health Care Revenue Fund, the Marshall Islands Health Fund, the Nuclear Claims Tribunal, the Marshall Islands Social Security Administration, and the discretely presented component units, which were all audited by us, with the exception of the Marshall Islands National Telecommunications Authority, as discussed above. We have issued separate reports on our consideration of internal control over financial reporting and our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements, and other matters for the entities that were audited by us. Other auditors issued a separate report on their consideration of internal control over financial reporting and their tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements, and other matters for the Marshall Islands National Telecommunications Authority. The findings, if any, included in those reports are not included herein.

Internal Control Over Financial Reporting

Management of RepMar is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered RepMar's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, 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 that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying Schedule of Findings and Questioned Costs (pages 11 through 29), we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses.

A *deficiency in internal control* 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 *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying Schedule of Findings and Questioned Costs as items 2012-01, 2012-04, and 2012-08 through 2012-11 to be material weaknesses.

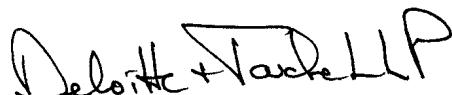
Compliance and Other Matters

As part of obtaining reasonable assurance about whether RepMar's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Findings and Questioned Costs as items 2012-5 and 2012-6.

We noted certain matters that we reported to management of RepMar in a separate letter dated July 29, 2013.

RepMar's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. We did not audit RepMar's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of management, the Honorable Members of the Nitijela, others within the entity, and the cognizant audit and other federal awarding agencies and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink that reads "Deloitte & Touche LLP". The signature is fluid and cursive, with "Deloitte" on the top line and "& Touche LLP" on the bottom line.

July 29, 2013

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS THAT COULD HAVE A DIRECT AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133 AND ON THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

His Excellency Christopher J. Loeak
President
Republic of the Marshall Islands:

Compliance

We have audited the Republic of the Marshall Islands' (RepMar's) compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of RepMar's major federal programs for the year ended September 30, 2012. RepMar's major federal programs are identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs (pages 11 through 29). Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of RepMar's management. Our responsibility is to express an opinion on RepMar's compliance based on our audit.

As discussed in Note 2B to the Schedule of Expenditures of Federal Awards, RepMar's basic financial statements include the operations of certain entities whose federal awards are not included in the Schedule of Expenditures of Federal Awards for the year ended September 30, 2012. Our audit, described below, did not include the operations of the entities identified in Note 2B as these entities conducted separate audits in accordance with OMB Circular A-133, if required.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about RepMar's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of RepMar's compliance with those requirements.

As described in items 2012-01 through 2012-07 in the accompanying Schedule of Findings and Questioned Costs, RepMar did not comply with requirements regarding allowable costs/cost principles, cash management, equipment and real property management, procurement and suspension and debarment, and subrecipient monitoring that are applicable to its Compact of Free Association Sector Grants (CFDA # 15.875) major program; and regarding cash management, equipment and real property management, and procurement and suspension and debarment that are applicable to its Special Education-Grants to States (CFDA # 84.027) major program. Compliance with such requirements is necessary, in our opinion, for RepMar to comply with the requirements applicable to those programs.

In our opinion, except for the noncompliance described in the preceding paragraph, RepMar complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended September 30, 2012.

Internal Control Over Compliance

Management of RepMar is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered RepMar's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of RepMar's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weakness have been identified. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies

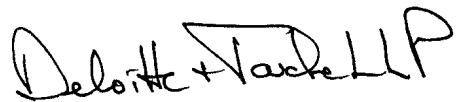
A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs as items 2012-01 through 2012-07 to be material weaknesses.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of RepMar as of and for the year ended September 30, 2012, and have issued our report thereon dated July 29, 2013, which contained an unqualified opinion on those financial statements and which report included a reference to other auditors and an explanatory paragraph concerning collectability of receivables federal agencies. Our audit was conducted for the purpose of forming our opinions on the financial statements that collectively comprise RepMar's financial statements. The accompanying Schedule of Expenditures of Federal Awards (pages 6 and 7) is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Schedule of Expenditure of Federal Awards is fairly stated in all material respects in relation to the financial statements as a whole.

RepMar's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. We did not audit RepMar's responses and, accordingly, we express no opinion on the responses.

This report is intended solely for the information and use of management, the Honorable Members of the Nitijela, others within the entity, and the cognizant audit and other federal awarding agencies and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte + Touche LLP

July 29, 2013

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Expenditures of Federal Awards Year Ended September 30, 2012

| <u>CFDA#</u> | <u>Agency/Program</u> | <u>Federal Expenditures</u> |
|--|--|---------------------------------|
| GENERAL FUND AND REIMBURSABLE FUND: | | |
| | <u>U.S. Department of Commerce:</u> | |
| 11.460 | Special Oceanic and Atmospheric Projects | \$ 423,989 |
| U.S. FEDERAL GRANTS FUND: | | |
| | <u>U.S. Department of Agriculture:</u> | |
| 10.567 | Food Distribution Program on Indian Reservations | \$ 545,681 |
| 10.664 | Cooperative Forestry Assistance | <u>17,526</u> |
| | Total U.S. Department of Agriculture | <u>563,207</u> |
| | <u>U.S. Department of the Interior:</u> | |
| 15.875 | Economic, Social and Political Development of the Territories: | |
| | Four Atoll Health Care | 990,203 |
| | HPO USAKA Grant | 4,789 |
| | Office of the Auditor General Grant | 33,472 |
| | RMI Legislation/On-Line VISA | <u>60,834</u> |
| | Sub-total CFDA # 15.875 | <u>1,089,298</u> |
| 15.904 | Historic Preservation Fund Grants-In-Aid | <u>180,335</u> |
| | Total U.S. Department of the Interior | <u>1,269,633</u> |
| | <u>U.S. Small Business Administration:</u> | |
| 59.037 | Small Business Development Centers | <u>24,079</u> |
| | <u>U.S. Department of Education:</u> | |
| 84.027 | Special Education-Grants to States | <u>1,795,443</u> |
| | <u>U.S. Department of Health and Human Services:</u> | |
| 93.003 | Public Health and Social Services Emergency Fund | 197,416 |
| 93.069 | Public Health Emergency Preparedness | 85,080 |
| 93.110 | Maternal and Child Health Federal Consolidated Programs | 281,532 |
| 93.116 | Project Grants and Cooperative Agreements for Tuberculosis Control Programs | 104,527 |
| 93.118 | Acquired Immunodeficiency Syndrome (AIDs) Activity | 103,220 |
| 93.163 | Health Services in the Pacific Basin | 719,296 |
| 93.163 | ARRA - Health Services in the Pacific Basin | 176,175 |
| 93.217 | Family Planning-Services | 279,041 |
| 93.243 | Substance Abuse and Mental Health Services-Projects of Regional and National Significance | 779,662 |
| 93.268 | Immunization Cooperative Agreements | 997,232 |
| 93.268 | ARRA - Immunization Cooperative Agreements | 44,032 |
| 93.889 | National Bioterrorism Hospital Preparedness Program | 167,323 |
| 93.938 | Cooperative Agreements to Support Comprehensive School Health Programs to Prevent the Spread of HIV and Other Important Health Problems | 23,728 |
| 93.958 | Block Grant for Community Mental Health Services | 68,378 |
| 93.959 | Block Grants for Prevention and Treatment of Substance Abuse | 521,411 |
| 93.977 | Preventive Health Services-Sexually Transmitted Diseases Control Grants | 76,846 |
| 93.988 | Cooperative Agreements for State-Based Diabetes Control Programs and Evaluation of Surveillance Systems | 174,886 |
| 93.988 | ARRA - Cooperative Agreements for State-Based Diabetes Control Programs and Evaluation of Surveillance Systems | <u>19,648</u> |
| | Total U.S. Department of Health and Human Services | <u>4,819,433</u> |
| | TOTAL U.S. FEDERAL GRANTS FUND | <u>\$ 8,471,795</u> |

See accompanying notes to schedule of expenditures of federal awards.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Expenditures of Federal Awards, Continued Year Ended September 30, 2012

| <u>CFDA#</u> | <u>Agency/Program</u> | <u>Federal Expenditures</u> |
|--|--|---------------------------------|
| COMPACT SECTOR GRANTS FUND: | | |
| <u>U.S. Department of the Interior:</u> | | |
| 15.875 | Economic, Social and Political Development of the Territories: Compact of Free Association Program, As Amended, Sector Grants: | |
| | Section 211(a)(1) Education Sector | \$ 11,651,936 |
| | Supplemental Education Grant | 5,474,546 |
| | Section 211(a)(2) Health Sector | 7,218,575 |
| | Section 211(a)(4) Public Sector Capacity Building | 217,517 |
| | Section 211(b)(1) Ebeye Special Needs | 3,546,288 |
| | Section 211(b)(2) Landowners Special Needs | 2,302,377 |
| | Section 211(b)(3) Kwajalein Environment | 557,472 |
| | Section 211(d)(1) Public Infrastructure Development | 5,373,063 |
| | Section 211(d)(2) Infrastructure Maintenance | 1,154,836 |
| | Section 211(e)(1) Disaster Assistance | 49,952 |
| | TOTAL COMPACT SECTOR GRANTS FUND | <u>\$ 37,546,562</u> |
| SECTION 212 KWAJALEIN LANDOWNERS FUND: | | |
| <u>U.S. Department of the Interior:</u> | | |
| 15.875 | Economic, Social and Political Development of the Territories: Compact of Free Association Program, As Amended: Section 212 Kwajalein Impact and Use | <u>\$ 17,160,578</u> |
| SECTION 213 AUDIT FUND: | | |
| <u>U.S. Department of the Interior:</u> | | |
| 15.875 | Economic, Social and Political Development of the Territories: Compact of Free Association Program, As Amended: Section 213 Audit | <u>\$ 155,152</u> |
| TOTAL FEDERAL PROGRAM EXPENDITURES | | |
| <u>\$ 63,758,076</u> | | |
| Reconciliation to the 2012 financial statements is as follows: | | |
| | General Fund (Reimbursable Fund) | (1) \$ 423,989 |
| | U.S. Federal Grants Fund | (2) 8,471,795 |
| | Compact Sector Grants Fund | (3) 37,546,562 |
| | Section 212 Kwajalein Landowners Fund | (4) 17,160,578 |
| | Section 213 Audit Fund | (5) 155,152 |
| | | <u>\$ 63,758,076</u> |

- (1) Included within total expenditures for the Reimbursable Fund of \$627,016 presented on page 105 of the 2012 financial statements.
- (2) Represents the aggregate total for expenditures and transfers out for the U.S. Federal Grants Fund of \$7,481,592 and \$990,203, respectively, presented on page 95 of the 2012 financial statements.
- (3) Represents the aggregate total for expenditures and transfers out for the Compact Sector Grants Fund of \$36,267,585 and \$1,278,977, respectively, presented on page 95 of the 2012 financial statements.
- (4) Represents the aggregate total for expenditures for the Section 212 Kwajalein Landowners Fund of \$17,160,578 presented on page 85 of the 2012 financial statements.
- (5) Represents the aggregate total for expenditures for the Section 213 Audit Fund of \$155,152 presented on page 95 of the 2012 financial statements.

See accompanying notes to schedule of expenditures of federal awards.

REPUBLIC OF THE MARSHALL ISLANDS

Notes to Schedule of Expenditures of Federal Awards Year Ended September 30, 2012

(1) Scope of Audit

The Republic of the Marshall Islands (RepMar) is a governmental entity governed by its own Constitution. All significant operations of RepMar are included in the scope of the OMB Circular A-133 audit (the "Single Audit"). The U.S. Department of the Interior has been designated as RepMar's cognizant agency for the Single Audit.

a. Programs Subject to Single Audit

The Schedule of Expenditures of Federal Awards presents each federal program related to the following agencies:

- U.S. Department of Agriculture
- U.S. Department of Commerce
- U.S. Department of Education
- U.S. Department of Health and Human Services
- U.S. Department of the Interior
- U.S. Small Business Administration

(2) Summary of Significant Accounting Policies

a. Basis of Accounting

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of RepMar and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133. All expenses and capital outlays are reported as expenditures.

b. Reporting Entity

For purposes of complying with the Single Audit Act of 1984, as amended in 1996, RepMar's reporting entity is defined in Note 1A to its September 30, 2012 basic financial statements; except that the Marshall Islands Scholarship, Grant and Loan Board, the Health Care Revenue Fund, the Marshall Islands Health Fund, the Marshall Islands Social Security Administration, and all of the discretely presented component units are excluded. Accordingly, the accompanying Schedule of Expenditures of Federal Awards presents the federal award programs administered by RepMar, as defined above, for the year ended September 30, 2012.

c. Matching Costs

Matching costs, i.e., the nonfederal share of certain program costs, are not included in the accompanying Schedule of Expenditures of Federal Awards.

REPUBLIC OF THE MARSHALL ISLANDS

Notes to Schedule of Expenditures of Federal Awards, Continued Year Ended September 30, 2012

(2) Summary of Significant Accounting Policies, Continued

d. Subgrantees

Certain program funds are passed through RepMar to subgrantee organizations. The Schedule of Expenditures of Federal Awards does not contain separate schedules disclosing how the subgrantees, outside of RepMar's control, utilized the funds. The following is a summary of program funds that are passed through to subgrantee organizations:

| <u>Grantor/Grant Title CFDA No.</u> | <u>Subgrantee</u> | <u>2012 Amount of Pass-through</u> |
|--|---|------------------------------------|
| <u>U.S. Department of the Interior – CFDA #15.875</u> | | |
| Economic, Social and Political Development of the Territories: | | |
| Compact of Free Association, As Amended, Education Sector Grant | College of the Marshall Islands | \$ 1,083,333 |
| Compact of Free Association, As Amended, Supplemental Education Grant | College of the Marshall Islands | \$ 162,713 |
| Compact of Free Association, As Amended, Public Infrastructure Development | College of the Marshall Islands | \$ 247,654 |
| Compact of Free Association, As Amended, Landowners Special Needs | Kwajalein Atoll Joint Utilities Resources, Inc. | \$ 2,187,072 |
| Compact of Free Association, As Amended, Environment Sector Grant | Majuro Atoll Waste Company, Inc. | \$ 325,000 |
| Compact of Free Association, As Amended, Public Infrastructure Development | Majuro Atoll Waste Company, Inc. | \$ 65,000 |
| Compact of Free Association, As Amended, Public Infrastructure Development | Majuro Water and Sewer Company, Inc. | \$ 150,000 |
| Compact of Free Association, As Amended, Education Sector Grant | Marshall Islands Scholarship, Grant and Loan Board | \$ 471,925 |

REPUBLIC OF THE MARSHALL ISLANDS

Notes to Schedule of Expenditures of Federal Awards, Continued Year Ended September 30, 2012

(2) Summary of Significant Accounting Policies, Continued

d. Subgrantees, Continued

| <u>Grantor/Grant Title CFDA No.</u> | <u>Subgrantee</u> | <u>2012</u> | <u>Amount of Pass-through</u> |
|---|---|-------------|-------------------------------|
| <u>U.S. Department of the Interior – CFDA #15.875</u> | | | |
| Economic, Social and Political Development of the Territories, Continued: | | | |
| Compact of Free Association, As Amended, Supplemental Education Grant | Marshall Islands Scholarship, Grant and Loan Board | \$ 707,052 | |
| Compact of Free Association, As Amended, Ebeye Special Needs Sector Grant | Marshall Islands Scholarship, Grant and Loan Board | \$ 100,000 | |

e. Indirect Cost Allocation

RepMar has not entered into an approved indirect cost negotiation agreement covering fiscal year 2012. RepMar did not charge federal programs for indirect costs during fiscal year 2012.

f. CFDA # 15.875

CFDA # 15.875 represents funding from the Office of Insular Affairs (OIA), U. S. Department of the Interior. Funding from this source is subject to varying rules and regulations since OIA administers the Compact of Free Association (the Compact), which is a treaty, and is not a federal program. The Compact is comprised of various funded programs, each with separate compliance requirements. To maximize audit coverage of OIA funding, the OIG has recommended that programs administered under CFDA # 15.875 be grouped by like compliance requirements and such groupings be separately evaluated as major programs.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs Year Ended September 30, 2012

Section I - Summary of Auditors' Results

Financial Statements

- | | | |
|--|---|---------------|
| 1. | Type of auditors' report issued: | Unqualified |
| Internal control over financial reporting: | | |
| 2. | Material weakness(es) identified? | Yes |
| 3. | Significant deficiency(ies) identified? | None reported |
| 4. | Noncompliance material to financial statements noted? | Yes |

Federal Awards

- | | | |
|---------------------------------------|--|---------------|
| Internal control over major programs: | | |
| 5. | Material weakness(es) identified? | Yes |
| 6. | Significant deficiency(ies) identified? | None reported |
| 7. | Type of auditors' report issued on compliance for major programs: | Qualified |
| 8. | Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB Circular A-133? | Yes |
| 9. | Identification of major programs: | |

| <u>CFDA #</u> | <u>Name of Federal Program</u> |
|---------------|--|
| 84.027 | Special Education – Grants to States |
| 15.875 | Economic, Social and Political Development of the Territories: Compact of Free Association, As Amended, Sector Grants |

- | | | |
|-----|--|--------------|
| 10. | Dollar threshold used to distinguish between Type A and Type B Programs: | \$ 1,912,742 |
| 11. | Auditee qualified as low-risk auditee? | No |

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2012

Section II - Financial Statement Findings

| <u>Finding Number</u> | <u>Findings</u> | <u>Refer Page #</u> |
|-----------------------|--|---------------------|
| 2012-01 | Allowable Costs/Cost Principles | 13 |
| 2012-04 | Equipment and Real Property Management | 18 - 19 |
| 2012-05 | RMI Procurement Code | 20 - 21 |
| 2012-06 | RMI Procurement Code | 22 - 23 |
| 2012-08 | General Ledger Account Reconciliations | 25 |
| 2012-09 | Accounts Receivable | 26 |
| 2012-10 | Construction-in-Progress/Retention Payable | 27 - 28 |
| 2012-11 | General Ledger Journal Entries | 29 |

Section III - Federal Award Findings and Questioned Costs

| <u>Finding Number</u> | <u>CFDA #</u> | <u>Findings</u> | <u>Questioned Costs</u> | <u>Refer Page #</u> |
|-----------------------|---------------|--|-------------------------|---------------------|
| 2012-01 | 15.875 | Allowable Costs/Cost Principles | \$ 2,203 | 13 |
| 2012-02 | 15.875 | Cash Management | Undeterminable | 14 - 15 |
| 2012-03 | 84.027 | Cash Management | Undeterminable | 16 - 17 |
| 2012-04 | 15.875 | Equipment and Real Property Management | \$ - | 18 - 19 |
| | 84.027 | Equipment and Real Property Management | \$ - | 18 - 19 |
| 2012-05 | 15.875 | Procurement and Suspension and Debarment | \$ 30,252 | 20 - 21 |
| 2012-06 | 84.027 | Procurement and Suspension and Debarment | \$ 3,402 | 22 - 23 |
| 2012-07 | 15.875 | Subrecipient Monitoring | \$ - | 24 |

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2012

Finding No.: 2012-01
Federal Agency: U.S. Department of the Interior
CFDA Program: 15.875 Economic, Social and Political Development of the Territories
Grant Number: Compact Sector Grants
Area: Allowable Costs/Cost Principles
Questioned Costs: \$2,203

Criteria: Expenditures incurred under federal programs should be in accordance with allowable costs/cost principles requirements and should be directly related to, and in accordance with, program intent and objectives.

Condition #1: Of \$22,134,625 in non-payroll expenditures for the Compact Sector Grants, one hundred one (101) items, totaling \$8,691,053, were tested. For two expenditures (or 2%), no underlying check voucher files were provided to support the following:

| <u>Fund</u> | <u>Check #</u> | <u>Account #</u> | <u>GL Account Name</u> | <u>PO #</u> | <u>APV #</u> | <u>Amount</u> |
|-------------|----------------|------------------|------------------------|-------------|--------------|-----------------|
| 410150 | 16738 | 01520 | Contractual Services | Q1378801 | 00016738 | \$ 1,659 |
| 410102 | 96844 | 02020 | Travel | A1338001 | 178522 | <u>497</u> |
| | | | | | | <u>\$ 2,156</u> |

Condition #2: Of \$15,411,937 in payroll expenditures for the Compact Sector Grants, forty-five (45) items, totaling \$31,756, were tested. For one expenditure (or 2%), an employee (# 212994) was overpaid \$47 for the pay period ended 02/11/2012. This overpayment has been extrapolated to determine a potential questioned cost, which exceeds the \$10,000 threshold.

Cause: The cause of the above conditions is the lack of attendant documentation indicating that expenditures charged to a federal program are directly related to the program and are in accordance with program intent and objectives.

Effect: The effect of the above condition is noncompliance with allowable costs/cost principles requirements. Accordingly, questioned costs in the amount of \$2,203 are reportable as the projected questioned costs exceed the \$10,000 threshold.

Recommendation: Management should require that expenditures incurred under federal programs be evidenced by supporting documentation indicating that such expenditures are directly related to and in accordance with program intent and objectives.

Prior Year Status: Lack of attendant documentation indicating that expenditures charged to a federal program are directly related to the program and are in accordance with program intent and objectives was reported as a finding in prior single audits as items 2009-1, 2009-2, 2010-1 and 2011-1.

Auditee Response and Correction Action Plan: We agree with the finding and recommendation. It is standard procedure of Ministry of Finance Accounts Payable division to require all expenditures are supported by adequate documentation. We believe the two exceptions noted pertain to deficiencies in the filing system and will locate the documents for the cited payments for subsequent clearance.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2012

Finding No.: 2012-02
Federal Agency: U.S. Department of the Interior
CFDA Program: 15.875 Economic, Social and Political Development of the Territories
Grant Number: Compact Sector Grants
Area: Cash Management
Questioned Costs: Undeterminable

Criteria: Article IV, Section 5(b)(2) of the Fiscal Procedures Agreement (FPA) states that all infrastructure projects and projects that are not funded by Operational Grants will be paid on the basis of accrued expenditures, provided the Government of the Republic of the Marshall Islands maintains procedures to minimize the time elapsing between transfer of funds and their disbursement.

Condition: Of \$7,541,013 in non-payroll expenditures for the Compact Sector Public Infrastructure Development and the Landowners Special Needs Grants, fourteen (14) items, totaling \$1,804,288, were tested. For 8 (or 57%), the following expenditures were not paid in a manner to minimize the time elapsed between transfer of funds and their disbursements:

| Check # | Check Date | Amount | Cash | Drawdown Deposit Date | Date Cleared | # of days Elapsed |
|---------|------------|------------|-------------------------|-----------------------|--------------|-------------------|
| | | | Disbursement Drawdown # | | | |
| 92408 | 11/30/2011 | \$ 232,800 | CD-02-2012 | 12/13/2011 | 01/13/2012 | 30 |
| 94040 | 01/11/2012 | \$ 232,800 | CD-06-2012 | 01/06/2012 | 01/13/2012 | 6 |
| 95047 | 02/29/2012 | \$ 73,018 | CD-09-2012 | 02/13/2012 | 02/23/2012 | 9 |
| 96645 | 04/20/2012 | \$ 358,887 | CD-11-2012 | 04/13/2012 | 04/20/2012 | 6 |
| 97471 | 05/18/2012 | \$ 50,649 | KDF-02-2012 | 05/10/2012 | 05/18/2012 | 7 |
| 97946 | 04/30/2012 | \$ 233,983 | CD-11-2012 | 04/13/2012 | 06/11/2012 | 58 |
| 98829 | 07/13/2012 | \$ 30,376 | CD-13-2012 | 07/05/2012 | 07/10/2012 | 4 |
| 99108 | 07/20/2012 | \$ 149,258 | CD-14-2012 | 07/17/2012 | 09/30/2012 | 74 |

Cause: The cause of the above condition is the lack of a formal methodology and procedures over the drawdown of federal funds to satisfy compliance with FPA cash management requirements.

Effect: The effect of the above condition is noncompliance with FPA cash management requirements. We projected a total interest liability of \$200 for the above condition based on the yield of 13-week U.S. Treasury bills. As this amount is below \$10,000, such is not reported as a questioned cost.

Recommendation: The Ministry of Finance should establish a formal methodology governing the drawdown of federal funds to minimize the time elapsed between the receipt of federal funds and the date applicable payments clear the bank.

Prior Year Status: Lack of a formal methodology and procedures over the drawdown of federal funds to satisfy compliance with FPA cash management requirements was reported as a finding in prior single audits as items 2005-7, 2006-5, 2007-8, 2008-1, 2008-2, 2009-3, 2009-4, 2010-2 and 2011-2.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2012

Finding No.: 2012-02, Continued
Federal Agency: U.S. Department of the Interior
CFDA Program: 15.875 Economic, Social and Political Development of the Territories
Grant Number: Compact Sector Grants
Area: Cash Management
Questioned Costs: Undeterminable

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. In fiscal year 2012 the drawdown of public infrastructure funds was delayed in some instances pending reconciliations of expenditures charged to the many on-going infrastructure projects. The MOF is current with its reconciliation procedures in fiscal year 2013 and will implement formal policies on the drawdowns of both Compact Public Infrastructure and Landowners Special Needs Grants.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2012

Finding No.: 2012-03
Federal Agency: U.S. Department of Education
CFDA Program: 84.027 Special Education – Grants to States
Grant Number: H027A110011
Area: Cash Management
Questioned Costs: Undeterminable

Criteria: Section 21 of 34 CFR 80, *Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments*, prescribes the basic standards and the methods under which a Federal agency will make payments to grantees and grantees will make payments to subgrantees and contractors. Methods and procedures for payment shall minimize the time elapsing between the transfer of funds and disbursement by the grantee or subgrantee in accordance with Treasury regulations at 31 CFR Part 205.

Condition: Of \$379,228 in non-payroll expenditures, thirteen (13) items, totaling \$97,322, were tested. For the following 10 (or 77%) expenditures, we were unable to perform required cash management tests as the detailed federal draw downs and supporting reimbursements were not available for examination:

| <u>Check #</u> | <u>APV #</u> | <u>Amount</u> |
|----------------|--------------|---------------|
| 91653 | 167837 | \$ 2,190 |
| 93915 | 172346 | \$ 990 |
| 95540 | 175907 | \$ 1,385 |
| 95674 | 175985 | \$ 4,664 |
| 96359 | 176454 | \$ 8,640 |
| 97947 | 180473 | \$ 50,000 |
| 98968 | 182296 | \$ 945 |
| 99082 | 183221 | \$ 4,656 |
| 99178 | 183690 | \$ 1,940 |
| 100505 | 183748 | \$ 3,402 |

Due to the lack of available information from the grantee, the amount of questioned costs, if any, applicable to the above is undeterminable.

Cause: The cause of the above condition is the lack of a formal methodology and procedures over the drawdown of federal funds to satisfy compliance with cash management requirements.

Effect: The effect of the above condition is noncompliance with cash management requirements.

Recommendation: The Ministry of Finance should establish a formal methodology governing the drawdown of federal funds to minimize the time elapsed between the receipt of federal funds and the date applicable payments clear the bank.

Prior Year Status: Lack of a formal methodology and procedures over the drawdown of federal funds to satisfy compliance with cash management requirements was reported as a finding in prior single audits as items 2005-7, 2006-4, 2007-8, 2008-1 and 2009-3.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2012

Finding No.: 2012-03, Continued
Federal Agency: U.S. Department of Education
CFDA Program: 84.027 Special Education – Grants to States
Grant Number: H027A110011
Area: Cash Management
Questioned Costs: Undeterminable

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. The standard policy for drawdown of Special Education and other Federal grants is to do so twice a month based on open encumbrances and to make the disbursement as soon as possible after receipt. Occasionally, because of delays in receiving invoices for the liquidation of the open encumbrances or other questions necessitating research by the Ministry of Education, there have been delays in making the disbursements. The MOF will formalize and implement its drawdown policy and related procedures in fiscal year 2013.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2012

Finding No.: 2012-04
Federal Agency: U.S. Department of the Interior
CFDA Program: 15.875 Economic, Social and Political Development of the Territories
Grant Number: Compact Sector Grants
Questioned Costs: \$0

Federal Agency: U.S. Department of Education
CFDA Program: 84.027 Special Education - Grants to States
Grant Number: H027A110011
Questioned Costs: \$0

Area: Equipment and Real Property Management

Criteria: Article VI , Section 1(f)(4) of the Fiscal Procedures Agreement (FPA) states that procedures for managing equipment, whether acquired in whole or in part with grant funds, will meet the following requirements:

- a. Property records must be maintained, which include (1) a description of the property, (2) a serial number or other identification number, (3) the source of property, (4) who holds title, (5) the acquisition date and cost of the property, (6) the percentage of United States funding used in the purchase, (7) the location, use and condition of the property, and (8) any ultimate disposition data including the date of disposal and sale price.;
- b. A physical inventory of the property must be taken and the results reconciled with the property records at least every two years;
- c. A control system must be developed to ensure adequate safeguards to prevent loss, damage, or theft of the property;
- d. Adequate maintenance procedures must be developed to keep the property in good condition; and
- e. If the grantee or subgrantee is authorized or required to sell the property, proper sales procedures must be established to ensure the highest possible return.

Condition: No inventory of fixed assets has been performed to satisfy compliance with applicable equipment management requirements. Capital outlay expenditures incurred by RepMar within the Compact Sector Grants Fund for fiscal years 2012, 2011 and 2010 were as follows:

| | |
|------------------|---------------|
| Fiscal Year 2012 | \$ 5,030,784 |
| Fiscal Year 2011 | \$ 7,188,740 |
| Fiscal Year 2010 | \$ 10,051,397 |

Cause: The cause of the above condition is the lack of adequate internal control policies and procedures to satisfy compliance with federal property rules and regulations.

Effect: The effect of the above condition is noncompliance with federal equipment management requirements.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2012

| | |
|-------------------|--|
| Finding No.: | 2012-04 |
| Federal Agency: | U.S. Department of the Interior |
| CFDA Program: | 15.875 Economic, Social and Political Development of the Territories |
| Grant Number: | Compact Sector Grants |
| Questioned Costs: | \$0 |
| | |
| Federal Agency: | U.S. Department of Education |
| CFDA Program: | 84.027 Special Education - Grants to States |
| Grant Number: | H027A110011 |
| Questioned Costs: | \$0 |
| | |
| Area: | Equipment and Real Property Management |

Recommendation: The Ministry of Finance should perform an inventory of RepMar's fixed assets as a basis for recording all assets in the financial statements and should complete such inventory in accordance with applicable federal property rules and regulations.

Prior Year Status: Lack of a fixed assets listing that reconciles with an inventory of RepMar's fixed assets was reported as a finding in prior single audits for fiscal years 1988 through 2000 and as items 2001-8, 2002-28, 2003-28, 2004-12, 2005-11, 2006-10, 2007-9, 2008-3, 2009-5, 2010-3 and 2011-3.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. The Ministry of Finance through its Procurement and Supply division will revive the functions of the Asset Monitoring Committee and have the Asset Accountability Officer in all respective government Ministries and agencies assist the Procurement and Supply division perform a RepMar-wide physical inventory of its capital and accountable fixed assets, no later than December 31, 2013. We note that except for a few large pieces of medical equipment, most of the capital additions in the last several years have been completed infrastructure projects, primarily school buildings, the inventory of which can be readily performed.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2012

Finding No.: 2012-05
Federal Agency: U.S. Department of the Interior
CFDA Program: 15.875 Economic, Social and Political Development of the Territories
Grant Number: Compact Sector Grants
Area: Procurement and Suspension and Debarment
Questioned Costs: \$30,252

Criteria: Article VI, Section 1(j)(1) of the Fiscal Procedures Agreement (FPA) states that RepMar may use its own procedures for procurement, whether done by the government or its Sub-Grantees, provided that they meet the standards identified in the FPA.

RepMar's Procurement Code states the following:

- (a) Section 124 – unless otherwise authorized by law, all Government contracts shall be awarded by competitive sealed bidding.
- (b) Section 127 – procurement of goods and services not exceeding \$25,000 may be made in accordance with small purchase procedures promulgated by RepMar's Policy Office. Small purchase procedures are those relatively simple and informal methods for securing services, supplies, or other property that do not cost more than \$25,000. RepMar's Ministry of Finance has previously declared that if small purchase procedures are used, price or rate quotations shall be obtained from three qualified sources.
- (c) Section 128 – a contract may be awarded for a supply, service, or construction item without competition when it is determined in writing that there is only one source for the required supply, service, or construction item.

Condition: Of \$22,134,625 in non-payroll expenditures, one hundred one (101) items, totaling \$8,691,053, were tested. For 4 (or 4%), supporting documentation was inadequate to evidence the procurement process for the following expenditures:

| <u>Item #</u> | <u>Fund #</u> | <u>Check #</u> | <u>PO #</u> | <u>APV #</u> | <u>Amount</u> |
|---------------|---------------|----------------|-------------|--------------|------------------|
| 1 | 410150 | 14420 | Q1398501 | 513691 | \$ 3,799 |
| 2 | 410110 | 99389 | | 184240 | 8,633 |
| 3 | 410100 | 100234 | P4469401 | 186405 | 12,000 |
| 4 | 410102 | 102839 | C0832302 | 190855 | 5,820 |
| | | | | | \$ <u>30,252</u> |

For item #s 1, 2 and 4, no evidence of obtaining informal price quotations was provided.

For item # 3, two of three price quotations solicited were unresponsive; however, no evidence of solicitation of other quotations was on file.

Cause: The cause of the above condition is the lack of adequate internal control policies and procedures requiring the documentation of procurement procedures to satisfy compliance with federal procurement requirements.

Effect: The effect of the above condition is noncompliance with applicable procurement requirements and questioned costs of \$30,252.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2012

Finding No.: 2012-05, Continued
Federal Agency: U.S. Department of the Interior
CFDA Program: 15.875 Economic, Social and Political Development of the Territories
Grant Number: Compact Sector Grants
Area: Procurement and Suspension and Debarment
Questioned Costs: \$30,252

Recommendation: RepMar should require that supporting documentation be adequate to comply with federal procurement requirements. Specifically, supporting documentation should indicate the history of procurement, including the rationale for vendor selection.

Prior Year Status: Lack of adequate internal control policies and procedures requiring the documentation of procurement procedures to satisfy compliance with federal procurement requirements was reported as a finding in prior single audits as items 2003-20, 2003-21, 2003-22, 2003-23, 2004-8, 2004-9, 2005-9, 2005-10, 2006-7, 2006-8, 2006-9, 2007-2, 2007-3, 2007-4, 2007-5, 2007-6, 2007-7, 2008-4, 2008-5, 2008-6, 2008-7, 2009-8, 2009-9, 2010-4, 2010-5, 2011-4, 2011-5 and 2011-6.

Auditee Response and Correction Action Plan: We agree with the finding and recommendation. Management notes the following for these four items:

Item #1: The exception pertained to a payment of Ebeye Finance, the documentation of the price quotations for which, were lost in transit on AMI to Majuro MOF. It is standard operating procedure for Ebeye Finance to require 3 quotes before vendor selection and the noted item is a non-recurring instance of lost documentation.

Item #2 represented a payment on a sole-sourced contract for hospital air conditioner repairs to a vendor who had originally provided and installed the air conditioners. Under the circumstances it was not felt appropriate to have other vendors provide quotations or perform the repairs due to their lack of familiarity with the equipment. In the future, exceptions of like nature will be documented by the Ministry of Health per Section 128 of Title 44.

Item #3 was for fence repair materials for which two of the three vendors from which quotations were solicited were non-responsive and no further attempts were made to obtain additional quotations. Management will clarify its policies and procedures concerning such situations to ensure the intent of small procurement controls are adhered to.

Item #4 pertained to an office lease for the National Training Council (NTC) for which comparative quotations were not obtained. Insofar as this lease is at reasonable rates and provides easy access to many clients and customers of the NTC, management will request the grantor agency to specifically approve this lease. Moreover, given the shortage of both housing and office space available for leasing, management will consider incorporating a permanent exemption of obtaining price quotations for this type of procurement.

It is standard procedure for MOF's procurement and supply department and accounts payable division to require adequate supporting documentation to support the history of a procurement including the rationale for vendor selection; this in accordance RepMar's procurement code. We note that all the instances cited were for small procurements for which any exceptions to Section 127 of Title 44 must be documented as per Section 128 (sole-source justification). MOF will reinforce adherence to this policy both with the line ministries and internally.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2012

Finding No.: 2012-06
Federal Agency: U.S. Department of Education
CFDA Program: 84.027 Special Education – Grants to States
Grant Number: H027A110011
Area: Procurement and Suspension and Debarment
Questioned Costs: \$3,402

Criteria: Section 80.36 of 34 CFR 80, *Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments*, states that RepMar may use its own procedures for procurement, whether done by government or its Sub-Grantees, provided that they meet the standards identified in this section.

RepMar's Procurement Code states the following:

- (a) Section 124 - unless otherwise authorized by law, all Government contracts shall be awarded by competitive sealed bidding.
- (b) Section 127 - procurement of goods and services not exceeding \$25,000 may be made in accordance with small purchase procedures promulgated by RepMar's Policy Office. Small purchase procedures are those relatively simple and informal methods for securing services, supplies, or other property that do not cost more than \$25,000. RepMar's Ministry of Finance has previously declared that if small purchase procedures are used, price or rate quotations shall be obtained from an adequate number of qualified sources.
- (d) Section 128 - a contract may be awarded for a supply, service, or construction item without competition when it is determined in writing that there is only one source for the required supply, service, or construction item.

Condition: Of \$379,228 in non-payroll expenditures, thirteen (13) items, totaling \$97,322, were tested. For 1 (or 8%), no documentation was provided to substantiate that the most economical fare was procured for the following:

| <u>Fund #</u> | <u>Check #</u> | <u>G/L Account Name</u> | <u>PO #</u> | <u>APV #</u> | <u>Amount</u> |
|---------------|----------------|-------------------------|-------------|--------------|---------------|
| 600350 | 100505 | International Travel | A1369201 | 183748 | \$ 3,402 |

Cause: The cause of the above condition is the lack of adequate internal control policies and procedures requiring the documentation of procurement procedures to satisfy compliance with federal procurement requirements.

Effect: The effect of the above condition is noncompliance with allowable costs/cost principles requirements and procurement standards. Accordingly, questioned costs in the amount of \$3,402 are reported.

Recommendation: RepMar should require that supporting documentation be adequate to comply with federal procurement requirements.

Prior Year Status: Lack of adequate internal control policies and procedures requiring the documentation of procurement procedures to satisfy compliance with federal procurement requirements was reported as a finding in prior single audit as item 2011-6.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2012

Finding No.: 2012-06, Continued
Federal Agency: U.S. Department of Education
CFDA Program: 84.027 Special Education – Grants to States
Grant Number: H027A110011
Area: Procurement and Suspension and Debarment
Questioned Costs: \$3,402

Auditee Response and Corrective Action Plan: MOF is aware that RepMar has only one travel agent with standing instruction to provide the most economical fare available for official travel. Absent specific evidence that a fare does not represent the most economical selection available, management does not believe this citation is appropriate. Management will clarify documentation required for international travel through instructions to the Fiscal Officers group.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2012

Finding No.: 2012-07
Federal Agency: U.S. Department of the Interior
CFDA Program: 15.875 Economic, Social and Political Development of the Territories
Grant Number: Compact Sector Grants
Area: Subrecipient Monitoring
Questioned Costs: \$0

Criteria: Article VI, Section 1(a)(1) of the Fiscal Procedures Agreement (FPA) states that fiscal control and accounting procedures of RepMar, as well as its Sub-Grantees, shall be sufficient to: (i) permit the preparation of reports required by the FPA and the Compact, as amended; and (ii) permit the tracing of funds to a level of expenditures adequate to establish that such funds have been used in compliance with the provisions of the Compact, as amended, and applicable agreements. Furthermore Article VI, Section 1(k)(1) of the FPA states that RepMar shall ensure that: (i) every Sub-Grant includes any clauses required by the Compact, as amended, the sector Grant awards, and the FPA; (ii) Sub-Grantees are aware of the requirements imposed upon them by the Compact, as amended, the sector Grants and the FPA; and (iii) Sub-Grantee can meet the financial management standards of the FPA.

Condition: During the year ended September 30, 2012, RepMar sub-granted Compact Landowners Special Needs grant to Kwajalein Atoll Joint Utilities Resources, Inc. (KAJUR). No Sub-Grant agreement or Memorandum of Agreement (MOA) was executed with KAJUR for the aforementioned funding. Additionally, the two MOAs executed with College of the Marshall Islands indicated Compact Education Sector grant as the sole funding source; however, funding was also sub-granted to CMI from Compact Infrastructure and Supplemental Education Grants.

As separate OMB Circular A-133 audits are performed on these entities, no questioned costs are reported.

Cause: The cause of the above condition is the lack of adequate internal control policies and procedures requiring 1) the execution of Sub-Grant agreements with Sub-Grantees; and 2) compliance with special tests and provisions of the FPA.

Effect: The effect of the above condition is noncompliance with specific provisions of the FPA.

Recommendation: RepMar should comply with the specific provisions of the FPA and execute Sub-Grant agreements with all Sub-Grantees.

Prior Year Status: Lack of adequate internal control policies and procedures requiring execution of Sub-Grant agreements with Sub-Grantees and compliance with special tests and provisions of the FPA was reported as a finding in prior single audits as items 2009-10, 2010-7, 2011-7 and 2011-7.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. Although the MOF's general practice is to implement subrecipient MOAs, failure to do so in the KAJUR case was an oversight, which will be remedied.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2012

Finding No.: 2012-08
Area: General Ledger Account Reconciliations

Criteria: Adequate internal control policies and procedures should be established to require periodic and timely reconciliation of all significant general ledger accounts, independent supervisory approval of reconciliations, and timely recording of transactions and adjustments identified through the reconciliation process to facilitate accurate financial reporting.

Condition: More than six months subsequent to September 30, 2012, reconciliations of significant general ledger accounts, including cash accounts, had not been completed by the Ministry of Finance. Consequently, significant portions of audit fieldwork could not commence until seven months after the end of fiscal year 2012, when reconciliations of significant accounts were completed.

Audit procedures performed identified errors in certain of the reconciliations and general ledger accounts, and certain audit adjustments were proposed to correct the affected general ledger account balances.

Cause: The cause of the above condition is the lack of adequate internal control policies and procedures requiring periodic and timely performance of and independent supervisory verification of significant general ledger account reconciliations.

Effect: The effect of the above condition is material misstatements of account balances, increased risk of undetected errors and fraud, and inaccurate federal financial reporting.

Recommendation: Management should establish policies and procedures requiring periodic and timely performance of and independent supervisory verification of significant general ledger account reconciliations. Furthermore, such policies and procedures should also require timely resolution of errors and recording of unrecorded transactions identified through the reconciliation process.

Prior Year Status: Lack of adequate internal control policies and procedures requiring periodic and timely performance of and independent supervisory verification of significant general ledger account reconciliations was reported as a finding in prior single audits as items 2010-12 and 2011-11.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. Management has identified all key control accounts and will assign appropriate staff to reconcile these on a periodic basis (monthly or quarterly), no later than September 2013.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2012

Finding No.: 2012-09
Area: Accounts Receivable

Criteria: Timely drawdowns of grant expenditures should occur to reimburse the General Fund.

Condition: For 5 (or 36%) of fourteen (14) non-payroll expenditures for the Compact Sector Public Infrastructure Development and the Landowners Special Needs Grants, the following expenditures had not been reimbursed eight (8) months after year end.

| <u>Check #</u> | <u>APV #</u> | <u>Amount</u> |
|----------------|--------------|---------------|
| 94925 | 174163 | \$ 73,574 |
| 97394 | 179667 | \$ 53,583 |
| 98416 | 181962 | \$ 75,000 |
| 99761 | 185097 | \$ 24,708 |
| 102134 | 189638 | \$ 70,579 |

Additionally, it appears that other grants may not be timely billed.

Cause: The cause of the above condition is the lack of adequate policies and procedures requiring periodic and timely analysis of grant expenditures to ascertain whether reimbursement of grant expenditures can occur.

Effect: The effect of the above condition is that the General Fund bears the costs of grant expenditures.

Recommendation: Management should establish policies and procedures requiring periodic and timely analysis of grant expenditures to ascertain whether reimbursement of grant expenditures can occur.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. Public infrastructure sector drawdowns were delayed in fiscal year 2012 because of difficulties in reconciliations caused by combining several infrastructure projects together under one cost center in the FMIS. In 2013, management has devised special Cyberquery reports to segregate these projects, timely reconcile them, and submit to OIA for reimbursement. MOF is working closely with OIA to ensure reconciliations are adequate to drawdown the funds and liquidate the accounts receivable on a timely basis.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2012

Finding No.: 2012-10
Area: Construction-In-Progress/Retention Payable

Criteria: Adequate internal control policies and procedures should be established to require that the fixed asset and retention payable subsidiary ledgers are updated in accordance with the progress of construction projects to facilitate accurate financial reporting.

Condition: The construction-in-progress (CIP) and retention payable subsidiary ledgers (SL) were not updated during fiscal year 2012. Consequently, the CIP SL was not reconciled during the year with transactions in GL A/c #s 510100-03219 construction expenditures and 510100-55050 retention payable.

Audit procedures performed identified the following exceptions in the CIP SL provided for audit:

- Total costs as of September 30, 2012 per the CIP SL for the following ongoing projects did not agree with contractor progress billings, as follows:

| <u>Project #</u> | <u>Per Contractor Billing</u> | <u>Per CIP SL</u> | <u>Difference</u> |
|------------------|-------------------------------|-------------------|-------------------|
| Contract # 2131 | \$ 1,770,000 | \$ 1,609,894 | \$ 160,106 |
| IDMP0044 | \$ 461,923 | \$ 399,871 | \$ 62,052 |
| IDMP0079/81 | \$ 710,153 | \$ 681,473 | \$ 28,680 |
| IDMP0089 | \$ 341,410 | \$ 304,712 | \$ 36,698 |

For contract # 2131, the CIP SL included a \$230,000 addition, which pertained to fiscal year 2011 and which was presented in RepMar's fiscal year 2011 audited financial statements. Adjustments to the CIP SL for the above differences were proposed.

- Project #s IDMP0060 and IDMP0075 were completed and capitalized in fiscal year 2012; however, the 2012 CIP SL did not reflect contractor progress billings for the year. Furthermore, for project # IDMP0060, the asset's capitalized cost was understated by \$44,471.
- Project # IDMP0052(B) was capitalized in fiscal year 2012; however, the 2012 CIP SL did not reflect project activity.
- The following projects were completed and capitalized at the correct costs in fiscal year 2012; however, total costs per the CIP SL prior to capitalization did not agree with contractor final billings, as follows:

| <u>Project #</u> | <u>Per Contractor Billing</u> | <u>Per CIP SL</u> | <u>Difference</u> |
|------------------|-------------------------------|-------------------|-------------------|
| IDMP0052A | \$ 362,470 | \$ 360,213 | \$ 2,257 |
| IDMP0053 | \$ 546,544 | \$ 513,179 | \$ 33,365 |
| IDMP0082 | \$ 413,258 | \$ 392,596 | \$ 20,663 |
| IDMP0083 | \$ 103,038 | \$ 98,080 | \$ 4,958 |

Consequently, for the above assets, the associated costs transferred from CIP during the year did not agree with contractor billings.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2012

Finding No.: 2012-10, Continued
Area: Construction-In-Progress/Retention Payable

Condition, Continued:

- Project IDMP0055 was completed in fiscal year 2011; however, such was not included in either the 2011 fixed asset register or the CIP register. The only 2012 activity pertained to \$3,279 in gross receipts tax withheld from a contractor payment in prior year and paid to the general fund treasury in 2012.

Cause: The cause of the above condition is the lack of policies and procedures requiring timely and periodic update of CIP and retention payable subsidiary ledgers and reconciliation with general ledger accounts. A further cause for the errors in valuation of both completed and ongoing projects is the lack of reconciliations with contractor billings, which are inclusive of retention and gross receipts tax, and with RepMar's Project Management Unit's monthly project status reports.

Effect: The effect of the above condition is the misstatement of capital assets, retention payable, and expenditures resulting in inaccurate financial reporting.

Recommendation: Management should establish policies and procedures requiring timely and periodic update of capital assets and retention payable subsidiary ledgers and reconciliation with general ledger accounts.

Prior Year Status: Lack of policies and procedures requiring timely and periodic update of capital assets and retention payable subsidiary ledgers and reconciliation with general ledger accounts was reported as a finding in prior single audit as item 2011-13.

Auditee Response and Corrective Action Plan: Management agrees with the finding and recommendation. MOF acknowledges its problems with reconciling Construction-In-Progress for its infrastructure projects and related transfers of completed projects to the Fixed Asset Register (FAR) and corresponding adjustment of retention payables. Beginning in the fourth quarter of fiscal year 2013, it is now receiving progress reports from the PMU regarding on-going and completed infrastructure projects and will begin periodically reconciling these reports with its accounting records.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2012

Finding No.: 2012-11
Area: General Ledger Journal Entries

Criteria: Adequate accounting controls necessitate segregation of duties. Journal entries and adjustments should accordingly be adequately supported and be independently approved.

Condition: Independent review and authorization of journal entries posted for fiscal year 2012 were not consistently documented, and general journal (GL) vouchers were not supported by underlying documentation. Furthermore, daily batch edit reports run prior and subsequent to posting of journal entries and update of general ledger accounts are not reviewed to determine timely disposition of errors.

Exceptions were also noted, as follows:

- JV #'s G12-01G, G12-328G, G12-364G and G12-373G were not supported by underlying documentation.
- JV # G12-255P was used twice to record two different entries.
- Other expenditures were recorded in GL A/c # 100100-02750 to reconcile general ledger balance sheet accounts; however, such amounts were not supported by underlying documentation and the JVs lacked evidence of approval, as follows:

| <u>JV #</u> | <u>Amount</u> | <u>GL Account #</u> | <u>Account Name</u> |
|-------------|---------------|---------------------|-----------------------|
| G13-285P | \$ 125,970 | 950000-13010 | General Fund Treasury |
| G13-302P | \$ 7,170 | 410110-28010 | Travel Advances |
| G13-311P | \$ 69,358 | 950000-13010 | General Fund Treasury |
| G13-319P | \$ 135,103 | 100100-50010 | A/P – CAPPs |

Cause: The cause of the above condition is the lack of adequate internal control policies and procedures requiring that journal entries and adjustments to the general ledger be subject to independent review and approval by designated persons.

Effect: The effect of the above condition is a possible misstatement of financial statement balances and recording of unauthorized transactions.

Recommendation: Management should establish policies and procedures relative to independent authorization and review of journal entries and adjustments.

Prior Year Status: The lack of adequate independent review and approval of journal entries and adjustments was reported as a finding in prior single audits as items 2009-12, 2010-10 and 2011-14.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. Management will begin independent internal verification and approval of general journal entries in the fourth quarter of fiscal year 2013.

REPUBLIC OF THE MARSHALL ISLANDS

Unresolved Prior Year Findings and Questioned Costs Year Ended September 30, 2012

Questioned Costs

The prior year Single Audit report on compliance with laws and regulations noted the following questioned costs and comments that were unresolved at September 30, 2012:

| | <u>Questioned Costs</u> | | |
|--|-------------------------|---------------------|---------------------|
| | <u>RepMar</u> | <u>Subrecipient</u> | <u>Total</u> |
| Questioned costs of RepMar as previously reported: | | | |
| Fiscal year 2008 Single Audit | \$ 645,618 | \$ - | \$ 645,618 |
| Fiscal year 2009 Single Audit | 1,360,234 | - | 1,360,234 |
| Fiscal year 2010 Single Audit | 2,243,301 | - | 2,243,301 |
| Fiscal year 2011 Single Audit | <u>3,156,810</u> | <u>-</u> | <u>3,156,810</u> |
| | 7,405,963 | - | 7,405,963 |
| Questioned costs of fiscal year 2012 Single Audit | <u>35,857</u> | <u>-</u> | <u>35,857</u> |
| Unresolved questioned costs of RepMar at September 30, 2012 | <u>\$ 7,441,820</u> | <u>\$ -</u> | <u>\$ 7,441,820</u> |

Unresolved Findings

The status of unresolved findings is discussed in the Schedule of Findings and Questioned Costs section of this report (pages 11 through 29).