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February 8, 2013

Mr. Alfred Alfred, Jr.
Secretary of Finance
Republic of the Marshall Islands

Dear Secretary Alfred:

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, 2011 (on which we have issued our report dated February 8, 2013), 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, 2011 that we wish to bring to your attention.

We have also issued a separate report to the President, His Excellency Christopher J. Loeak, also dated February 8, 2013 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, 2011:

Petty Cash Imprest Accounts

At September 30, 2011, the Ministry of Finance recorded thirty petty cash imprest accounts aggregating \$29,787, including a non-existent account (G/L A/c # 950000-11044, Ebeye Thyroid, \$7,585) identified in a prior audit. We also tested another \$4,100 petty cash imprest account (G/L A/c # 950000-12040, Sea Patrol) and also determined that it was non-existent. 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 that the Ministry of Finance examine all recorded petty cash imprest accounts and assess their validity. This matter was discussed in our previous letters to management for the audits of fiscal years 2007 through 2010.

Embassy Imprest Accounts

At September 30, 2011, the Ministry of Finance recorded the following embassy imprest accounts, for which the September 2011 imprest account reconciliations reported unknown variances.

<u>Embassy</u>	<u>GL A/c #</u>	<u>Imprest Fund</u>	<u>Unknown Overage (Shortage)</u>
Fiji	950000-12010	\$ 19,700	\$ 3,416
Washington, D.C.	950000-12035	\$ 50,000	\$ (5,870)
Arkansas Consulate	950000-12045	\$ 20,000	\$ (1,982)
Hawaii Consulate	950000-12070	\$ 10,000	\$ (1,637)

Additionally, the September 2011 Washington, D.C. Embassy bank reconciliation included a \$1,080 travel advance to a consultant that is over six years old.

We recommend that imprest accounts be regularly reconciled and that unknown variances be timely investigated. We further recommend that management determine collectability and disposition of the long outstanding travel advance.

United Nations Mission Imprest Account

At September 30, 2011, the Ministry of Finance recorded a \$50,000 imprest account for the Mission to the United Nations; however, the September 2011 imprest account reconciliation reported a total imprest fund balance of \$109,775. The variance of \$59,775 appears to result from the following unrecorded deposits to the Mission's bank accounts:

- In March 2006, \$60,000 in grant receipts was deposited into a savings account in the Mission's name, which account was separate from the Mission's imprest bank account. The Ministry of Finance recorded neither the \$60,000 grant nor the savings account. In April 2011, the Mission closed the savings account and transferred a \$31,929 balance to the imprest bank account.
- In August 16, 2007, a \$27,846 deposit was made to the Mission's imprest account. This deposit was not recorded by the Ministry of Finance as the source and purpose were unknown.

APPENDIX I, CONTINUED

United Nations Mission Imprest Account, Continued

Furthermore, the September 2011 imprest account reconciliation reported an additional unrecorded \$9,492 grant from an international donor.

We recommend that the Ministry of Finance require monthly reconciliations of the imprest account and documentation and resolution of reconciling items. We further recommend that the Ministry of Finance require that grants are recorded. This matter was discussed in our previous letter to management for the audit of fiscal year 2010.

Japan Embassy Imprest Account

At September 30, 2011, the Ministry of Finance recorded a \$100,000 imprest account for the Japan Embassy for which no imprest account and bank account reconciliations were prepared for fiscal year 2011. We were unable to perform alternative audit procedures to test the account balance as the associated September 2011 bank statement was not available. We recommend that the Ministry of Finance require timely reconciliation of embassy imprest accounts. This matter was discussed in our previous letter to management for the audit of fiscal year 2010.

Bank of Marshall Islands (BOMI) Imprest Accounts

At September 30, 2011, the Ministry of Finance recorded cash of \$22,268 and \$5,042 for the Asian Development Bank Loan # 1791 Imprest Account (GL A/c # 800405-12062) and for the MOE/PEC Imprest Account (GL A/c # 950000-11081), respectively. Bank confirmation responses obtained in prior audits indicated that both accounts had been closed; however, we were unable to ascertain the final disposition of the remaining account balances. We recommend that the Ministry of Finance determine the final disposition of these account balances and verify whether such were deposited to RepMar's General Fund bank account. This matter was discussed in our previous letters to management for the audits of fiscal years 2008 through 2010.

General Fund Bank Account

The September 2011 bank reconciliation for the General Fund account (G/L Acct # 950000-13010) included an unrecorded fiscal year 2009 \$13,059 deposit which represented grant receipts. Since the relevant grant documents are not available, the Ministry of Finance accounting department is unable to record such to specific revenue accounts. Additionally, the reconciliation included \$9,980 of unrecorded disbursements pertaining to wire payments to off-island vendors in September 2011. In accordance with the Ministry's policy, checks were processed for these wire payments; however, the checks had not been re-deposited into the bank account as of July 2012.

We recommend that the Ministry of Finance determine the disposition of unrecorded transactions in a timely manner. This matter was discussed in our previous letters to management for the audits of fiscal years 2009 and 2010.

Ebeye General Fund Account

The September 2011 bank reconciliation for the Ebeye General Fund account (G/L Acct # 950000-13015) included a \$50 deposit in transit dated 9/29/2011 for which the underlying cash receipt and deposit ticket were not available. We recommend that the Ministry of Finance require that bank account reconciling items are adequately supported.

Bank Errors

The September 2011 bank reconciliation for the Payroll Account (G/L Acct # 950000-13020) included a \$10,612 bank error. Since the bank reconciliations were completed eight months after year end, the error was not known and was not timely resolved. We recommend that the Ministry of Finance require periodic and timely bank account reconciliations and that bank errors are investigated and resolved with financial institutions in a timely manner. This matter was discussed in our previous letters to management for the audits of fiscal years 2007 through 2010.

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 2011 bank statements and account reconciliations for such were not available for examination. We recommend that 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 our previous letter to management for the audit of fiscal year 2010.

Miscellaneous Receivables

At September 30, 2011, 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	\$ 196,494
950000-24100	\$ (1,566)

No audit adjustments were proposed for the above accounts as these receivables were offset by a corresponding allowance for uncollectible accounts. We recommend that the Ministry of Finance reconcile these receivables and determine their ultimate collectability. This matter was discussed in our previous letters to management for the audits of fiscal years 2007 through 2010.

Travel Advances

At September 30, 2011, the Ministry of Finance recorded \$2,102 of travel advances in GL A/c # 700370-28010 that were not supported by an underlying subsidiary ledger. No audit adjustment was proposed as this amount was not considered material to the financial statements. We recommend that the Ministry of Finance reconcile travel advances to supporting DILOG subsidiary ledgers on a monthly basis. This matter was discussed in our previous letters to management for the audits of fiscal years 2008 through 2010.

Fixed Assets Register

The fixed assets register (FAR) as of September 30, 2011 included the following exceptions:

- Items that did not meet the capitalization threshold of \$50,000 for singular pieces of machinery and equipment, as follows:

<u>Item #</u>	<u>Asset #</u>	<u>Asset Description</u>	<u>Acquisition Date</u>	<u>Cost per FAR</u>
1	18661	Pick-up truck	01/25/1995	\$ 102,970
2	none	4 Mazda vans and 1 pick-up truck	04/01/2009	\$ 89,990
3	none	20 air system units, 1 ventilator and related installation costs	02/17/2010	\$ 118,000

Fixed Assets Register, Continued

For item # 1, the FAR cost is in Japanese Yen; the actual estimated cost in US Dollar is \$12,000.
 For item #s 2 and 3, the assets were recorded in the FAR as clusters rather than as individual assets.

- Two dump trucks (asset #s 23405 and 23408) acquired in April 2001 at a cost of \$55,000 each had been disposed of in a prior year.

No audit adjustments were proposed as expenditures for the above assets had been recorded in the year of acquisition. However, we recommend that management establish policies and procedures pertaining to timely and accurate update of the fixed assets register for additions and disposals.

Accounts Payable - Other

At September 30, 2011, the Ministry of Finance recorded \$6,037 of accounts payable in GL A/c # 700370-50020 that were not supported by an underlying subsidiary ledger. No audit adjustment was proposed as this amount was not considered material to the financial statements. We recommend that the Ministry of Finance reconcile accounts payable to the supporting subsidiary ledgers on a monthly basis.

Accounts Payable – Landowners

At September 30, 2011, payable to landowners (G/L A/c # 100100-55040), wherein airport land lease payments received but not yet paid to the landowners are recorded, had a net debit balance of \$20,919. A total of \$94,861 in debit balances, which appear to relate to erroneous recording of vendor payments, was included in the account. Furthermore, the account balance included a \$27,013 credit balance that was carried forward from the prior year. No audit adjustment was proposed as the above amounts were not considered material to the financial statements. We recommend that the Ministry of Finance determine the validity and disposition of amounts payable to landowners. We further recommend that debit balances are investigated and resolved. Determination of the validity and disposition of amounts payable to landowners was discussed in our previous letters to management for the audits of fiscal years 2007 through 2010.

Labor Bonds Payable

At September 30, 2011, 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

It appears that the debit balances resulted 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 that the Ministry of Finance perform regular reconciliations of the labor bonds payable accounts and require that refunds are issued based on valid labor bonds recorded. This matter was discussed in our previous letter to management for the audit of fiscal year 2010.

Cancelled Checks

At September 30, 2011, the Ministry of Finance recorded general and payroll fund cancelled check liabilities (G/L A/c #s 100100-50060 and 100100-55020, respectively) of \$678,136 and \$59,161, respectively, which were not supported by reconciled subsidiary ledgers. Alternative audit procedures were performed to verify and support the account balances. We recommend that the Ministry of Finance monitor and reconcile stale checks in accordance with the Financial Management Act 1990, Section 150.

Tax Revenues

Of seventy-three General Fund tax revenue receipts tested, we noted the following exceptions:

- The following cash receipts (CR) were not supported by Form 1178a attachment:

<u>Location</u>	<u>CR #</u>	<u>CR Amount</u>	<u>Revenue</u>
Ebeye	09019504	\$ 78,340	Marshallese income tax
Ebeye	09020649	\$ 54,998	Expat income tax
Majuro	00387076	\$ 59,619	Marshallese income tax
Majuro	00392724	\$ 17,979	Marshallese income tax
Majuro	00395292	\$101,343	Expat income tax

Additionally, Majuro cash receipt # 00392724 did not include a related penalty of \$558, which remained unpaid as of our test date (4/27/2012).

- Amounts paid per Majuro cash receipts #s 00383139, 00385042, 00391594, 00398386 and 00402754, did not agree with the associated payroll register attached to Form 1178.

We recommend that the Ministry of Finance require that tax revenue receipts are supported by underlying tax returns. In addition, we recommend that management adopt policies and procedures for following up on unpaid penalties and interest. A requirement for tax revenue receipts to be supported by underlying tax returns was reported in our previous letters to management for the audits of fiscal years 2007 through 2010.

General Fund Payroll Expenditures – Group Life Insurance Premiums

Of \$215,807 in payroll expenditures for employer share of group life insurance premiums, two items totaling \$44 were tested, and we noted the following exceptions for employee # 66315:

<u>Actual</u> <u>Employer</u> <u>Share</u>	<u>Expected</u> <u>Employer</u> <u>Share</u>	<u>Variance</u>	<u>Actual</u> <u>Employee</u> <u>Share</u>	<u>Expected</u> <u>Employee</u> <u>Share</u>	<u>Variance</u>
\$ 28.71	\$ 23.49	\$ 5.22	\$ 19.80	\$ 16.20	\$ 3.60

Based on discussions with payroll department personnel, the above exceptions appear to be due to input errors. We recommend that management establish internal control policies and procedures to require that edits to the payroll master files are independently verified.

Other Grants Assistance Payroll Expenditures

Of five other grants assistance payroll expenditures tested (non-U.S. federal assistance), the following exceptions were noted:

- Fund 600350: Employee # 89356 was underpaid by 30 hours or \$260 for pay period ended 08/27/2011.
- Fund 700360: Underlying grant award was not available, thus, we were unable to ascertain eligibility of the payroll expenditure for employee # 90079 for pay period ended 01/29/2011.

We recommend that management establish policies and procedures to facilitate accurate payroll processing. We further recommend that grant documents are maintained to support payroll expenditures.

Other Governmental Funds Payroll Expenditures

Of twenty-nine other governmental funds payroll expenditures tested, the following exceptions were noted in Fund 200090:

- Employee # 222743 was underpaid by a net total of \$1,770 during fiscal year 2011. This employee received a pay increment on 03/14/2010 which was not effected until pay period ended 12/04/2010. The employee's retroactive increment payment in pay period ended 11/20/2010 was based on 80 hours per pay period rather than on the employee's actual timesheet hours. Furthermore, the retroactive payment was not applied to the employee's overtime and night differential hours worked.
- Employee #s 220899 and 73288 were overpaid by \$260 in the pay period ended 10/23/2010 and by \$14 in the pay period ended 06/18/2011, respectively.
- Employee # 220899 was overpaid by \$133 in the pay period ended 09/24/2011. Additionally, the expenditure was not supported by an approved timesheet.

We recommend that management establish policies and procedures to facilitate accurate payroll processing.

General Fund Non-payroll Expenditures

Of forty-one General Fund non-payroll expenditures tested, the following exceptions were noted:

- Travel expense reports for check #s 80637 and 89854 were not available.
- Supporting documentation was not available for the following checks:

<u>Check #</u>	<u>PO #</u>	<u>APV #</u>	<u>Amount</u>
81801		148082	\$ 3,125
82292	C0359001	148589	\$ 2,250
83097	P3859201	150092	\$ 364
83310		151347	\$ 43,321
83480		151780	\$ 208,133
83480		151781	\$ 187,722
84709	M0653502	152826	\$ 6,000
86190	T0949001	156029	\$ 2,065
87533		158867	\$ 193,454
87819		159272	\$ 900
88429	P4034501	160421	\$ 1,579
89234	P4072001	162083	\$ 400
89824	M0685002	163324	\$ 39,700
90534	T0959601	165319	\$ 375
92467	P4129401	169504	\$ 210

Check #s 90534 and 92467 represent fiscal year 2012 expenditures. As amounts are not considered material to the financial statements, no adjustment was proposed.

- The underlying reimbursement requests for wire transfer #s 0900760 and 0900824 paid to the Taiwan Embassy and UN Mission, respectively, were not available. Consequently, the underlying invoices for rental and communication expenditures of \$1,128 and \$1,542, respectively, for the Taiwan Embassy and UN Mission, respectively, were not available.

General Fund Non-payroll Expenditures, Continued

We recommend that the Ministry of Finance establish policies and procedures requiring that payments to vendors are adequately supported by vendor invoices, contracts, and other appropriate documentation. This matter was discussed in our previous letter to management for the audit of fiscal year 2010. We further recommend that the Ministry of Finance require that expenditures are recorded in the proper period.

Other Grants Assistance Non-payroll Expenditures

Of thirty-nine other grants assistance non-payroll expenditures tested, one \$16,353 item (check # 77486) was disbursed in August 2010 as local matching for a local government grant which had not been approved. The check was returned and the expenditure was reversed in August 2011; however, there was no explanation provided as to why the check was disbursed in the first place since subsidies to local governments for grant matching funds should only be for approved grants.

Other Government Funds Non-payroll Expenditures

Of three other governmental funds non-payroll expenditures tested, one \$516 item (check # 79898) representing travel expenditure (Fund 200340) was not supported by an underlying trip report. Additionally, voided check #84285 (Fund 510610) was not available for examination. We recommend that the Ministry of Finance require that travel expenditures are supported by underlying trip reports and that voided checks are retained on file.

Encumbrances

Of three and fifteen outstanding encumbrances tested for the General Fund and the Grants Assistance Fund, respectively, we noted the following exceptions:

- The following encumbrances were not valid as of September 30, 2011:

<u>Fund</u>	<u>PO#/ Contract#</u>	<u>Outstanding Encumbrance</u>
100100	M0496902	\$ 3,917
100100	T0968201	\$ 4,753
410100	A1289801	\$ 6,802
510130	C0315001	\$ 4,400
600350	M0104401	\$ 10,200
600350	P2335601	\$ 6,241

- The following encumbrances were not adjusted for gross receipts taxes withheld from payments to contractors:

<u>Fund</u>	<u>Contract#</u>	<u>Outstanding Encumbrance</u>	<u>Gross Receipts Tax</u>
510100	C0213101	\$ 1,212,500	\$ 6,075
510100	C0414901	\$ 518,814	\$ 1,225
510100	C0783501	\$ 153,775	\$ 1,553
700370	C0275102	\$ 44,841	\$ 4,057

We recommend that the Ministry of Finance periodically examine the encumbrance subsidiary ledger and de-obligate amounts no longer considered valid. This matter was discussed in our previous letter to management for the audit of fiscal year 2010. Furthermore, we recommend that encumbrances are de-obligated for taxes withheld from contractor payments.

Subsequent Disbursements

Of forty-five subsequent disbursements tested, the underlying check voucher was not available for one item (check # 92645). We recommend that supporting documentation be retained.

Off-Island Vendor Payments

The following checks payable to the same off-island vendor were picked up by Ministry of Education (MOE) staff and subsequently returned to the Ministry of Finance, which wired the payments to the vendor:

<u>Check #</u>	<u>Check Amount</u>	<u>Check Date</u>	<u>Picked up by MOE Staff</u>	<u>Wired to Vendor</u>
81152	\$ 123,914	12/08/2010	June 2011	July 2011
81627	\$ 123,914	12/30/2010	May 2011	October 2011

We recommend that off-island vendor payments be wire transferred by Treasury Department personnel directly to vendors.

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, 2011 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.

As of September 30, 2011, the Secretary of Finance had not published the existence of such property in the local newspaper. We recommend that the Ministry of Finance publish the existence of escheated property in accordance with the enabling legislation. This matter was discussed in our previous letters to management for the audits of fiscal years 2003 through 2010.

General Ledger Accounts

There is a lack of control over creation of new general ledger accounts. We observed creation of two new accounts (GL A/c # 950000-13038 and 950000-13045) by accounting department personnel without documented supervisory approval. We recommend that the Ministry of Finance establish policies and procedures relative to creation of new general ledger accounts.

Receiving Reports

Based on discussions with the Chief Procurement Officer, formal receiving reports are not consistently prepared and filed upon receipt of goods from vendors. A log is maintained by the Procurement & Supply office which only documents when goods are picked up by RepMar's ministries and agencies. We recommend that the Ministry of Finance prepare and maintain receiving reports upon receipt of goods from vendors.

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 could 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, to monitor their activities in the EDP environment. This matter discussed in our previous letters to management for the audits of fiscal years 2009 and 2010.

Enhancement of Network Security

There is a lack of control on network activities resulting in a higher chance of data integrity and confidentiality issues. For example, hackers 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 our previous letters to management for the audits of fiscal years 2009 and 2010.

SECTION III – DEFINITIONS

The definition of a deficiency that is established in AU 325, *Communicating Internal Control Related Matters Identified in an Audit*, is as follows:

A *deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A deficiency in design exists when (a) a control necessary to meet the control objective is missing or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective would not be met. A deficiency in operation exists when (a) a properly designed control does not operate as designed, or (b) the person performing the control does not possess the necessary authority or competence to perform the control effectively.

MANAGEMENT'S RESPONSIBILITY FOR, AND THE OBJECTIVES AND LIMITATIONS OF, INTERNAL CONTROL OVER FINANCIAL REPORTING

The following comments concerning management's responsibility for internal control over financial reporting and the objectives and inherent limitations of internal control over financial reporting are adapted from auditing standards generally accepted in the United States of America.

Management's Responsibility

RepMar's management is responsible for the overall accuracy of the financial statements and their conformity with generally accepted accounting principles. In this regard, management is also responsible for establishing and maintaining effective internal control over financial reporting.

Objectives of Internal Control over Financial Reporting

Internal control over financial reporting is a process affected by those charged with governance, management, and other personnel and designed to provide reasonable assurance about the achievement of the entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. Internal control over the safeguarding of assets against unauthorized acquisition, use, or disposition may include controls related to financial reporting and operations objectives. Generally, controls that are relevant to an audit of financial statements are those that pertain to the entity's objective of reliable financial reporting (i.e., the preparation of reliable financial statements that are fairly presented in conformity with generally accepted accounting principles).

Inherent Limitations of Internal Control over Financial Reporting

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.