

Management Letter

Marshall Islands Development Bank

(A Component Unit of the Republic of the Marshall Islands)

Year ended September 30, 2022



June 19, 2024

The Board of Directors and Management
Marshall Islands Development Bank

In planning and performing our audit of the financial statements of the business-type activities of Marshall Islands Development Bank (MIDB) as of and for the year ended September 30, 2022, in accordance with auditing standards generally accepted in the United States, and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, we considered its internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the MIDB's internal control. Accordingly, we do not express an opinion on the effectiveness of the MIDB's internal control.

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 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. A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

During our audit, we noted the following deficiencies in internal control (as described above) and other matters:

Cash in Bank - Stale-dated Checks

Condition: As of September 30, 2022, bank reconciliations included outstanding checks of \$756,454, of which \$29,475 pertained to stale-dated checks.

Recommendation: We recommend management establish internal policies and procedures requiring timely resolution and follow-up of outstanding checks that have been outstanding for over six months.

Loans Receivable

Condition: Tests of a representative sample of thirty-eight (38) loans revealed certain matters in the design, implementation and adherence to internal controls over the lending and credit administration area. These matters are as follows:

- a. For nine loans, the loan number was not documented or reflected on the promissory note and loan agreement.
- b. For eight loans, information such as borrower's name, maturity date, open date, payment frequency, note number, scheduled first payment date, and scheduled payment amount was not consistent throughout the loan file, i.e. promissory note, loan agreement, amortization table, and loan trial balance.
- c. For one loan, the updated amortization table to reflect loan amendments was not on file.
- d. One loan in the loan trial balance had incorrect loan tagging.

Recommendation: We recommend management perform a comprehensive review of lending policies and procedures and consider strengthening internal controls over lending and credit administration and monitoring of such controls.

Allowance for Loans Losses

Condition: For two of thirty-eight loans, we noted variances in the calculation of past due days. Projected quantitative impact of the error in the entire loan population could not be reasonably estimated. Moreover, management uses loss reserve ratios that are not directly related to the level of credit losses and not supported by a loss migration analysis. Furthermore, management does not have a robust system to determine allowance for loan losses based on a migration of historical losses or individual evaluation of loan impairment and related losses.

Recommendation: We recommend management require a thorough understanding of the loan system configuration be performed by involved personnel and that random verification of correctness of assigned past due days calculation be performed in relation to the allowance for loan loss calculation. Finally, we recommend management establish internal control policies and procedures requiring comprehensive analysis of historical losses and other qualitative factors in determining the adequacy of the allowance.

Undrawn Loan Funds

Condition: As of September 30, 2022, undrawn loan funds amounting to \$471,693 included 272 non-moving/inactive accounts aggregating \$244,435 that have been outstanding for more than 1 year.

Recommendation: We recommend management establish internal control policies and procedures to timely monitor long outstanding undrawn loan funds.

Loan Overpayments

Condition: Loan payments are received from borrowers through payroll deductions or allotments remitted by borrower employers. Excess payments received over outstanding loan balances are deposited to the borrower's deposit account.

Recommendation: We recommend management timely monitor and update loan accounts with excess payments and clear outstanding overpayments. Furthermore, we recommend management consider designating a person responsible for informing related borrowers of excess payments.

Related Party Loans

Condition: Related party loans are compiled manually resulting in errors and incomplete capture of these loans.

Recommendation: We recommend management tag related party loans at the time of origination and perform regular review to identify change in their status. Timely and accurate loan tagging will facilitate accurate identification and reporting.

Customer Refunds Payable

Condition: For two customer refunds payable amounts, such were improperly tagged and included in the customer refunds ledger. This condition results to revision of the customer refunds ledger and recording of adjustment.

Recommendation: We recommend management establish internal control policies and procedures requiring proper tagging of accounts (i.e., customer refunds payable, undrawn loan balance or deposits pledged).

Interest Income

Condition: We noted errors in the initial assumptions used in the manual calculation of the amount of interest income to be reversed (recorded interest income arising from payments received from non-accruing/ bad loans (loans that are more than 90 days past due)).

Recommendation: We recommend management perform a more robust review and analysis of the interest income adjustment.

Retirement Savings Plans

Condition: During the year ended September 30, 2022, MIDB made employer contributions, totaling \$67,889, to employee retirement savings plans. Taxes are not currently withheld and paid on the employer contributions.

Recommendation: We recommend management obtain an interpretation from the Ministry of Finance, Banking and Postal Services Chief of Revenue and Taxation concerning the applicability of withholding taxes on employer contributions to employee retirement savings plans.

Board Sitting Fees and Management Allowances

Condition: During the year ended September 30, 2022, MIDB paid sitting fees of \$59,600 to Board members and paid allowances of \$25,000 to senior management. These fees and allowances may constitute wages under the Income Tax Act 1989 and thus may be subject to withholding taxes. No withholding taxes were withheld by MIDB.

Recommendation: We recommend management obtain an interpretation and/or official documentation from the Ministry of Finance, Banking and Postal Services Chief of Revenue and Taxation concerning the applicability of withholding taxes on sitting fees and allowances paid to Board members and senior management.

Board Member Bonuses

Condition: During the year ended September 30, 2022, MIDB paid bonuses totaling \$5,000 to Board members. These payments may constitute earnings under the Social Security Act and thus may be subject to required employer matching contributions. No employer matching contribution were paid by MIDB.

Recommendation: We recommend management obtain an interpretation and/or official documentation from the Marshall Islands Social Security Administration concerning the applicability of employer matching contributions on bonuses paid to Board members.

Lease Agreements

Condition: Examination of lease agreements indicated the following:

- a. Revised lease arrangements for one of MIDB's land leases was not formally documented.
- b. Revised lease arrangements for one of MIDB's rental spaces was not formally documented.

Recommendation: We recommend management require lease agreements with counterparties be formally documented to memorialize revised contractual arrangements.

This communication is intended solely for the information and use of management, the Board of Directors, others within the organization, and the Office of the Auditor-General, and is not intended to be and should not be used by anyone other than these specified parties. However, this report is also a matter of public record.

June 19, 2024

At this time, we would like to thank all the staff and management of MIDB for their cooperation extended to us during the course of our audit. We would be pleased to discuss the above matters or to respond to any questions, at your convenience.

Ernst + Young LLP