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December 28, 2020

Honorable Henry S. Falan
Governor, State of Yap
Federated States of Micronesia

Dear Governor Falan:

In planning and performing our audit of the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Yap (the State) as of and for the year ended September 30, 2019, which collectively comprise the State's basic financial statements (on which we have issued our report dated December 28, 2020) and which report includes an adverse opinion for the omission of a certain component unit, and includes explanatory paragraphs concerning collectability of receivables and the impact of COVID-19, in accordance with the auditing standards general 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 the State'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 the State's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the State'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 and other matters involving the State's internal control over financial reporting as of September 30, 2019 that we wish to bring to your attention.

We have also issued a separate report to the Governor of Yap, also dated December 28, 2020, on our consideration of the State'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 that we consider to be material weaknesses or significant deficiencies under standards established by the American Institute of Certified Public Accountants.

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.

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This report is intended solely for the information and use of the State's management, the Office of the Governor, the Office of the FSM National Public Auditor, federal awarding agencies, and others within the organization 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 the State for their cooperation and assistance during the course of this engagement.

Most respectfully,

Deloitte + Touche LLP

SECTION I – DEFICIENCIES

We identified, and have included below, deficiencies involving the State's internal control over financial reporting as of September 30, 2019 that we wish to bring to your attention:

1. Cash Deposits

Cash was deposited to the bank between 9 to 11 days after cash was collected at dispensaries. We recommend that the State establish procedures to timely deposit cash collections.

2. Retainage Payable

As of September 30, 2019, the net unrecorded retainage on construction work-in progress amounted to $126,091. The State should recognize expenditures and liabilities related to those obligations when the associated liability is incurred.

3. Journal Vouchers

Various journal vouchers (1) reflected no evidence of review by an appropriate level of management and/or (2) hardcopy documents were not provided. We recommend that a review of these documents be required by an appropriate level of management and to document that such a review was performed.

4. Receivables from FSM

An estimated maximum amount of unbilled receivables to the FSM National Government amounted to $23,256. We recommend management revisit associated internal control procedures (1) over monitoring of receivable cutoff and billings to the FSM and (2) the matching of receivables and collections.

5. Overtime Rate

The estimated understatement of overtime salaries due to an incorrect overtime rate amounted to $11,644. We recommend that management implement internal control procedures over paying employees overtime rates in accordance with the rate per the underlying contract/personnel action form.

6. Interdepartmental Transactions

The State records interdepartmental revenues and expenses within the general fund, e.g. for office space rentals. The amount is not believed to be material to the State's financial statements as a whole. We recommend management eliminate interdepartmental revenues and expenses within the general fund and consider reallocation of budget.

SECTION II – OTHER MATTERS

Our observations concerning other matters related to operations, compliance with laws and regulations, and best practices involving internal control over financial reporting that we wish to bring to your attention at this time are as follows:

1. Procurement

For 4 non-payroll transactions tested aggregating $97,487, the State requirement to perform formal bidding procedures was waived by the Governor. However, rationale supporting the basis of the emergency is insufficient and was not adequately justified.

Transaction	Amount	Check No.
220605	$ 40,069	
226635	36,440	100798
238275	18,234	104590
219244	2,744	98688
	$ 97,487	

We recommend management follow and document full and open competition procedures in accordance with applicable procurement requirements and conform to standard Yap State policies.

SECTION III – DEFINITION

The definition of a deficiency is as follows:

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

MANAGEMENT'S RESPONSIBILITY FOR, AND THE OBJECTIVES AND INHERENT 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

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

Objectives of Internal Control over Financial Reporting

An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel and designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with accounting principles generally accepted in the United States of America. An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction, of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

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 assessment of the effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.