Management Letter

Federated States of Micronesia National Government

Year ended September 30, 2023

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December 22, 2025

Management and Those Charged with Governance
Federated States of Micronesia
National Government

In planning and performing our audit of the financial statements of the governmental activities, the aggregate discreetly presented component units, each major fund and the aggregate remaining fund information of the Federated States of Micronesia National Government (the National Government) as of and for the year ended September 30, 2023, 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 National Government's internal control. Accordingly, we do not express an opinion on the effectiveness of the National Government'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 which we believe should be brought to the attention of management.

Segregation of Duties

We observed potential weaknesses in the segregation of duties within key financial processes. Effective segregation of duties is crucial in mitigating the risk of errors and fraud, as it ensures that no single individual has control over all aspects of any significant transaction.

Certain individuals are responsible for multiple stages of financial transactions, including initiation, approval, and recording. This concentration of responsibilities increases the risk of unauthorized transactions and diminishes the effectiveness of internal controls.

The current structure may lack adequate oversight, as individuals performing critical functions may not be subject to sufficient review or approval by another party.

We recommend that management:

- review and redefine roles and responsibilities to ensure that critical financial processes are divided among multiple individuals

- establish additional oversight mechanisms, such as regular reviews of financial transactions by other personnel. This will help ensure that all transactions are properly authorized and recorded

- provide training to staff on the importance of segregation of duties and internal controls. This will help foster a culture of compliance and awareness regarding the risks associated with inadequate segregation of duties.

Timely Finalization of Subsidiary Ledgers and Reconciliation of Capital Assets

The FSM National Government's Financial Management Regulations (FMR) require prompt recordkeeping of a Fixed Asset Register that tracks all assets with a value of $3,000 or greater detailing the following:

- date of purchase
- general description of the asset
- make and model number
- identification number/unique serial number
- FSM allocated fixed asset number
- general location in office
- custodian (if specifically assigned to a person for use)
- USD value
- date of disposal (once disposed)
- physical count dates

We noted that the subsidiary ledger for capital assets has not been finalized, and there have been delays in the reconciliation process.

The absence of a finalized subsidiary ledger for capital assets can lead to discrepancies between the general ledger and the subsidiary records. This lack of alignment may result in misstatements in financial reporting and hinder effective asset management.

Delays in the reconciliation of capital assets can prevent timely identification of errors or irregularities. This can impact decision-making and financial planning, as management may not have an accurate understanding of the National Government's capital asset position.

We recommend that management:

- implement a process for timely finalization and upkeep of the subsidiary ledger for capital assets to include clear timelines and responsibilities for updating and reviewing the ledger to ensure it reflects accurate and complete information

- prioritize the reconciliation of capital assets on a regular basis, ideally monthly or quarterly

- conduct routine physical counts as required by the FMR.

Implement a monitoring system to track the status of subsidiary ledgers and reconciliation processes. Regular reporting to management on the progress and any outstanding issues will help maintain accountability and ensure timely resolution.

Improvement of Bank Account Management and Confirmation Procedures

We have identified a significant obstacle in the bank confirmation procedures due to the presence of different signatories for FSMNG's bank accounts. This situation complicates the confirmation process and may lead to delays in obtaining the necessary confirmations from financial institutions.

Additionally, it has come to our attention that the Department of Finance and Administration (DOFA) does not have access to foreign bank accounts. Given that DOFA is responsible for performing bank reconciliations, it is imperative that they have direct access to these accounts; such as through electronic banking system. Relying solely on bank statements provided by the various FSM Embassies may not provide a complete and accurate picture of the cash in bank balances.

We recommend reviewing and potentially revising the signatory requirements for bank accounts to ensure that the confirmation procedures are efficient and timely. We encourage designating the Secretary of Finance and Administration as signatory for all the bank accounts to facilitate quicker access to confirmations.

It is also essential to provide DOFA with direct access to foreign bank accounts to enhance their ability to perform accurate and timely bank reconciliations. This access will allow them to verify transactions directly and reduce reliance on the FSM Embassies.

Accurate Employee Record Management

We identified deficiencies in the accuracy of employee records. The employee listing provided contains discrepancies, including incorrect dates of employment, termination and missing information. This allows an unreliable determination of the number of employees at any given point in time. This lack of accurate record-keeping poses risks to compliance, payroll processing, and overall human resource management.

We recommend that management undertake a thorough review and reconciliation of employee records to identify and correct inaccuracies. This should include verifying employment dates, positions, and other relevant information.

Establish a reliable system for maintaining employee records that ensures data accuracy and completeness. This system should include regular updates and reviews to capture changes in employment status and other relevant details.

Implement regular monitoring of employee records to ensure ongoing accuracy. Management should receive periodic reports on the status of employee records, including any discrepancies identified and actions taken to resolve them.

Implementation of Accounts Receivable and Accounts Payable Aging Schedules

We identified a critical gap in the financial management processes; the absence of complete aging schedules for Accounts Receivable (AR) and Accounts Payable (AP). This oversight limits visibility into outstanding balances, making it difficult to effectively track overdue accounts and manage collections of receivables and disbursements for accounts payable.

We recommend that management implement aging schedules for both Accounts Receivable and Accounts Payable. These schedules should categorize outstanding balances based on the duration they have been due, facilitating better monitoring and assessment.

Management should perform regular reviews of the aging schedules to identify long-outstanding balances. Prompt follow-up on overdue accounts will enhance cash flow management and reduce the risk of bad debts.

Timely Clearance of Long Outstanding Checks

We observed that several checks issued by FSMNG have been outstanding for over six months (with some checks all the way from 2021). This delay in clearance can lead to inaccuracies in cash flow reporting and may indicate potential issues with vendor relationships or payment processes.

These stale checks also accumulate in an Accounts Payable (AP) account, which may create a misleading representation of liabilities and may hinder effective cash management.

We recommend that management establish a regular review process for outstanding checks, particularly those that have not cleared within six months. This process should include identifying the reasons for the delays and taking appropriate actions to resolve them.

Management should reach out to payees/vendors of long outstanding checks to confirm whether the checks were received and if there are any issues preventing their clearance. This communication can help address any concerns and facilitate timely resolution.

For checks that remain outstanding after a reasonable follow-up period, management should consider issuing stop payments and re-issue checks as necessary. This will help ensure that funds are accurately reflected in FSMNG's financial records.

Strengthening cash management practices will aid in reducing the occurrence of long outstanding checks. This may include improving the processes for issuing and tracking payments.

Perform reconciliation between subsidiary ledgers and recorded federal program costs

Subrecipient expenditures for ALN 93.959, amounting to $568,349, differed from actual cash payments made to subrecipients amounting to $639,897, resulting in an understatement of $71,548 in subrecipient expenditures reported in the schedule of expenditures of federal awards (SEFA).

We also observed that the subsidiary ledger for ALN 15.875 showed an amount for subrecipient expenditures that was greater than the amount reported on the SEFA. Finance personnel informed us that the subsidiary ledger is not correct.

We recommend responsible personnel periodically perform reconciliations between all subsidiary ledgers and recorded federal program expenditures and ensure that all subsidiary ledgers are complete and accurate.

Other Matters

We noted the beginning October 1, 2022 investment balances of the Early Retirement of Asia Development Bank Trust Fund investment schedules differed from the ending September 30, 2022 balances that supported prior year financial statements of not only FSMNG, but also the financial statements of the FSM State Governments.

There were multiple versions of the SEFA provided to us.

FSMNG confirmed FYE 2023 balances of amounts due from/to Kosrae and Chuuk State Governments. Those confirmations were used as audit evidence for the Kosrae and Chuuk audited financial statements. Subsequent to finalization of the Kosrae and Chuuk audited financials statements, FSMNG revised its trial balance amounts of due from/to FSM State Governments, including Chuuk and Kosrae. Thus, making the confirmations ultimately unreliable. This is an indication that reconciliations are not performed accurately and not performed with due care.

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This communication is intended solely for the information and use of management of the FSM National Government, others within the organization, and the Office of Public Auditor, 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 information.

We would be pleased to discuss the above matters or to respond to any questions, at your convenience.

Sincerely,

Ernst + Young LLP