



Deloitte & Touche LLP
361 South Marine Corps Drive
Tamuning, GU 96913-3911
USA
Tel: (671)646-3884
Fax: (671)649-4932
www.deloitte.com

June 30, 2013

Honorable Kensley Ikosia
Secretary of Finance and Administration
Federated States of Micronesia:

Dear Secretary Ikosia:

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 Federated States of Micronesia (FSM) National Government as of and for the year ended September 30, 2012 (on which we have issued our report dated June 30, 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 the FSM National Government'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 FSM National Government's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of FSM National Government'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 the FSM National Government's internal control over financial reporting and other matters as of September 30, 2012 that we wish to bring to your attention.

We have also issued a separate report to the President, His Excellency Emmanuel Mori, also dated June 30, 2013, on our consideration of the FSM National Government'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 the management of the FSM National Government and the Office of the FSM National 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 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 FSM National Government for their cooperation and assistance during the course of this engagement.

Very truly yours,

SECTION I – OTHER MATTERS

We identified, and have included below, other matters involving the FSM National Government's internal control over financial reporting as of September 30, 2012 that we wish to bring to your attention:

1. Deposits

Comment: Certain cash receipts were not timely deposited. It appears that the delay may be due to the absence of staff charged with depositing the funds.

Recommendation: The FSM National Government should consider staff assignment alternatives to achieve timely deposits.

2. Missing Documents

Comment:

1. Certain underlying documentation requested for non-U. S. federal transactions could not be located. The dollar value of the unlocated items was considered to be immaterial to the financial statements.

2. Fuel bunker delivery reports and/or receiving reports for tested fuel purchases were not evident.

Recommendation: The FSM National Government should maintain sufficient documentation to substantiate recorded costs.

3. Reconciliation of Advances

Comment: Certain advances were not timely reversed when related goods or services were received or provided.

Recommendation: The FSM National Government should timely reconcile advances.

4. Encumbrances

Comment: Manual liquidations are not automatically posted in the encumbrance ledger. We noted instances of manual encumbrance liquidations that were not posted.

Recommendation: The FSM National Government should consistently post manual encumbrance liquidations.

5. Dormant Accounts

Comment: Dormant accounts submitted in the current year included a \$45,419 National Government account.

Certain provided dormant accounts did not include depositor details.

Recommendation: The FSM National Government should establish the funding source and record the transfer to the appropriate fund.

6. Vehicle Registrations

Comment: Registrations for certain vehicles expired and had not been renewed.

Recommendation: The FSM National Government should timely renew vehicle registrations.

7. Stale Dated Checks

Comment: Recorded stale checks approximate \$700,000.

Recommendation: The FSM National Government should identify the originating fund to allow appropriate reversals.

8. Procurement

Comment: Certain underlying procurement documentation, such as quotes and solicitations, were not obtained or performed for non-U.S. federal transactions. The dollar value of the unlocated items was considered to be immaterial to the financial statements.

Recommendation: The FSM National Government should obtain and maintain sufficient procurement documentation to evidence that appropriate procurement procedures were followed.

9. Grant Awards

Comment:

1) Certain grant awards for non-U.S. federal awards were not locatable.

2) Certain grant awards for non-U.S. federal awards reflected that expenditures were charged past the period of availability

Recommendation: The FSM National Government should maintain grant awards and monitor applicable period of availability requirements.

10. Reconciliation of Accounts Payable

Comment: Certain accounts payables to component units were not reconciled.

Recommendation: The FSM National Government should timely reconcile payables due component units.

11. Annual Leave

Comment: Of four samples tested, three reflected variances.

Recommendation: The FSM National Government should regularly update and monitor annual leave accruals.

12. Continuing Appropriation Schedule

Comment: Certain appropriations reflect negative balances.

Recommendation: Expenditures should be applied against the correct program number in the schedule of continuing appropriations.

13. Reconciliation of Federal Holding Account

Comment: Details per grant or program number comprising the balance of the federal holding account are not available. Certain drawdowns allocated to the National Government were not timely released from the account, resulting in an overstatement of the federal grants fund accounts receivable. This matter was addressed as a passed reclassification entry.

Recommendation: The FSM National Government should timely release federal drawdowns to reflect accurate accounts receivable. The federal holding account is identified per state. The Government should also maintain a schedule of the allocation of the remaining balance per program or grant.

14. CTA Receipts

Comment: Certain CTA receipts were not timely remitted to Treasury due to system failures.

For certain CTA receipts tested, tax assessments were not attached to the tax files, and recalculation of the tax collected could not occur.

Recommendation: CTA receipt processes should be subjected to frequent internal audits and correction action should be maintained.

15. Allotments and Assignment of Accounts

Comment: A difference was noted between the continuing appropriation schedule and the system generated fund status report. Certain fund balances from FOCUS were not carried over to Fundware. The Fundware system is used for purposes of funds availability certification and incorrect certifications of available fund balances may result.

Recommendation: Fundware should be updated with correct fund balances to minimize opportunities for erroneous certifications.

16. Counter Value Fund (CVF) under Japan Non-Project Grant Aid

Comment: Payments pertaining to the FSMNG's share allocated to two States were made without support of an Advice of Allotment.

Recommendation: The FSM National Government should make payments allocated to states based on support of an Advice of Allotment.

17. Transfers In and Out

Comment: Certain transfers in and out of the General Fund were not supported by corresponding appropriations. Furthermore, a transfer out exceeded the amount appropriated.

Recommendation: Transfers should be reconcilable against respective appropriation laws.

18. Allotments and Budgeted Amounts

Comment: Differences were noted between amounts in budgetary schedules and the amounts allotted.

Recommendation: The budgetary schedule should be timely reconciled with changes in allotments.

19. Budget Process

Comment: Appropriation computations do not appear to specify an offset for automatic debt repayments.

Recommendation: The manner in which automatic debt repayments are factored into the budgetary process should be considered.

20. Cash

Comment: Cash movement should occur to maintain compliance with associated agreements.

Recommendation: Cash movements should timely occur to demonstrate compliance with associated agreements.

21. Deferred Revenue

Comment: Little to no movement occurred in non-federal related deferred revenue accounts and related awards are generally silent as to the return of funds upon project completion. Additionally, several deferred revenue balances are maintained on the prior accounting software and have not been transferred to the primary accounting software. We additionally noted a bank transfer recorded as deferred revenue that appears to possibly relate to general fund revenues.

Recommendation: Deferred revenue balances should be completely accounted for and be subject to monitoring over compliance agreements. Additionally, resolution of completed programs should occur with related grantors.

SECTION II – 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

FSM National Government 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.