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June 20, 2013

Mrs. Lalain Jano  
Acting Executive Director  
Pohnpei State Housing Authority  
P.O. Box 1109  
Kolonia, Pohnpei 96941

Dear Mrs. Jano:

In planning and performing our audit of the financial statements of the Pohnpei State Housing Authority (the Authority), a component unit of the Pohnpei State Government, as of and for the year ended September 30, 2012 (on which we have issued our report dated June 20, 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 Authority'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 Authority's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Authority'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 Authority's internal control over financial reporting as of September 30, 2012 that we wish to bring to your attention.

We have also issued a separate report to the Board of Directors, also dated June 20, 2013, on our consideration of the Authority'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, others within the organization, and the Office of the National Public Auditor and is not intended to be and should not be used by anyone other than these specified parties.

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 Authority for their cooperation and assistance during the course of this engagement.

Very truly yours,

## SECTION I – DEFICIENCIES

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

### **Fixed Assets**

Comment: Controls do not appear to be in place to require price quotations for the purchase of fixed assets.

Recommendation: We recommend that the Authority obtain at least three price quotations to support fixed asset purchases.

### **Loan Processing**

Comments:

- Property inspections will be carried out by PSHA inspectors or another competent inspector who may be contracted to perform such services. For new loans tested, there were no property inspection documents evidencing that such requirement was completed before loan issuance. There is a lack of control over meeting and monitoring loan requirements.
- For new loans tested, there were no documents evidencing the borrower's request and rationale for a loan restructure. There is a lack of control over maintaining and monitoring loan requirements.

Recommendation: The Authority should comply with its Rules and Regulations that specify Application Processing.

### **Project Requirements**

Comment: Applicants are responsible for obtaining required construction permits before projects can begin. For new loans tested, there were no required permits such as Building, EPA protection, Earth moving and HPO Clearance.

Recommendation: The Authority should comply with its Rules and Regulations which specify project requirements.

### **Housing Project**

Comment: For one new loan tested, a borrower was not the owner of land collateralizing the loan.

Recommendation: The Authority should comply with its Rules and Regulations governing project requirements.

### **Refund of Loan Payments**

Comment: In absence of a refund policy, borrowers are given cash for amounts paid in advance of loan approval.

Recommendation: The Authority should implement a formal refund policy.

**SECTION II – DEFINITION**

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 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**

The Authority'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.