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June 17, 2014

Ms. Carmen Kigimnang  
General Manager  
The Diving Seagull, Inc.

Dear Ms. Kigimnang:

In planning and performing our audit of the financial statements of the Diving Seagull, Inc. (the Company), a component unit of the FSM National Government, as of and for the year ended September 30, 2013 (on which we have issued our report dated June 17, 2014), 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 Company'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 Company's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Company'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 Company's internal control over financial reporting as of September 30, 2013 that we wish to bring to your attention.

We have also issued a separate report to the Board of Directors, also dated June 17, 2014, on our consideration of the Company'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 Board of Directors, management, others within the organization, 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.

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 Company 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 Company's internal control over financial reporting as of September 30, 2013 that we wish to bring to your attention:

**1. Timely Submission of Cash Receipts**

Comment: Several old cash receipts from prior years were submitted by a crew member for reimbursement.

Recommendation: We recommend that management request timely submission of cash receipts.

**2. Fuel Inventory**

Comment: A fuel log was not obtained from fishing vessels at fiscal year end.

Recommendation: We recommend that management obtain year-end fuel logs.

**3. Reconciliation of Regional License Fees**

Comment: Regional fishing license fees were not reconciled to the statement.

Recommendation: We recommend that management perform periodic reconciliations of these fees.

**4. Missing Supporting Documents**

Comment: Several documents supporting regional access license fees were not available for inspection.

Recommendation: We recommend that management maintain all documents supporting such fees.

**5. Cash Disbursement from E-Banking Account**

Comments: The Company requires two signatures for its regular checking accounts; however, it requires GM's ID and password only for the E-Banking account.

Recommendation: We recommend that management consider an internal authorization form to approve payments from the E-Banking account and maintain dual control over such account.

**6. Missing Invoices from Fishing Vessels**

Comments: An invoice for engine repair which was paid from petty cash of a fishing vessel was not in file.

Recommendation: We recommend that management improve employee awareness of payment policies and obtain invoices.

**7. Fixed Asset Disposal**

Comments: Fixed asset disposals occurred without informing management and such were not updated in the fixed asset register. A policy regarding fixed asset disposals was not established by management.

Recommendation: We recommend that management establish a policy regarding fixed asset disposals.

**SECTION II – DEFINITION**

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.

The definition of a deficiency and a significant deficiency are as follows:

A *deficiency* in internal control over financial reporting 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**

The Company'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.