

June 30, 2014

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, 2013 (on which we have issued our report dated June 30, 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 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, 2013 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, 2014, 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,

Deloitte + Touche LLP

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, 2013 that we wish to bring to your attention:

1. Cash

Comment: The General Fund checking account contained two duplicate checks of \$5,392. The duplicate item has not been collected as of June, 2014.

Recommendation: The FSM National Government monitor checks for duplicate payments

2. Travel Advances

Comment: Travelers were reimbursed for travel liquidations that were submitted past the ten-day liquidation period after completion of travel.

Recommendation: The FSM National Government should monitor compliance with the ten day requirement or should consider extending this time frame.

3. 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 establish alternatives to achieve timely deposits.

4. Missing Documents

Comment: 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.

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

5. CTA Receipts

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

For certain CTA receipts tested, the tax assessments were not attached to the tax files; hence, recalculation of the tax collected cannot occur.

Recommendation: Cash should be deposited the following business day and include a report or memo that supporting collection will follow upon system availability. The system malfunction should not hinder the timely deposit of cash but only the timely submission of the collection reports.

Tax assessments should be completely filed to allow for verification.

6. Deferred Revenue

Comment: For certain non-US Grants, there were no movements in recorded deferred revenue during the year and the award was silent as to the return of excess funds upon project completion.

Several deferred revenue accounts have not yet been transferred to Fundware.

Certain grant awards were not available to determine the validity of the recorded balances.

Recommendation: The non-moving deferred revenue may no longer be valid. If determined by the Government as legally allowable, this deferred revenue could provide additional funding for other projects/programs. The continuing validity of the deferred revenue accounts should be assessed. Coordination with the department allotted the funds should occur.

The fund status report of Fund 23 is not complete since certain programs included in deferred revenue are not transferred to Fundware. Due to unavailable data in the Fundware system, respective allottees of the impacted programs may not be aware of fund availability. All deferred revenue should also be encoded in the Fundware system to provide readily available information for allottees.

SECTION II – 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 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.