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July 4, 2022

Honorable Eugene Amor
Secretary, Department of Finance & Administration
Federated States of Micronesia
Palikir, Pohnpei FM 96941

Greetings Secretary Amor,

In planning and performing our audit of the financial statements of the Renewable Energy Development Project (the "Project"), a Project funded by the Asian Development Bank and administered by the Department of Finance & Administration and implemented by the Department of Resources & Development of the FSM National Government, for the period December 03, 2019 to September 30, 2021, which collectively comprise the Project's financial statements (on which we have issued our report dated July 4, 2022), 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 Project'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 Project's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Project'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, other matters involving the Project's internal control over financial reporting for the period December 03, 2019 to September 30, 2021 that we wish to bring to your attention.

We have also issued a separate report to the President of the FSM and the members of the 22nd Congress, also dated July 4, 2022, on our consideration of the Project's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreement and other matters that we consider to be material weaknesses or significant deficiencies under standards established by the American Institute of Certified Public Accountants.

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 Project's management, the Office of the President, the Asian Development Bank and others within the organization 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 Department of Finance & Administration and Department of Resources & Development of the FSM National Government for their cooperation and assistance during the course of the engagement.

Sincerely,

Haser H Hainrick
National Public Auditor

APPENDIX I

SECTION I – DEFICIENCIES

We identified the following deficiency involving the Project's internal control over financial reporting for the period December 03, 2019 to September 30, 2021 that we wish to bring to your attention:

Non-Maintenance of separate accounts and records for the Project

Criteria: Section 4.02 of Article IV of the grant agreement dated 12/03/19 states that the recipient shall maintain separate accounts and records for the project.

Condition: DOFA as the executing agency did not maintain separate accounts specifically for the project, therefore relied on the Asian Development Bank Client Portal for Disbursements to prepare the financial statements for REDP. We also noted that the Fundware was not updated even though an account number has been allocated for the project.

Nevertheless, we acknowledge the efforts by DORD and DOFA to recruit an Officer to track the project expenditure and disbursements and maintain project accounts.

Root-Cause: Lack of resources at DOFA to designate a position with the responsibility of maintaining the project records and updating project accounts including Fundware.

Effects: Non-compliance with the requirements of the grant agreements.

Recommendations:

We recommend that DOFA and DORD expedite the recruitment of the Officer and ensure that Fundware and other project records are properly updated within specified timelines.

Management Responses:

The finding is accurate and one that we have already identified internally and have started to process to improve our performance in this area. One shortfall of the project was in the allocation of funds and appropriate level of national staffing to Output 4: Efficient Project Management. There was an original focus on international staffing to provide the outside expertise required to support the project technical aspects (the contract for the Project Implementation Consultants, Entura), and with one National Coordinator on a part-time basis. In mid-2021 DOFA and DORD noted the need to enhance the local PMU based at DORD with additional staff, including a priority focus on a Finance & Administration Officer (FAO) who should look after all contracts, keep manual and electronic ledgers of payments and other similar financial duties – including working with DOFA to set up and maintain Fundware related to the recently approved Advice of Allotment for the project – to support the National Coordinator effectively implement the project. The ADB agreed and approved this additional staffing to the PMU. We agree with your recommendation and expect to have the FAO in place by the end of June 2022, and who will work closely with DOFA to ensure that all financial project records are accurately maintained on a timely basis, and who will also enable more efficient and timely annual project audits.

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.

APPENDIX II

MANAGEMENT'S RESPONSIBILITY FOR, AND THE OBJECTIVES AND INHERENT 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 Project's management is responsible for the overall accuracy of the financial statements and their conformity with accounting principles generally accepted in the United States of America. In this regard, management is also responsible for establishing and maintaining effective internal control over financial reporting.

Objectives of Internal Control over Financial Reporting

An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel and designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with accounting principles generally accepted in the United States of America. An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction, of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

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 override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any assessment of the effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.