

Management Letter

**GCF Project- Climate Resilience Food Security for Farming Households Across the
Federated States of Micronesia SAP020**

Year ended December 31, 2024





FEDERATED STATES OF MICRONESIA

Office of The National Public Auditor

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September 19, 2025

Ms Mae Bruton-Adams
Chief Executive Officer
Micronesia Conservation Trust
Kolonia, Pohnpei FM 96941

and

Board of Directors
Micronesia Conservation Trust
Kolonia, Pohnpei FM 96941

Dear Ms Bruton Adams and Members of the Board,

In planning and conducting our audit of the financial statements of the SAP020 Climate Resilience Food Security for Farming Households Across the Federated States of Micronesia (FSM)(the Project), a project funded by the Green Climate Fund (GCF), administered by the Micronesia Conservation Trust, a GCF-accredited organization, and implemented by three executing entities, the Department of Resource and Development (DR&D), Department of Environment, Climate Change & Emergency Management (DECCEM) and College of Micronesia- FSM (COM-FSM) as of and for the year ended December 31, 2024, in accordance with auditing standards generally accepted in the United States, 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 as a basis for designing auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Project's internal control. Accordingly, we do not express an opinion on the effectiveness of the Project's internal control.

Our consideration of internal control over financial reporting was limited to the purpose described in the preceding paragraph. It was not designed to identify all deficiencies in internal control over financial reporting. However, in connection with our audit, we have identified and included in the attached Appendix I deficiencies related to the project's internal control over financial reporting and other matters as of and for the year ended December 31, 2024, that we wish to bring to your attention.

We also issued a separate report to the President of the FSM and the Members of the 24th Congress dated September 19, 2025 on our review of the project's internal control over financial reporting and our tests of its compliance with specific provisions of laws, regulations, contracts, and agreements, as well as other matters that we consider to be of significant deficiencies under standards established by the American Institute of Certified Public Accountants.

The definition of a deficiency is also outlined in the Appendix.

A description of management's responsibility for establishing and maintaining internal control over financial reporting, along with the objectives and inherent limitations of such controls, are outlined in the attached Appendix II and should be read in conjunction with this report.

Although we have included management's written response to our comments in the attached Appendix 1, such responses have not been subjected to the auditing procedures applied in our audit of the financial statements. Accordingly, we do not express an opinion or provide any form of assurance on the appropriateness of the responses.

This report is intended solely for the use and information of Project Management, the Board of Directors, the FSM President, Members of the 24 FSM Congress, Green Climate Fund, and other members within the organization. It is not meant to be, and should not be, used by anyone other than these specified parties. However, this report is also a matter of public records.

We would like to thank the staff and management of the Micronesia Conservation Trust for their cooperation and assistance throughout the engagement.

Sincerely,



Haser H. Hainrick
National Public Auditor

We identified the following significant deficiencies in the Project’s internal control over financial reporting for the year ended December 31, 2024, that we want to bring to your attention:

2024/01: Inaccurate and Untimely Preparation of Trial Balance

Criteria: Under generally accepted accounting principles (GAAP), entities must prepare and maintain accurate accounting records, including a complete and balanced trial balance, to ensure reliable financial reporting. Additionally, U.S. generally accepted auditing standards (GAAS) require auditors to communicate any significant deficiencies in internal control that they identify during audits. Effective financial management and adherence to accounting standards require a trial balance to be thorough, precise, and balanced, as it serves as the foundation for preparing trustworthy financial statements.

Condition: During the audit, we noted that the trial balance provided by the Project contained several issues, including:

- An imbalance between the total debits and credits.
- Retained earnings not rolling forward from the prior year; and
- Unusual account balances (for example, a debit balance in “Due to Project”).

These issues indicate that the trial balance, as prepared, was not accurate or reliable for financial reporting purposes.

Effects: Because the trial balance was not accurate, the Project’s financial reporting process cannot be considered reliable without substantial auditor intervention. This represents a material weakness in internal control over financial reporting, as it creates a reasonable possibility that a material misstatement of the financial statements could occur and not be prevented or detected in a timely manner.

Root Causes: The deficiencies appear to result from inadequate financial closing procedures, insufficient review of accounting records, and the absence of timely reconciliations of key accounts.

Recommendations:

We recommend that project management:

1. Strengthen the financial closing process to ensure a complete and accurate trial balance is prepared at year-end.
2. Perform timely reconciliations of all accounts, including retained earnings and inter-project balances.
3. Establish internal review procedures before submission to auditors.
4. Provide additional training to accounting staff on year-end financial reporting and trial balance preparation.

Management Comments:

Management recognizes the critical importance of accurate and timely preparation of the trial balance and fully supports efforts to strengthen financial closing procedures, ensure prompt reconciliations, and enhance internal review controls. We also agree that additional training for accounting staff will contribute meaningfully to the reliability of year-end reporting.

However, we respectfully disagree with the classification of the noted issues as a material weakness. The imbalances and unusual account balances identified during the audit were primarily due to timing adjustments and formatting inconsistencies in the preparation of audit schedules, rather than deficiencies in the core accounting records or closing processes. These findings, in our view, do not reflect a fundamental flaw in the Project's financial reporting framework, but rather point to areas for procedural refinement and improved audit readiness.

Detailed account reports affirm the integrity of the recorded balances, and management is actively evaluating an upgrade to the accounting system to enhance operational efficiency and improve grant tracking capabilities.

We remain committed to implementing the recommended improvements and continuously strengthening our financial reporting processes to reduce the likelihood of similar issues in future reporting cycles.

2024/02: Weakness in the bank reconciliation process

Criteria: Sound financial management practices and internal control standards require regular and timely bank reconciliations to ensure accurate and complete cash balances. Reconciliations should be performed monthly, reviewed promptly, and approved by an independent official to minimize the risk of errors or irregularities.

Condition: Our review of the reconciliation process revealed that the bank reconciliation only began during the year under audit (FY24). Quarterly reconciliations were performed, but no reconciliations for earlier periods were completed. Furthermore, the Chief Financial Officer (CFO) is the only person performing the reconciliation process without independent review or approval. As a result, there is no separation of duties.

Effects: The present procedure raises the possibility of:

- Bank balance errors or irregularities that go unnoticed.
- Lack of segregation of duties could lead to fraud opportunities.
- Cash/fund balances in the financial statements are misrepresented.
- Decreased financial reporting reliability.

Root causes: The weaknesses noted appear to be due to the absence of established policies and procedures to ensure timely and independently reviewed bank reconciliations.

Recommendations:

Project management to:

- Ensure all periods—including previously unreconciled periods—are covered by monthly bank reconciliations.
- Establish processes mandating that a designated officer other than the preparer independently review and approve reconciliations.
- Implementing a sufficient segregation of duties within the reconciliation process.

Management Comments:

Management acknowledges the importance of timely and independently reviewed bank reconciliations as a vital element of internal control. We fully support the principle that such reconciliations contribute to the integrity of financial reporting and the safeguarding of assets. However, we respectfully disagree that the current process constitutes a significant weakness in internal control over financial reporting.

While formal reconciliations were initiated in FY24 and performed quarterly rather than monthly, cash balances were consistently monitored throughout the year through alternative oversight mechanisms. These procedures provided sufficient visibility into cash activity, and we do not believe they compromised the reliability of financial reporting or the security of funds.

To provide context, the CFO assumed responsibilities in the second quarter of 2024. Reconciliations were primarily conducted by a finance officer, with the CFO offering support only when additional assistance was required. The timing of these reconciliations corresponded with the release of official bank statements, which are issued quarterly. Although this practice does not fully align with internal control best practices, management has taken proactive steps to strengthen the process.

Specifically, we have revised roles and responsibilities to ensure proper segregation of duties and have implemented more frequent reconciliation procedures. Moving forward, cash monitoring through online banking will be conducted regularly, and formal reconciliations will be completed promptly upon receipt of quarterly bank statements.

Management remains committed to continuous improvement and to reinforcing internal controls that support accurate financial reporting and responsible stewardship of financial resources.

2024/03: Slow progress in project implementation and utilization of funds

Criteria: The financing agreement states that the project must utilize at least 70% of the previous disbursement before requesting additional funds. Project activities should be implemented promptly to ensure efficient use of donor funds.

Condition: Our review of the project disbursements reveals that no further requests were made between FY21 and FY23, indicating a slow utilization of project funds.

Effects: The delay in implementing project activities could impact the achievement of project objectives and reduce the overall efficiency of the project.

Root cause: Delays in project implementation were partly due to the late recruitment of key positions, which hindered the timely execution of planned activities.

Recommendations:

The project management to expedite the recruitment of critical positions and implement a more proactive plan to utilize funds efficiently. Regular monitoring of funds should be strengthened to prevent similar delays in the future.

Management Comments:

Management acknowledges the observation regarding the slow progress in project implementation and fund utilization between FY21 and FY23. We recognize the importance

of the timely execution of activities and the efficient use of donor funds, in line with the financing agreement requirement to utilize at least 70% of previous disbursements before requesting additional funding.

It is important to note that the project only became effective on 21 July 2021, with the first disbursement received on 06 October 2021. As outlined in the Funded Activity Agreement (FAA), there are conditions precedent to all disbursements—including the first and second—which require time to fulfill. The Executing Entities (EEs) met the conditions for the second disbursement only toward the end of 2023.

Between 06 October and 31 December 2021, no GCF proceeds were applied toward project activities, as the Micronesia Conservation Trust (MCT) was working closely with the FSM Department of Resources and Development to establish the Project Management Unit (PMU). The PMU was fully staffed by the end of the first quarter of 2022.

This is the first GCF project jointly implemented by the FSM National Government, MCT, and other Executing Entities. The process has required significant adaptive management and flexibility to ensure strong administration and implementation. Additionally, FSM was among the last countries to transition from a zero-COVID policy to active pandemic status, beginning in July 2022. This shift caused further delays as the country adjusted to its “new normal.”

Despite these challenges, management has taken concrete steps to accelerate implementation. Key positions have been filled, and project activities have resumed with renewed momentum. A more proactive planning approach has been adopted to ensure that funds are utilized efficiently and in alignment with project timelines.

To further strengthen implementation, we have instituted regular monitoring of fund utilization and activity progress. These measures are expected to improve execution efficiency and prevent similar delays in the future.

Management remains committed to achieving the project’s objectives and ensuring responsible stewardship of donor resources.

Deficiency: A deficiency in internal control 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, 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 adequately 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.*

Material Weakness: A deficiency, or a combination of deficiencies, in internal controls, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Significant Deficiency: A deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

APPENDIX II

MANAGEMENT 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 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 of 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.