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May 27, 2026

Hon. Elina P. Akinaga
Secretary
Department of Resources and Development (DR&D)
National Government of the Federated States of Micronesia
Palikir, Pohnpei FM 96941

Greetings Secretary Akinaga:

In planning and conducting our audit of the financial statements of the Small Islands Food and Water Project (SIFWaP), Enhancing the Climate Change Resilience of Vulnerable Island Communities in the Federated States of Micronesia (FSM)(the Project), for the year ended September 30, 2025, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in the Government Auditing Standards issued by the Comptroller General of the United States.

In doing so, 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.

The Project is funded by the International Fund for Agriculture Development (IFAD), administered by the Department of Finance and Administration (DoFA), and implemented by the Department of Resources and Development (DR&D). of the Federated States of Micronesia.

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 September 30, 2025, 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 FSM Congress on May 27, 2026 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 deficiency 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 FSM President, Members of the 24th FSM Congress 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 project's staff and management for their cooperation and assistance throughout the engagement.

Sincerely,

Haser H. Hainrick
National Public Auditor

SECTION 1 – DEFICIENCIES
APPENDIX I

The following deficiencies in internal control over financial reporting and other matters were identified during our audit of the Small Islands Food and Water Project (SIFWaP) for the year ended September 30, 2025.

Significant Deficiency

2025/01 Misstatement in Payroll and Related Expenditure Accounts
The Project's payroll and related expenditure accounts are misstated and do not accurately reflect supporting payroll and accounting records maintained in the FundWare system.

Criteria: The International Fund for Agricultural Development (IFAD) Financial Management Guidelines require that project financial statements present fairly, in all material respects, the project's financial position and expenditures and be supported by accurate accounting records and reconciliations.

The Government Accountability Office Standards for Internal Control in the Federal Government (Green Book) require that transactions and other significant events be accurately recorded and classified in a timely manner to maintain reliable financial reporting and accountability.

Condition: During audit testing of salaries and wages expenditure for FY2025, auditors initially identified a variance of USD 2,123.08 between payroll expenses reported in the financial statements and supporting payroll records.

This variance was initially assessed as an isolated payroll discrepancy potentially caused by system-generated reversal entries within the FundWare accounting system.

However, further audit procedures performed to investigate the matter revealed that the issue was not limited to payroll only. Expanded testing identified additional misstatements across payroll-related and expenditure accounts, resulting in cumulative discrepancies totaling **USD 14,087.70.**

The breakdown of the affected amounts is as follows:
Salaries: USD 3,846.16
Contractual Services: USD 9,230.78
Health Contributions: USD 47.28
Social Security Contributions: USD 963.48

The misstatements were associated with system-generated reversal entries and related posting issues in the FundWare system following interruptions in payroll batch processing.
According to correspondence from the Department of Finance and Administration (DOFA) dated March 30, 2026, addressed to IFAD, the discrepancies resulted from automated reversal entries triggered when payroll batch processing terminated prematurely.

DOFA explained that both the original and reversal entries remained in the system to preserve the integrity of the audit trail.

DOFA further advised that, because the affected transactions relate to a closed accounting period, adjustments cannot be made directly within the system and will instead be corrected through journal entries in the current open accounting period following reconciliation.

At the time of audit fieldwork, management had not provided a fully reconciled audit trail linking original entries, reversal entries, and any subsequent re-postings to explain the cumulative differences identified.

Root Causes: The misstatement resulted from:

- System-generated reversal entries caused by interruptions in payroll batch processing within the FundWare system;
- Lack of formal control procedures over system-generated reversal entries;
- Inadequate reconciliations among payroll records, general ledger balances, and project financial statements before the financial statements were finalized; and
- Insufficient review and monitoring of payroll-related journal entries and adjustments.

Effects: The identified weaknesses:

- Reduced the reliability of accounting records generated by FundWare;
- Increased the risk that material misstatements in payroll and related expenditure accounts would not be detected on a timely basis;
- Contributed directly to cumulative misstatements totaling USD 14,087.70 in the financial statements; and
- Resulted in the financial statements being materially inaccurate at the time of audit fieldwork.

Although DOFA subsequently confirmed that the discrepancies were system-generated and did not represent unauthorized expenditures, corrective adjustments had not been fully processed and verified during the audit.

Recommendations:

We recommend that Project management and DOFA:

1. Reconstruct a complete audit trail for all affected payroll and expenditure entries, including original postings, reversal entries, and any subsequent re-postings;
2. Perform comprehensive reconciliations among payroll records, the general ledger, and financial statements prior to finalization;
3. Process all necessary correcting journal entries in a timely manner and retain adequate supporting documentation;
4. Establish formal procedures for the review and approval of system-generated reversal entries within FundWare; and
5. Strengthen supervisory review controls over payroll processing and related financial reporting.

Management Comments:

Management acknowledges the audit finding regarding the discrepancies identified in payroll and related expenditure accounts. We appreciate the auditors' efforts in identifying the issue and recognize the importance of maintaining accurate and reliable financial records.

As noted in the finding and confirmed by the Department of Finance and Administration (DOFA), the discrepancies resulted from system-generated reversal entries and related posting issues within the FundWare accounting system following interruptions in payroll batch processing. The FundWare system, payroll processing, and general ledger maintenance are administered and controlled by DOFA. As such, Project Management does not have the authority or system access necessary to investigate, modify, or correct system-generated accounting entries within FundWare.

Management agrees that reconciliations between project records and financial reports are important and will continue to strengthen its review of financial information received from DOFA. Management will work closely with DOFA to obtain timely reconciliations and supporting documentation prior to the finalization of future financial statements.

With respect to the recommendations:

1. **Reconstruct a complete audit trail for all affected payroll and expenditure entries, including original postings, reversal entries, and subsequent re-postings** — Management agrees with this recommendation; however, implementation falls under DOFA's responsibility as custodian of the FundWare system and accounting records. Management will formally request that DOFA complete and maintain the necessary audit trail documentation.

2. **Perform comprehensive reconciliations among payroll records, the general ledger, and financial statements prior to finalization** — Management agrees with this recommendation and will continue to perform reviews and reconciliations of project records against reports provided by DOFA before financial statements are finalized. However, complete reconciliation of general ledger transactions remains dependent on information maintained and provided by DOFA.
3. **Process all necessary correcting journal entries in a timely manner and retain adequate supporting documentation** — Management agrees that corrective entries should be processed and adequately documented. Since journal entries affecting FundWare records can only be processed by DOFA, Management will recommend that DOFA implement the necessary corrections and maintain supporting documentation.
4. **Establish formal procedures for the review and approval of system-generated reversal entries within FundWare** — Management agrees that such procedures would strengthen internal controls. However, this recommendation is directed to DOFA, as the owner and administrator of the FundWare system.
5. **Strengthen supervisory review controls over payroll processing and related financial reporting** — Management agrees with this recommendation. To the extent possible, Project Management will continue its oversight of project expenditures and financial reporting. However, supervisory controls over payroll processing and system generated transactions within FundWare should be strengthened by DOFA.

Management notes that DOFA has already acknowledged the cause of the discrepancies and advised that corrections will be processed through journal entries in an open accounting period following reconciliation. Management will continue to coordinate with DOFA to monitor the status of these corrective actions and to ensure that project financial reports accurately reflect the underlying accounting records.

2025/02: Delays in Providing Audit Documentation

There were significant delays in obtaining supporting documentation from the Department of Finance and Administration (DOFA), which affected the timely completion of audit procedures.

Criteria: In accordance with Section 3 (Responsibilities of the Borrower/Recipient) and Section 4 (Audit Requirements) of the IFAD Handbook for Financial Reporting and Auditing of IFAD-Financed Projects, the Project is required to maintain complete and reliable accounting records and supporting documentation and to provide auditors with timely access to all information necessary to support audit procedures.

Further, under the Financing Agreement between the Government of the Federated States of Micronesia and IFAD, the Borrower/Recipient is required to maintain proper books and records and to ensure that such records are made available to auditors in a timely manner for audit and verification.

Condition: During the audit, significant delays were experienced in obtaining requested supporting documentation from DOFA.

The delays resulted in extensions to the audit timeline and prevented completion of certain audit procedures within the originally planned schedule. In addition, the Project relied primarily on DOFA to maintain supporting financial documentation and did not maintain complete duplicate project records.

Effects: The delays:

- Reduced audit efficiency and prolonged completion of audit procedures;
- Increased the risk that records may not be readily available for verification and oversight purposes;
- Increased the risk of incomplete audit evidence; and
- May affect the timely issuance of audited financial statements required under the financing agreement.

Root causes: The delays resulted primarily from:

- Insufficient coordination and delayed responses from DOFA in providing the requested audit documentation; and
- Weak document retention and filing practices at the project level.

Recommendations:

We recommend that DOFA improve responsiveness and coordination with Project management and auditors to ensure that requested documentation is provided within agreed-upon timelines.

We further recommend that Project management strengthen document retention and coordination procedures by maintaining complete, organized project files, including approved payment vouchers, invoices, payroll records, contracts, travel authorizations, and other supporting documentation, in accordance with IFAD requirements and the Project Implementation Manual.

Management Comments:

Management acknowledges the audit finding regarding delays in the provision of supporting documentation during the audit process and recognizes the importance of timely access to records to facilitate efficient audit procedures and compliance with IFAD reporting requirements.

Management notes that the delays experienced during the audit were attributable to the Department of Finance and Administration (DOFA), which maintains the Project's accounting records, financial transactions, and supporting documentation within the Government's centralized financial management system. The Project provided all records maintained at the project level in a timely manner and fully cooperated with the auditors throughout the audit process.

Management respectfully disagrees with the assertion that weak document retention and filing practices at the project level contributed to the delays. The Project maintains organized and complete project files, including contracts, travel authorizations, correspondence, procurement records, and other documentation required for project implementation and oversight. The delays referenced in the finding were related to financial records and supporting documentation maintained by DOFA, which were outside the direct custody and control of Project Management.

With respect to the recommendations:

1. **Recommendation directed to DOFA:** Management notes that this recommendation is appropriately directed to DOFA, as the delays identified in the finding resulted from the untimely provision of financial records and supporting documentation maintained by DOFA. Project Management will continue to coordinate with DOFA and support efforts to facilitate timely access to documentation required for future audits.
2. **Strengthen document retention and coordination procedures by maintaining complete and organized project files —** Management respectfully disagrees that project level document retention practices contributed to the delays identified in this finding. The Project maintains complete and organized project records in accordance with IFAD requirements and the Project Implementation Manual and provided all records under its custody during the audit. Management will continue to maintain these practices and coordinate with DOFA to obtain financial documentation as needed.

Management remains committed to supporting audit activities and will continue to work collaboratively with DOFA to ensure timely access to information required for future audits.

SECTION II - DEFINITION
APPENDIX II

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 III

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 in future periods are subject to the risk that controls may become inadequate due to changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.