



FEDERATED STATES OF MICRONESIA

Office of The National Public Auditor

P.O. Box PS-05, Palikir, Pohnpei FSM 96941

Tel: (691) 320-2862/2863; Fax: (691) 320-5482

CID Hotline: (691) 320-6768; E-mail: hhainrick@fsmopa.fm

October 5, 2015

Mr. Marion Henry
Secretary, FSM R&D
MTEC Interim Secretariat
P. O. Box PS-12
Palikir, Pohnpei FM 96941

Dear Mr. Henry:

In planning and performing our audit of the financial statements of the Micronesian Trade and Economic Community (MTEC), a nonprofit organization of the Government of Federated States of Micronesia, Republic of Marshall Island and Republic of Palau, for the year ended September 30, 2014, (on which we have issued our report dated October 5, 2016), 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 Organization'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 Organization's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Organization'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 designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, in connection with our audit, we identified, and included in the attached Attachment I, deficiencies related to the Organization's internal control over financial reporting and other matters as of September 30, 2014 that we wish to bring to your attention.

We have also issued a separate report to the MTEC Ministers, also dated October 5, 2015, on our consideration of the Organization'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 attached Attachment I.

A description of the responsibility of management for establishing and maintaining internal control over financial reporting and of the objectives and inherent limitations of internal control over financial reporting, is set forth in the attached Attachment II and should be read in conjunction with this report.

This report is intended solely for the information and use of management, the Ministers and others within the Organization and is not intended to be and should not be used by anyone other than those 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 Organization for their cooperation and assistance during the course of this engagement.

Sincerely,

A handwritten signature in blue ink, appearing to read 'Haser Hainrick', with a large, sweeping flourish above the name.

Haser Hainrick
National Public Auditor

SECTION I – DEFICIENCIES

We identified the following deficiencies involving the Organization’s internal control over financial reporting as of September 30, 2014 that we wish to bring to your attention:

Finding No. 2014-01 Proper books of accounts not maintained

Criteria: The Standard accounting practices require that books of accounts should be maintained to meet the accountability requirements and preparation of financial statements for each financial period.

Best practice requires that member’s contributions should be collected yearly.

Condition: Our verification of MTEC records indicated the following matters:

- Annual budget was not prepared to provide comparison with actual expenditure.
- The books of accounts for the purpose of funds accountability and preparation of financial statements were not maintained. There were no set of books e.g., disbursement book, cash receipt book, general journal and general ledger books.
- There was no periodic preparation of the financial statements for information and decision making purposes.
- There was no periodic reconciliation of bank accounts and financial records to ensure that financial records are accurate, complete and consistent.
- Only two out of the three Member States paid for their annual contribution.

Cause: The Director General did not ensure that the Secretariat performs and accounts the financial activities of MTEC in accordance with best practices. In addition, there was no available staff at MTEC who is knowledgeable in keeping the accounting records and in preparing the basic financial statements.

The obligation to pay annual membership dues was not properly established in the MTEC Financial Management Regulation.

Effect: The financial statements of MTEC are not regularly prepared for information and decision making purposes. We noted a discrepancy of \$1,061 in the cash accountability but this was not detected timely.

Recommendation: We recommend that the General Director or designee should:

- Prepare an annual budget to provide control, management and monitoring of the use of funds.
- Implement the necessary bookkeeping procedures to properly record and account the MTEC’s financial transactions.
- Require the periodic reporting of the basic financial statements such as Statement of financial position (also called a balance sheet), Statement of Activity (also called an income and expense statement), and the Statement of Cash Flow. Period reconciliation of MTEC bank account
- Require the periodic reconciliation of MTEC bank account.

- Ensure that annual contribution by State Members be clearly established in the MTEC Financial Management Regulation.

Management Response: *Annual contribution* - The MTEC Interim Secretariat will assist the Member States to obtain ratification of the MTEC Treaty and the Protocol to the Treaty with a view to address the legal issues pertaining to Member State's annual membership contribution. In addition, the Interim Secretariat will also prepare an Issues Paper to guide the discussion on MTEC annual membership contribution at the 8th MTEC Ministers' meeting.

Book keepers and Reporting - Given the limited financial contributions from the MTEC Member States, the MTEC Secretariat relies exclusively on Staff of the FSM Department of Resources and Development for the management of the MTEC financial affairs who have no extensive knowledge of accounting and book keeping practices. The MTEC Secretariat will conduct a basic training in accounting for all staff currently involved in the management of the MTEC financial affairs.

Annual Budget – The MTEC Interim Secretariat will prepare a proposed fiscal year 2016 budget for adoption by the MTEC Ministers in accordance with the MTEC Financial Regulations.

SECTION II – DEFINITION

The definition of a deficiency is 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 CONTROLS 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 and generally accepted in the United States of America.

Management's Responsibility

The Organization'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 safeguarding of assets against unauthorized 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 Controls over Financial Reporting

Because of the inherent limitations of internal controls 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 control may become inadequate because changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.