



FEDERATED STATES OF MICRONESIA

Office of The National Public Auditor

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September 22, 2016

Hon. Lukner Weilbacher
Secretary
Department of Transportation, Communication and Infrastructure
FSM National Government
Palikir, Pohnpei FM 96941

Dear Secretary Weilbacher:

In planning and performing our audit of the financial statements of the Federated States of Micronesia Omnibus Infrastructure Development Project (the "Project") financed by Asian Development Bank (ADB) Loan No.'s 2099-FSM (SF) and 2100-FSM (OCR) for the year ended September 30, 2014, on which we have issued our report dated September 22, 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 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, deficiencies related to the Project'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 President of the Federated States of Micronesia and members of the FSM's 19th Congress also dated September 22, 2016, on our consideration of the Project's internal control over financial reporting and on our tests of its compliance with certain provision of laws, regulations, contracts, and loan agreements and other matters.

The definition of a deficiency is also set forth in Section III of 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 Secretary, Department of TC&I, management, others within the department, and the Office of the National Public Auditor and is not intended to be and should not be used by anyone other than these 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 Department of TC&I for their cooperation and assistance during the course of this engagement.

Sincerely yours,

Haser, H. Hainrick
National Public Auditor

SECTION 1 – CONTROL DEFICIENCIES

We identified, and have included below, control deficiencies involving the Project's internal control over financial reporting as of September 30, 2014 that we wish to bring to your attention.

1. Lack of Reconciliation and Review

Comment: Our verification of the Project Accountant's records for payments against the ADB's subsidiary ledger maintained on the Loan Financial Information System (LFIS) disclosed that transactions were either paid or were debited by ADB but not recorded by the Project Accountant. We also noted that no documents were filed by the Department of Transportation, Communication & Infrastructure (TC&I) for those transactions.

Recommendation: The Project Accountant should regularly (e.g. monthly) reconcile her records with the ADB's subsidiary ledger maintained at LFIS to ensure that all transactions are recorded.

2. Gaps In Sequential Numbering of Withdrawal Applications

Comment: There were gaps in the numbering sequence for Withdrawal Applications supporting the request for direct payment from ADB.

Recommendation: The Project Accountant should monitor and account the numbering sequence when preparing Withdrawal Applications requesting for direct payments.

3. Interest Income not Earned

Comment: The Project has maintained in a non-interest bearing checking account with the Bank of Guam. It also has incurred bank service charges in connection therewith. At the time the bank account was established by the Department of Finance and Administration the bank offered, and still does offer, an interest bearing checking account.

Recommendation: Consider opening and transferring balances into an interest bearing account. The Bank of Guam currently offers a business premium checking account which earns interest. In addition, the bank offers statement savings accounts that while limiting the number of monthly withdrawals earn a higher rate of interest and may be a suitable investment for project funds given the level of project activity.

4. Maintenance of Imprest Fund

Comment: Requests for replenishment were prepared and submitted to ADB by the Project Accountant; however, their liquidations or replenishments were not followed-up when not received.

Recommendation: We recommend that the Project Accountant should consider requesting periodic liquidation of expenditures in the imprest fund and ensure that the requests are followed up until they are replenished.

APPENDIX I, CONTINUED

5. Unpaid Withdrawal Applications

Comment: Withdrawal Applications for direct payments were prepared and submitted to ADB by the Project Accountant but have remained unpaid for long time. As of the end of FY2014, withdrawal applications in the amount \$853,966 were unpaid.

Recommendation: The Project Accountant should regularly follow up with ADB on all outstanding Withdrawal Applications to verify timely recording in the project account or timely disposition of problems if there are any. We also recommend that the management review those pending withdrawal applications to determine which ones are for cancellation and for follow up for payments.

6. Unrecorded FSM Share

Comment: The Project Accountant did not have complete records, files, and documents supporting payments made by FSM for its share (e.g.; 20%) of project costs.

Recommendation: We recommend the Project Accountant should;

- File and maintain all documents supporting the transactions for the FSM Share;
- Update, reconcile records and payments for the FSM share of the project to accurately reflect them in the project account record; and
- Maintain and file clear copies of the original documents.

SECTION II – OTHER MATTERS

We noted below other matters related to our observations concerning operations, compliance with laws and regulations involving internal control over financial reporting that we wish to bring to your attention.

1. Statement of Project Account and Record Keeping

Comment:

- The auditor has been preparing the Statement of Project Account based on client records and obtaining accountants/management signature of the statement.
- Files of documents supporting transactions were incomplete, misfiled or missing

Recommendation: We recommend the following:

- The Project Accountant prepares the Statement of Project Account under the supervision of the Department of Finance and Administration.
- The Department of TC&I and Department of Finance and Administration jointly evaluate the qualifications of the current Project Accountant in terms of accounting and bookkeeping abilities.

APPENDIX I, CONTINUED

2. Unallowable Cost

Comment: The Chuuk Public Utilities Corporation (CPUC) had purchased vehicles using the ADB Loan allocated for the Chuuk Electrical Power Rehabilitation project.

Recommendation: We recommend that the Project Administration strengthen controls to verify strict compliance with the requirements of the contract. We also recommend that the un-allowable cost be returned to the imprest account.

3. Supporting Documentations Not Properly Filed

Comment: Transaction documents were neither filed nor maintained by the Project Accountant. As of the end of FY2014, the Project have accumulated a total of \$2,249,377 of transactions either without corresponding files or which were not properly supported by documents.

Recommendation: The Project Accountant should comply with the requirements of the ADB Disbursement Handbook regarding proper filing and maintenance of documentation supporting project transactions and the project statement of account.

SECTION III – DEFINITIONS

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 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 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.