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Wednesday, August 21, 2024

Rose N. Nakanaga
Secretary
Department of Finance & Administration
FSM National Government
Palikir, Pohnpei FM 96941

Greetings Secretary Nakanaga

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 Resource and Development of the FSM National Government, for the year ended September 30, 2023. These collectively comprise the Projects financial statements (on which we have issued our report dated August 21, 2024) 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 projects 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 Projects 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 projects internal control over financial reporting and other matters as of September 30, 2023, 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 23rd Congress, also dated August 21, 2024 on our consideration of the projects internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreement and other matters that we consider to be a significant deficiency under standards established by the American Institute of Certified Public Accountants.

The definition of a deficiency is also set forth in the Appendix 1.

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.

Although we have included managements 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 and, 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 information and use of the projects 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 records.

We want to thank the staff and management of the Department of Finance & Administration and the Department of Resources & Development of the FSM National Government for their cooperation and assistance during the course of the engagement.

Sincerely,

Miriama Naivalu
Acting National Public Auditor

Cc: Secretary, Department of Resources & Development
Assistant Secretary, Division of Investment & International Finance
National Project Coordinator, REDP

We identified the following significant deficiency involving the Project's internal control over financial reporting for the year ended September 30, 2023, that we wish to bring to your attention:

SIGNIFICANT DEFICIENCY

2023/01: Non-Maintenance of separate accounts and records for the Project

Criteria: Section 4.02 of Article IV of the grant agreement dated December 3, 2019, states that the recipient shall maintain separate accounts and records for the project.

Condition: Despite the efforts by DoRD and DoFA in recruiting a Project Finance and Administration Officer who is responsible for maintaining the project accounts and a National Coordinator for overall supervision, the following anomalies were noted:

- separate accounts and records specifically for the project were not maintained such as reconciliations, trial balances, subsidiary expenses ledgers
- Journal vouchers summary sent to DOFA for Fundware updates failed to be updated and reconciled on payments made out of LFIS
- Reliance on the Asian Development Bank Consultant to prepare the financial statements for REDP.
- There was a variance of $2,008.10 between Fundware ($465,622.50) and LFIS payout ($463,614.40).

Effects: As a result of not maintaining separate accounts and records for the Projects:

- There were delays in the preparation and submission of draft financial statement for audit. The draft financial statement was submitted to ONPA vis Shared folder on 06/26/24 which has lapsed deadline for completion which was March 31, 2023.
- Non-compliance to the requirements of the Project Administration Manual

Root-Causes: Oversight function is not effective to ensure that:

- records are maintained and updated for the Project.
- Proper training and capacity building for Project Finance & Administration Officer to ensure that reconciliations are maintained for balance sheet items, subsidiary expenses ledgers are maintained and trial balances are maintained and updated.
- financial statements are thoroughly reviewed prior to submission for audit verification.

Recommendations: Oversight function to be strengthened by:

- increased monitoring by the National Project Coordinator to ensure that records are maintained and updated for the Project.

- Proper training and capacity building for Project Finance & Administration Officer to ensure that reconciliations are maintained for balance sheet items, subsidiary expenses ledgers are maintained and trial balances are maintained and updated.
- Ensuring that financial statements are thoroughly reviewed, checking that all balances are properly supported and free from errors and misstatements, prior to submission for audit verification.

Management Responses:

1. Separate accounts and records specifically for the project were not maintained such as reconciliations, trial balances, subsidiary expenses ledgers
- ***As mentioned, we don't have a separate bank account to do reconciliation on since all transactions are paid directly to the vendors by ADB and we do journal vouchers to populate the DOFA Fundware and we reconcile the CPD transactions against the Expense report from DOFA.***
- ***Payment are made based off the PAM on contractual basis. JV's are under contractual as all activities are under contract per output.***
- ***The PMU will work with DOFA team to see if contractual payment can be sub-categorized in the Fundware system however payments made meet PAM requirement set forth by the grant owner/ADB which FSM Government is required to adhered to.***

2. Journal vouchers summary sent to DOFA for Fundware updates failed to be updated and reconciled on payments made out of LFIS/
- ***We need justification from auditors for which updates were made way before the field audit was expedited. JV's were made after the new National Coordinator (NC) came on board since this was one of the findings for the previous audit.***
- ***Journal voucher entries to DOFA will be submitted monthly and reconciliation will be maintained monthly to ensure disbursement in Fundware expenditure matches ADB LFIS disbursement records.***
- ***Actions have been taken by the PMU team to enhance and strengthen procedures for control to schedule monthly reconciliation of ADB LFIS and Fundware records, modifying record keeping procedures in Cashbook to reflect ADB LFIS and Fundware transaction number, date processed in each system and assigned JV number.***

3. Reliance on the Asian Development Bank Consultant to prepare the financial statements for REDP.
- ***This is only because there was no PA/FO at that time that ADB sent a consultant to prepare their FS. Also this should be a plus since it was done by ADB themselves.***
- ***The consultant is DORD consultant as it was paid for by DORD funds.***
- ***Moving forward, PMU team will set up their processes to ensure learning opportunities in preparation of Financial Statements for future audits.***

4. There was a variance of $2,008.10 between Fundware ($465,622.50) and LFIS payout ($463,614.40).
- ***The variance has been identified and a reverse JV will balance out Fundware and LFIS payout amount. The PMU team will work with the Treasury Division team to ensured corrective action to missed entry to be processed.***

Deficiency: 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.

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 managements 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.