

MARSHALL ISLANDS DEVELOPMENT BANK

INDEPENDENT AUDITORS' REPORTS ON  
INTERNAL CONTROL AND ON COMPLIANCE

YEAR ENDED DECEMBER 31, 2000

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON INTERNAL  
CONTROL OVER FINANCIAL REPORTING BASED UPON THE AUDIT PERFORMED  
IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

Board of Directors  
Marshall Islands Development Bank:

We have audited the financial statements of the Marshall Islands Development Bank (MIDB) as of and for the year ended December 31, 2000, and have issued our report thereon dated January 21, 2003, which report was qualified due to our inability to determine the propriety of the allowance for loan losses. Except as discussed in the preceding sentence, 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 *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether MIDB's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered MIDB's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect MIDB's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs (pages 6 through 9) as items 2000-1 through 2000-3.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider item 2000-2 to be a material weakness. We also noted other matters involving the internal control over financial reporting, which we have reported to management of MIDB in a separate letter dated January 21, 2003.

This report is intended solely for the information and use of the Board of Directors, management, federal awarding agencies, and the cognizant audit and other federal agencies and is not intended to be and should not be used by anyone other than these specified parties.

*Deloitte & Touche*

January 21, 2003



INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND INTERNAL CONTROL  
OVER COMPLIANCE APPLICABLE TO EACH MAJOR FEDERAL AWARD PROGRAM  
AND ON THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Board of Directors  
Marshall Islands Development Bank:

Compliance

We have audited the compliance of the Marshall Islands Development Bank (MIDB) with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to its one major federal program for the year ended December 31, 2000. MIDB's major federal program is identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs (pages 6 through 9). Compliance with the requirements of laws, regulations, contracts, and grants applicable to its one major federal program is the responsibility of MIDB's management. Our responsibility is to express an opinion on MIDB's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about MIDB's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on MIDB's compliance with those requirements.

In our opinion, MIDB complied, in all material respects, with the requirements referred to above that are applicable to its one major federal program for the year ended December 31, 2000.

Internal Control Over Compliance

The management of MIDB is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered MIDB's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

#### Schedule of Expenditures of Federal Awards

We have audited the basic financial statements of MIDB as of and for the year ended December 31, 2000, and have issued our report thereon dated January 21, 2003, which report was qualified due to our inability to determine the propriety of the allowance for loan losses. Our audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying Schedule of Expenditures of Federal Awards (page 5) is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. This schedule is the responsibility of the management of MIDB. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had the propriety of loans receivable been determined, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

This report is intended solely for the information and use of the Board of Directors, management, federal awarding agencies, and the cognizant audit and other federal agencies and is not intended to be and should not be used by anyone other than these specified parties.

*Deville + Joushe*

January 21, 2003

MARSHALL ISLANDS DEVELOPMENT BANK

Schedule of Expenditures of Federal Awards  
Year Ended December 31, 2000

	<u>Grant Award</u>	<u>Retained Earnings (Deficit) Beginning of Year</u>	<u>Federal Funds Received</u>	<u>Contributions or Earnings on Funds</u>	<u>Funds Expended</u>	<u>Retained Earnings (Deficit) End of Year</u>
<u>U.S. Department of the Interior</u> <u>CFDA #15.875</u>						
Agreement between the Government of the United States and the Government of the Marshall Islands for the Implementation of Section 111 of the Compact of Free Association.	\$ 10,000,000	\$ (7,250,108)	\$ -	\$ 804,437	\$ 773,829	\$ (7,219,500)
Agreement between the Government of the United States and the Government of the Marshall Islands for the Implementation of Section 211 of the Compact of Free Association.	4,994,603	(2,632,509)	-	89,821	42,964	(2,585,652)
<u>U.S. Department of Agriculture</u> <u>CFDA #10.433</u>						
Rural Housing Preservation	<u>200,000</u>	<u>21,229</u>	<u>64,166</u>	<u>5,311</u>	<u>4,156</u>	<u>86,550</u>
	<u>\$ 15,194,603</u>	<u>\$ (9,861,388)</u>	<u>\$ 64,166</u>	<u>\$ 899,569</u>	<u>\$ 820,949</u>	<u>\$ (9,718,602)</u>

The above U.S. Department of the Interior funds are received in a subrecipient capacity through the Republic of the Marshall Islands. The loan portfolio established through Section 111 of the Compact of Free Association and the loan portfolio established through Section 211 of the Compact of Free Association were also selected for detailed compliance testing in accordance with applicable OMB Circular A-133 requirements. The loan portfolio related to Section 111, net of the allowance for doubtful loans of \$8,619,095, amounted to \$160,189 at December 31, 2000, and the loan portfolio related to Section 211, net of the allowance for doubtful loans of \$1,011,690, amounted to \$736,896 at December 31, 2000.

The above U.S. Department of Agriculture funds are received directly from the federal grantor agency. These funds are issued to loan customers under the Housing Preservation Grant fund. The loan portfolio related to the Housing Preservation Grant amounted to \$29,571 at December 31, 2000.

The Schedule of Expenditures of Federal Awards is presented on the accrual basis of accounting, and is presented in accordance with the requirements of OMB Circular A-133.

See Accompanying Independent Auditors' Report on Compliance and Internal Control Over Compliance Applicable to Each Major Federal Award Program and on the Schedule of Expenditures of Federal Awards.

MARSHALL ISLANDS DEVELOPMENT BANK

Schedule of Findings and Questioned Costs  
Year Ended December 31, 2000

**Section I - Summary of Auditor's Results**

1. The Independent Auditors' Report on the financial statements expressed a qualified opinion.
2. Reportable conditions in internal control over financial reporting were identified, one of which is considered to be a material weakness.
3. No instances of noncompliance considered material to the financial statements were disclosed by the audit.
4. No reportable conditions in internal control over compliance with requirements applicable to the major federal award program were identified.
5. The Independent Auditors' Report on compliance with requirements applicable to the major federal award program expressed an unqualified opinion.
6. The audit disclosed no findings required to be reported by OMB Circular A-133.
7. MIDB's one major program was as follows:

<u>Name of Federal Program</u>	<u>CFDA Number</u>
Compact of Free Association	15.875

8. A threshold of \$300,000 was used to distinguish between Type A and Type B programs as those terms are defined in OMB Circular A-133.
9. MIDB did not qualify as a low-risk auditee as that term is defined in OMB Circular A-133.

**Section II - Financial Statement Findings**

<u>Reference Number</u>	<u>Findings</u>	<u>Refer Page #</u>
2000-1	External Financial Reporting	7
2000-2	Receivables	8
2000-3	Receivables	9

**Section III - Federal Award Findings and Questioned Costs**

No federal awards findings are reported for the year ended December 31, 2000.

MARSHALL ISLANDS DEVELOPMENT BANK

Schedule of Findings and Questioned Costs, Continued  
Year Ended December 31, 2000

**Section II - Financial Statement Findings**

External Financial Reporting

Finding No. 2000-1

Criteria: An entity's chart of accounts should be structured so that financial statements can present useable information.

Condition: MIDB currently segregates its loan portfolio between funds received from Compact of Free Association funding and the Republic of the Marshall Islands. More useable information could be derived if MIDB's chart of accounts classified loans by industry type (i.e., agriculture, fisheries, tourism, forestry, small industries, handicraft, construction and services).

Cause: The cause of the above condition is the current configuration of MIDB's chart of accounts.

Effect: The effect of the above condition is that information on the types of industries for which MIDB is promoting economic development is not presented either in the financial statements or footnotes of MIDB.

Recommendation: We recommend that MIDB begin classifying loans receivable by industry type.

Prior Year Status: Lack of a structure determining industry type loans within the chart of accounts was reported as a finding in the Single Audits of MIDB for fiscal years 1994 through 1999.

MARSHALL ISLANDS DEVELOPMENT BANK

Schedule of Findings and Questioned Costs, Continued  
Year Ended December 31, 2000

Receivables

Finding No. 2000-2

Criteria: Loans should reflect valid assets of MIDB. The allowance for loan and interest receivable losses should be adjusted based on a periodic review of all loans receivable to determine collectibility.

Condition: MIDB did not review and assess the collectibility of its loan portfolio for the year ended December 31, 2000.

Cause: The cause of the above condition is loans and interest receivable are not periodically reviewed for collectibility and the assessment of loan losses is not being performed on a timely basis.

Effect: The effect of the above condition is that loans receivable were overstated.

Recommendation: We recommend that MIDB enforce its policy on determining the adequacy of the allowance for loan receivable losses and that all loans receivable be reviewed on a monthly basis to determine collectibility. This assessment should include management judgments incorporating micro- and macro-economic factors; past, current, and anticipated events based on facts in evidence at the balance sheet date; and realistic courses of action it expects to take.

Prior Year Status: Lack of periodic review and adjustment of the allowance for loan receivable losses was reported as a finding in the Single Audits of MIDB for fiscal years 1994 through 1999.

MARSHALL ISLANDS DEVELOPMENT BANK

Schedule of Findings and Questioned Costs, Continued  
Year Ended December 31, 2000

Receivables

Finding No. 2000-3

Criteria: MIDB policies and regulations require all applicants to fill out the standard loan application form stating the purpose of the loan. Commercial loans are primarily to finance capital assets of an entity. If commercial loans finance working capital of a project, the project should be for the development of the economy, consistent with MIDB's development policies, and the project cannot obtain financing from any other source

Condition: Our testing noted that check # 21036 was issued for a loan of \$300,000 to a credit union for which proper loan documents were not obtained. The only document on file was the loan agreement, and we did not note any collateral related to the loan.

On August 7, 2000, MIDB entered into a loan agreement with RepMar for \$1,800,000, proceeds from which were used to pay debts owed by the Marshall Islands Social Security Administration for medical bills. Loans to pay debts would appear to be inconsistent with MIDB's development policies.

Cause: The cause of the above condition is unknown.

Effect: The effect of the above condition is noncompliance with established policies and procedures.

Recommendation: We recommend that MIDB adhere to its policies and procedures when processing and issuing loans.

MARSHALL ISLANDS DEVELOPMENT BANK

Unresolved Prior Year Findings and Questioned Costs  
Year Ended December 31, 2000

Questioned Costs

There are no unresolved questioned costs or matters of noncompliance from prior year Single Audits of MIDB.

Findings

The status of unresolved prior year findings is disclosed within the Schedule of Findings and Questioned Costs section of this report (pages 6 through 9).

United States Department of the Interior, Office of the Inspector General, Marshall Islands Development Bank, Republic of the Marshall Islands - Report dated August, 1999

Questionable loans:	\$12,410,148
Questionable loans converted to equity:	\$ 2,933,321



# Marshall Islands Development Bank

Post Office Box 1048  
Majuro, Republic of the Marshall Islands  
MH 96960

## Board of Directors:

Donald Capelle Chairman  
Joel Philip Vice-Chairman  
Clyde Heine Director  
Kinja Andrike Director  
Amon Tibon Managing Director

All correspondence  
to be addressed to:

MANAGING DIRECTOR  
Tel.: (692) 625-3230/5270 Fax: (692) 625-3309

Corrective Action Plans to Questioned Costs and Findings included in the Independent Auditors' Report on Internal Control and Compliance for the Year Ended December 31, 2000

## **Financial Statement Findings Section**

### External Financial Reporting

#### Finding No. 2000-1

The new computer loan system will be able to provide such information. All loans have been classified by industry type.

### Receivables

#### Finding No. 2000-2

Once the new computer loan system is in place, periodically review of delinquent loans could be made on a quarterly basis. With the new system in place, the allowance for loan and interest receivable loses would be adjusted on a regular basis.

### Receivables

#### Finding No. 2000-3

Management agrees with the finding. However, when the \$300,000 and \$1,800,000 loans were discussed during the Board meeting, it was made clear that the loans were outside of Bank's policies and guidelines. Since the purposes of both loans were for the benefit of citizens of the Republic, the Board had approved them. For your information, both loans have been paid off.



# Marshall Islands Development Bank

Post Office Box 1048  
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## Summary of Schedule of Prior Audit Findings

Status of audit findings included in the schedule of findings and questioned costs for the year ended December 31, 1999:

### **Financial Statement Findings Section**

- Finding No. 99-1 - Not corrected. See corrective action plan to Finding No. 2000-1.
- Finding No. 99-2 - Corrective action has been taken.
- Finding No. 99-3 - Not corrected. See corrective action plan to Finding No. 2000-2.

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**Deloitte  
Touche  
Tohmatsu**

January 21, 2003

CONFIDENTIAL

Mr. Amon Tibon  
Managing Director  
Marshall Islands Development Bank

Dear Mr. Tibon:

In planning and performing our audit of the financial statements of the Marshall Islands Development Bank (MIDB) for the year ended December 31, 2000, on which we have issued our report dated January 21, 2003, which report was qualified due to our inability to determine the propriety of the allowance for loan losses, we developed the following recommendations concerning certain matters related to MIDB's internal control and certain observations and recommendations on other accounting, administrative and operating matters. Our principal recommendations are summarized below:

(1) Inactive Cash Account

The Bank of New York account #730978 has been inactive for five years. The last statement received by the Bank of New York was for the period ended April 30, 1997 with a \$464 balance. Although we did not consider the effect of this condition to be material to the financial statements, we recommend that the funds be withdrawn and that the account be closed. This matter was brought to management's attention in our previous letters dated August 6, 2001, October 25, 1999 and November 26, 1998.

(2) Loan Disbursements

Of twenty-five loan disbursements tested, loan #s 12297 and 20017 were not supported by a loan agreement signed by the Loan Officer or the Managing Director. Additionally, loan # 13316 did not have a loan guarantee on file. We recommend that all loan agreements be signed by the Loan Officer or the Managing Director and that loan guarantees be obtained from the customer.

(3) Cash Disbursements

Of twenty-five cash disbursements tested, check # 20961, for a consumer loan drawdown of \$15,000, had a contractual life of twenty-four months, for which the credit life insurance premium was calculated based on a term of thirty-four months. We recommend that management ensure that credit life insurance premiums are based on the actual term of the loan. This matter was brought to management's attention in our previous letter dated August 6, 2001.

(4) Loan Disbursements

Loan amounts for loan #s 12392, 12599, 13033, 13311 and 13660 were entered into the loan system at amounts that differed from the loan agreement. We were informed that this difference was a result of human error and system error that eventually was corrected during reconciliation of the loan accounts. We recommend that management ensure that the loan system is properly reconciled.

(5) Cash

We were not provided cancelled check #s 21373, 21378 and 21388 of the operations fund bank reconciliation. Additionally, we were not provided cancelled check # 20587 during our testing of cash disbursements. We recommend that management ensure that cancelled checks are maintained and filed.

(6) Cash Disbursements

Check # 20406 was issued to a Board member for sitting fees for which Board minutes did not document that the Board member was in attendance. We recommend that management ensure that Board minutes document members in attendance to support sitting fees.

(7) Cash Receipts

Daily Cash Summary reports were not prepared for the majority of the collections during the year. We were informed that cash summaries are only prepared when the listing of allottees is numerous and management cannot easily determine details of loan or interest payments. We recommend that management utilize the Daily Cash Summary report to facilitate management review of cash collections.

(8) Cash Receipts

We were unable to formulate a random selection based on cash receipt numbers as cash receipts were not issued in a sequential manner. We recommend that management ensure that cash receipts are issued in a sequential manner.

(9) Other Receivables

As of December 31, 2000, MIDB recorded other receivables totaling \$62,952, which included an amount of \$3,864 due from one Director. This amount related to personal charges on MIDB's corporate credit card, which were carried forward from fiscal year 1999. We recommend that management establish a formal policy regarding the use of the corporate credit card, including a restriction on the use of the credit card for personal charges. Furthermore, we recommend that this policy be formally authorized by the Board of Directors. This matter was brought to management's attention in our previous letters dated August 6, 2001 and October 25, 1999.

(10) Loans Receivable

One loan, to M&F Fishing for \$1,000,000, was written-off in the prior year and was still recorded in the loan ledger at December 31, 2000. This situation appeared to be the result of a system error. We recommend that loans written-off be removed from the loan ledger.

(11) External Financial Reporting

We were unable to review subsequent general ledger entries relating to repayments of salary advances for employees, as records relating to fiscal year 2001 transactions were not available. We were informed that repayment entries were unavailable due to failures encountered with the backup system. We recommend that MIDB obtain a reliable backup system.

(12) Travel Advances

Our review of the travel advance accounts noted \$26,289 related to credit card charges which had not been liquidated with supporting documentation. We recommend that management ensure that travel advances to employees are liquidated in accordance with established policies and procedures, whereby, the traveler is required to close the travel authorization after completion of the trip. We further recommend that credit card charges be limited to business use. This matter was brought to management's attention in our previous letters dated August 6, 2001, October 25, 1999 and November 26, 1998.

(13) Savings Supporting Pledge

The supporting pledge savings account was set-up to account for customer deposits as security for loans. The interest rate for the savings account is 4%, which was not properly approved by the Board. The account is actually used as a regular savings account and deposits and withdrawals are made on a regular basis. We recommend that the Board review the program and establish formal policies and authorization.

(14) Accrued Expenses

Our testing of accrued expenses noted an overpayment made to RepMar of \$2,120 for January 2000 withholding tax. We noted that check # 18548 was issued for withholding taxes for December 1999 and January 2000. In September 2000, check # 20370 was issued which included withholding taxes for January to August 2000. We were informed that management is unaware of the double payment but will consult with the Chief of Revenue and Taxation for a refund or an adjustment to future withholding taxes. Additionally, we also noted that MIDB was late in filing and remitting the taxes, and no receipt or tax forms were noted on file. We recommend that management ensure that withholding taxes are filed and paid when due. Additionally, RepMar receipts and tax forms should be maintained on file to evidence filing and remittance of income taxes.

(15) Accrued Expenses

We were unable to verify if the last quarterly payment for social security withholding was remitted as management was unable to provide a check, tax form or receipt for the withholding tax for December 31, 2000. We recommend that management ensure that payments for withholding taxes are paid as they are due and ensure that proper documents evidencing remittance are properly maintained and filed.

(16) Annual Leave

During the year ended December 31, 2000, MIDB made disbursements to employees representing cash payments for unused annual leave. MIDB does not have a formal policy with respect to unused annual leave. We recommend that management establish a formal policy regarding unused annual leave, including a policy of mandatory vacation for its employees for internal control purposes. Furthermore, we recommend that this policy be formally authorized by the Board of Directors. This matter was brought to management's attention in our previous letters dated August 6, 2001 and October 25, 1999.

(17) Loan Fees

Statement of Financial Accounting Standards (SFAS) No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*, establishes the accounting for loan origination fees and costs. Loan origination fees, net of direct loans origination costs, should be deferred and recognized over the contractual life of the loan as an adjustment of yield using the interest method. During the year ended December 31, 2000, MIDB recognized loan origination fees of \$60,625 as income. No portion of this amount was deferred to be recognized in future periods. Although we do not consider the effect of this condition to be material to the financial statements, we recommend that management recognize loan origination fees in accordance with SFAS No. 91. This matter was brought to management's attention in our previous letter dated August 6, 2001.

(18) Employee and Director Receivables

As of December 31, 2000, MIDB recorded \$442,599 and \$64,438 in loan receivables from employees and directors, respectively. As with all loan receivables, MIDB did not review and assess the collectibility of loans to employees and directors as of December 31, 2000. We recommend that MIDB review and assess the collectibility of employee and directors receivables.

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We have previously communicated certain matters noted during our audit of the financial statements of MIDB for the year ended December 31, 2000, which we considered to be reportable conditions, in our report to the Board of Directors dated January 21, 2003.

This report is intended solely for the information and use of management, and others within the organization and is not intended to be used and should not be used by anyone other than these specified parties.

We would like to thank the accounting staff and management for their assistance during the course of our audit. Should you have any questions regarding the matters discussed herein, please contact our office at your convenience.

Very truly yours,

