

MARSHALL ISLANDS DEVELOPMENT BANK

**INDEPENDENT AUDITORS' REPORTS ON
INTERNAL CONTROL AND ON COMPLIANCE**

YEAR ENDED SEPTEMBER 30, 2004

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN 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 September 30, 2004, and have issued our report thereon dated December 22, 2006, which report was qualified due to our inability to determine the propriety of the carrying value of loans and accrued interest receivable and the non-deferrals of insurance premiums and loan origination fees. 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.

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 an opinion 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 24) as items 2004-1 through 2004-8.

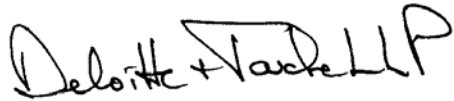
A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being 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 items 2004-1 through 2004-5 to be material weaknesses.

Compliance and Other Matters

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 grant agreements, 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*.

We also noted certain additional matters that we reported to management of MIDB in a separate letter dated December 22, 2006.

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.

A handwritten signature in black ink that reads "Deloitte + Tatchell LLP". The signature is written in a cursive, slightly stylized font.

December 22, 2006

**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 September 30, 2004. 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 24). 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 September 30, 2004.

Internal Control Over Compliance

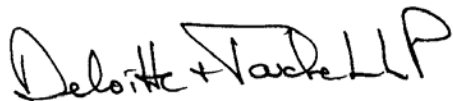
The management of MIDB is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered MIDB's internal control over compliance 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 reportable 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 caused by error or fraud 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 September 30, 2004, and have issued our report thereon dated December 22, 2006, which report was qualified due to our inability to determine the propriety of the carrying value of loans and accrued interest receivable and the non-deferrals of insurance premiums and loan origination fees. 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 our 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 and accrued interest receivables been determined and had MIDB deferred insurance premiums and loan origination fees, 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.

A handwritten signature in black ink that reads "Deloitte + Touche LLP". The signature is written in a cursive, stylized font.

December 22, 2006

MARSHALL ISLANDS DEVELOPMENT BANK

Schedule of Expenditures of Federal Awards
Year Ended September 30, 2004

	<u>Grant Award</u>	<u>Net Assets Beginning of Period</u>	<u>Federal Funds Received</u>	<u>Contributions or Earnings on Funds</u>	<u>Funds Expended</u>	<u>Net Assets End of Period</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 211 of the Compact of Free Association.	\$ 4,994,603	\$ 2,515,560	\$ -	\$ (17,665)	\$ 43,085	\$ 2,454,810
<u>U.S. Department of Agriculture</u> <u>CFDA #10.433</u>						
Rural Housing Preservation	<u>200,000</u>	<u>325,741</u>	<u>-</u>	<u>200,899</u>	<u>-</u>	<u>526,640</u>
	<u>\$ 5,194,603</u>	<u>\$ 2,841,301</u>	<u>\$ -</u>	<u>\$ 183,234</u>	<u>\$ 43,085</u>	<u>\$ 2,981,450</u>

The above U.S. Department of the Interior funds were received in a subrecipient capacity through the Republic of the Marshall Islands. The loan portfolio established through Section 211 of the Compact of Free Association was also selected for detailed compliance testing in accordance with applicable OMB Circular A-133 requirements. The loan portfolio related to Section 211, net of the allowance for doubtful loans of \$1,090,938, amounted to \$282,549 at September 30, 2004.

The above U.S. Department of Agriculture funds were received directly from the federal grantor agency. These funds were issued to loan customers under the Housing Preservation Grant fund. The loan portfolio related to the Housing Preservation Grant, net of the allowance for doubtful loans of \$3,881, amounted to \$15,259 at September 30, 2004.

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 September 30, 2004

Section I - Summary of Auditor's Results

1. The Independent Auditors' Report on the financial statements expressed a qualified opinion due to our inability to determine the propriety of the carrying value of loans and accrued interest receivable and the non-deferrals of insurance premiums and loan origination fees.
2. Reportable conditions in internal control over financial reporting were identified, some of which are considered to be material weaknesses.
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 major federal awards programs 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 is 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>
2004-1	Loan Origination Fees/Insurance Premiums	7
2004-2	Loans Receivable	8-17
2004-3	Loans Receivable	18
2004-4	Loans Receivable	19
2004-5	Liabilities	20
2004-6	External Financial Reporting	21
2004-7	External Financial Reporting	22
2004-8	Insurance Coverage	23

Section III - Federal Award Findings and Questioned Costs

No federal awards findings are reported for the year ended September 30, 2004.

MARSHALL ISLANDS DEVELOPMENT BANK

Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2004

Section II - Financial Statement Findings

Loan Origination Fees/Insurance Premiums

Finding No. 2004-1

Criteria: Statement of Financial Account 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

Condition: During the year ended September 30, 2004, MIDB recognized loan origination fees and insurance premiums of \$76,930 and \$140,710, respectively, as income. No portion of these amounts was deferred to future periods.

Cause: The cause of the above condition is noncompliance with SFAS No. 91.

Effect: The effect of the above condition is the misstatement of income and deferred revenue.

Recommendation: We recommend that MIDB recognize loan origination fees in accordance with SFAS No. 91.

Prior Year Status: Noncompliance with SFAS No. 91 was discussed in our previous letters to management dated November 9, 2006, October 13, 2006, October 31, 2003, January 21, 2003 and August 6, 2001.

Auditee Response and Corrective Action Plan: Marshall Islands Development Bank (MIDB) is currently updating the Loan System, all efforts and resources are used to get the system updated. Management has agreed to get the help of Bank of Marshall Islands (BOMI) IT Department to revise the Loan System and incorporate SFAS No. 91 accounting treatment on processing fees and insurance fees.

Management has discussed the subject matter with the Finance Department to recognize proper processing fee and insurance premiums during the fiscal year and defer part of it to future periods.

MARSHALL ISLANDS DEVELOPMENT BANK

Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2004

Loans Receivable

Finding No. 2004-2

Criteria: Loan policies and procedures should address significant areas such as documentation and underwriting, loan review, grading, review of the allowance for loan losses, collection and recovery, review and approval of charge-offs, and foreclosure. Additionally, loan subsidiary ledgers should be maintained and reconciled with the general ledger and loan statements should be provided to borrowers on a regular basis.

Condition: MIDB's loan policies and guidelines do not address the above areas. Consequently, we noted various discrepancies including loans recorded in the wrong period, multiple holder #s for the same borrower, and loan #s that were not the same in the "Request for Loan Drawdown" form and the loan system. We also noted that loans receivable at September 30, 2004 included one loan (note # 12377) that had been cleared in a house purchase agreement with the borrower. Additionally, MIDB does not have policies that require nonperforming loans to be placed on nonaccrual status.

Based on our review of twenty-five new loans, we noted the following:

- Standard one-page forms serve as the promissory note and loan agreement, with blanks for the borrower's name, loan amount, payment terms, interest rate, etc. We noted typographical errors in these forms and incomplete or missing forms. We also noted reference in the loan agreement to a security agreement; however, none was found.
- Loan documents do not bear the loan number. This omission created confusion and contributed to documentation and filing errors.
- The amortization schedule does not bear the loan number and is not signed and dated by the borrower.
- Loan drawdown/disbursement sheets are often incomplete and do not bear the loan number, including the number of existing loans being paid off or partially paid.
- The loan policy limits consumer loans to \$15,000. We noted multiple loans at the maximum amount issued to one borrower on the same day; however, this is not specifically allowed in the loan policy.

Additionally, we noted the following specific deficiencies:

Loan Number: 18887

Loan Amount: \$15,269

- The loan application is not signed by the borrower.
- The "Notice of Assignment of Salary" was signed by the borrower.
- There is no evidence of a credit check.
- The loan agreement is dated March 24, 2004; however, the system loan open date in the loan system is March 15, 2004.

MARSHALL ISLANDS DEVELOPMENT BANK

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Loans Receivable, Continued

Finding No. 2004-2, Continued

Condition, Continued

Loan Number: 18574:

Loan Amount: \$15,269

- The term per the loan agreement and promissory note is twenty-four months; however, the term in the loan system is eight months.
- The Notice of Assignment of a revenue source does not indicate the actual amount. Such information is necessary to determine whether the required monthly payment will be met.

Loan Number: 25794:

Loan Amount: \$15,409

- The stated purpose of the loan in the consumer loan application is "Business Expansion". It is unclear whether the information provided in the loan application is for the applicant or a business.
- The Loan Disclosure sheet is incomplete and was signed by the applicant on February 19, 2004; the loan open date in the loan system is March 17, 2004.
- The amortizing schedule incorrectly states the interest rate to be 12% rather than 14%.
- The Personal Guarantee is dated June 19, 2003, nine months before the loan open date.
- Credit checks on file are dated August 2003, more than six months before the loan open date.
- The employment verification form is incomplete.
- There is no pay stub on file.
- The Notice of Assignment of Salary is incomplete and instead refers to a promissory note with MIDB dated November 2003.
- The credit life insurance premium of \$369 appears to be incorrect for the loan amount and term.
- The loan fee of 1% applies if this is a commercial loan.
- The drawdown form does not contain the note #.

MARSHALL ISLANDS DEVELOPMENT BANK

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Loans Receivable, Continued

Finding No. 2004-2, Continued

Condition, Continued

Loan Number: 18802:

Loan Amount: \$15,269

- The term per the loan agreement is twenty-four months; however, the term loan system indicates two months.
- The loan application is incomplete and was signed by the borrower on April 4, 2004, which is subsequent to the loan open date in the loan system of March 9, 2004.
- Credit check request forms were not signed by the borrower.
- The borrower had several loans outstanding with MIDB at the time this new loan was issued.
- The Notice of Assignment of a certain revenue source does not indicate the actual amount. Such information is necessary to determine whether the required monthly payment will be met.
- No pay stub or employment verification form on file.

Loan Number: 26035:

Loan Amount: \$15,430

- The term is thirty-six months, which exceeds the maximum period allowed per loan policy.
- The credit life insurance premium of \$390 appears incorrect.
- The loan application form is incomplete
- The Loan Disclosure sheet is dated January 26, 2004 but the system loan open date is January 22, 2004.
- The Personal Guarantee form was signed by the guarantor on June 13, 2004.
- The borrower had other unpaid loans with MIDB at the time this new loan was issued.
- No pay stub, employment verification, or assignment of salary form is on file.
- The note numbers (new and old ones being paid off) and the borrower's signature are missing from the drawdown form.

MARSHALL ISLANDS DEVELOPMENT BANK

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Loans Receivable, Continued

Finding No. 2004-2, Continued

Condition, Continued

Loan Number: 25706:

Loan Amount: \$3,344

- The amount borrowed per loan documents is \$4,452; however, the actual amount borrowed is \$3,344. The amount borrowed per the loan system is \$28,381. The balance at September 30, 2004 in the loan system is \$27,871 due to a posting error that was corrected in November 2004; interest income for fiscal year 2004 is overstated by \$1,604 due to the error.
- No Assignment of Salary (Allotment) form is on file.

Loan Number: 26062:

Loan Amount: \$15,409

- The loan term is thirty-six months, which exceeds the maximum twenty-four months allowed by the loan policy.
- The credit life insurance premium of \$369 appears incorrect.
- The Personal Guarantee form is signed by the guarantor on June 10, 2004; the loan open date in the loan system is June 7, 2004.
- No evidence of a credit check.
- No employment verification form is on file.
- The borrower had other unpaid loans with MIDB at the time this new loan was issued.
- There is no Assignment of Salary (Allotment) form on file.

Loan Number: 18876:

Loan Amount: \$15,269

- The Loan Disclosure sheet is dated March, 17, 2004, while the system open date is March 14, 2004.
- The loan application was not signed by the borrower.
- The Request for Loan Drawdown form on file is incomplete.

MARSHALL ISLANDS DEVELOPMENT BANK

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Loans Receivable, Continued

Finding No. 2004-2, Continued

Condition, Continued

Loan Number: 18707:

Loan Amount: \$15,409

- The loan purpose per the application is for an automobile purchase; the purpose stated in the loan agreement is for loan restructuring.
- The employment verification is incomplete and was not signed by the borrower.
- The credit check request form was not signed by the borrower.
- There is no Assignment of Salary (Allotment) form on file.
- The credit life insurance premium of \$369 appears incorrect.
- Another loan (# 18706 for \$14,000) was granted to this borrower on the same date. The combined loans exceed the \$15,000 maximum allowed per existing policy. We were informed that this is allowed; however, this is not specifically mentioned in the loan policy.
- The amount borrowed per the loan documents is \$15,409; however, the amount per the loan system is \$14,945.

Loan Number: 18516:

Loan Amount: \$15,269

- The loan application is incomplete.
- There is no employment verification and Assignment of Salary form on file.

Loan Number: 25847:

Loan Amount: \$15,309

- The amount borrowed per the loan agreement is \$15,269; the amount borrowed per the loan system is \$15,309.
- The loan application form is incomplete.
- The Assignment of certain revenue is incomplete and instead refers to a promissory note with MIDB dated March 2004.
- No employment verification form on file.
- The borrower had other unpaid loans at the time this loan was issued.

MARSHALL ISLANDS DEVELOPMENT BANK

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Loans Receivable, Continued

Finding No. 2004-2, Continued

Condition, Continued

Loan Number: 18811:

Loan Amount: \$15,269

- The borrower's name on the loan application form differs from that recorded in the system.
- The loan application is incomplete.

Loan Number: 20443:

Loan Amount: \$16,254

- The amount borrowed per the loan agreement is \$14,254; the amount borrowed per the loan disclosure form is \$7,417; the amount borrowed in the loan system is \$16,254, which exceeds the policy limit.
- No Assignment of Salary or other payments is on file.
- No employment/source of income verification form is on file.
- One check payment (# 5798) and the related drawdown form are dated September 19, 2003, which predates the loan open date of October 3, 2003.
- The borrower had another unpaid loan (#25133) at the time this loan was issued.

Loan Number: 18644:

Loan Amount: \$15,269

- The payment frequency per the loan agreement is monthly for two years; the payment frequency in the loan system is annually for two years.
- The stated purpose of the loan in the loan application is for an automobile purchase and school tuition; the purpose stated in the loan agreement is for loan restructuring.
- No evidence of a credit check is on file.
- The Notice of Assignment of a certain revenue source does not indicate the actual amount. Such information is necessary in determining whether the required monthly payment will be met.
- No pay stub or employment verification form is on file.

MARSHALL ISLANDS DEVELOPMENT BANK

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Loans Receivable, Continued

Finding No. 2004-2, Continued

Condition, Continued

Loan Number: 18644:, Continued

Loan Amount: \$15,269

- Another loan (# 18776 for \$14,687) was granted to this borrower on the same date. The combined loans exceed the \$15,000 maximum allowed for consumer loans to any one borrower. We were informed that this is allowed; however, this is not specifically stated in the loan policy.
- No loan term is indicated in the loan system for loan # 18776.

Loan Number: 17712:

Loan Amount: \$15,366

- The amount borrowed per the loan agreement is \$15,269; the amount borrowed in the loan system is \$15,366.
- Check # 6305 and the related drawdown form are dated October 29, 2003, which predates the loan open date of November 5, 2003.

Loan Number: 20444:

Loan Amount: \$15,269

- No evidence of a credit check is on file.

Loan Number: 20470:

Loan Amount: \$15,269

- The credit check request form was not signed by the borrower.

Loan Number: 26281:

Loan Amount: \$16,157

- The loan application is incomplete.
- The pay stub on file is from May 2003; the loan open date is July 16, 2004.
- The employment verification form did not name the employer, was not signed by the borrower, and is incomplete.
- The credit check forms were not signed by the borrower.

MARSHALL ISLANDS DEVELOPMENT BANK

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Loans Receivable, Continued

Finding No. 2004-2, Continued

Condition, Continued

Loan Number: 26281:, Continued

Loan Amount: \$16,157

- The amount borrowed per the loan documents is \$15,375; the amount borrowed in the loan system is \$16,157, which exceeds the loan policy limit.
- No authorized payroll allotment form is on file.
- The Assignment of certain revenue relates solely to a one time payment.

Loan Number: 19213:

Loan Amount: \$15,269

- The Personal Guarantee form is dated December 17, 2003, a day after the loan was opened.
- The loan application form is incomplete and is dated December 17, 2003, a day after the loan was opened.
- The credit check forms on file are incomplete; one was not signed by the borrower; and two are dated December 17, 2003, a day after the loan was opened.
- There is no pay stub, employment verification or authorized payroll allotment forms on file.
- The promissory note refers to an assignment of salary; however, no such assignment document is on file.
- Certain loan proceeds were used to make partial payment of an existing loan (note # 15216). This is not in accordance with loan policies, which require that existing loans be paid in full.

Loan Number: 18292:

Loan Amount: \$15,269

- The Loan Disclosure form was signed by the borrower on October 26, 2003, which predates the loan open date of November 7, 2003. It appears that the form was completed after it was signed by the borrower.
- The Loan Disclosure form incorrectly states the loan amount to be \$15,000.
- The loan application is incomplete and there is no evidence of application approval.

MARSHALL ISLANDS DEVELOPMENT BANK

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Loans Receivable, Continued

Finding No. 2004-2, Continued

Condition, Continued

Loan Number: 18292:, Continued

Loan Amount: \$15,269

- The Personal Guarantee form is only for \$15,000.
- The employment verification form is incomplete.
- No authorized payroll allotment form is on file.
- The payment frequency is monthly; however, the source of payment is the assignment of a quarterly payment.
- The loan drawdown form for check payment #8173 does not indicate a loan number.

Loan Number: 20647:

Loan Amount: \$16,635

- The amount borrowed exceeds the policy limit.
- The loan drawdown forms do not indicate the loan numbers (the new and old loans being paid off).

Loan Number: 18588:

Loan Amount: \$15,269

- The loan file was not locatable.

Loan Number: 20473:

Loan Amount: \$20,900

- The term in the loan system is fifteen months; the actual loan term is 180 months.

Loan Number: 18803:

Loan Amount: \$14,803

- The maturity date in the loan system is February 19, 2010; the actual maturity date is February 19, 2024.

Loan Number: 19036:

Loan Amount: \$10,687

- The loan term in the loan system is eighty months; the actual loan term is 240 months.

MARSHALL ISLANDS DEVELOPMENT BANK

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Loans Receivable, Continued

Finding No. 2004-2, Continued

Condition, Continued

Loan Number: 11674:
Loan Amount: \$27,811

- The maturity date in the loan system is June 25, 2101, which is more than 105 years from the open date of March 25, 1996.

Loan Number: 25122:
Loan Amount: \$14,400

- There is no loan term in the loan system.

Loan Number: 17556:
Loan Amount: \$5,096

- The maturity date in the loan system is July 31, 2027; the open date is July 31, 2003. The maximum term for consumer loans is two years.

Loan Number: 18239:
Loan Amount: \$5,097

- The maturity date in the loan system is November 30, 2051; the open date is October 20, 2003. The maximum term for consumer loans is two years.

Loan Number: 20482:
Loan Amount: \$45,000

- The balance at September 30, 2004 of \$14,947 in the loan system is incorrect due to a posting error that was corrected in November 2004.

Loan Number: 25669:
Loan Amount: \$12,224

- The borrower's confirmation response indicated a zero balance at September 30, 2004; the loan balance in the system was \$12,224. No explanation was provided for the discrepancy.

Cause: The cause of the above condition is the lack of formal policies and procedures.

MARSHALL ISLANDS DEVELOPMENT BANK

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Loans Receivable, Continued

Finding No. 2004-2, Continued

Condition, Continued

Effect: The effect of the above condition is the possible misstatement of loans receivable, accrued interest receivable and interest income.

Recommendation: We recommend that MIDB adopt and enforce loan policies and procedures regarding documentation and underwriting, loan review, grading, review of the allowance for loan losses, collection and recovery, review and approval of charge-offs, and foreclosure. Such policies and procedures should be reviewed and approved on a regular basis. We also recommend that management ensure that loan subsidiary ledgers are maintained and reconciled with the general ledger and that loan statements are provided to borrowers on a regular basis.

Prior Year Status: Lack of formal loan policies and procedures was reported as a finding in the Single Audits of MIDB for fiscal years 2002 and 2003.

Auditee Response and Corrective Action Plan: MIDB Management has agreed to review the whole loan process from loan documentation and underwriting, loan review, grading, review of allowance for loan losses, collection and recovery, review and approval of charge-offs and foreclosure. The process review will give Management a clear understanding of the loan processes in order to come up and update the Bank's loan policies and procedures.

MARSHALL ISLANDS DEVELOPMENT BANK

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Loans Receivable

Finding No. 2004-3

Criteria: Management should routinely review critical loan information such as delinquency reports and restructured loans to effectively manage the loan portfolio.

Condition: Management does not routinely review critical information in the loan portfolio.

Cause: The cause of the above condition is the lack of formal policies and procedures to ensure that critical loan information is routinely reviewed by management.

Effect: The effect of the above condition is the possible misstatement of loans receivable.

Recommendation: We recommend that MIDB adopt policies and procedures to ensure that critical information is provided to and routinely reviewed by management.

Prior Year Status: Lack of management review of critical loan portfolio information was reported as a finding in the Single Audits of MIDB for fiscal years 2002 and 2003.

Auditee Response and Corrective Action Plan: Management is exhausting all efforts to update the Loan System so that accurate loan balances and delinquency reports can be obtained from the system that will be used in conducting routine review and evaluation of all delinquent and restructured loans.

The Loan System Reports are currently being reviewed by the Finance Department to assess what reports are useful to Management, delinquency reports are being revised to show the correct delinquent loan accounts which will help Management effectively and efficiently appraise certain critical loan portfolio and thereafter effectively make sound loan collection decisions.

MARSHALL ISLANDS DEVELOPMENT BANK

Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2004

Loans Receivable

Finding No. 2004-4

Criteria: The allowance for loan and interest receivable losses should be periodically reviewed and maintained at a level adequate to absorb estimated losses.

Condition: The adequacy of the allowance for loans and interest receivable was not assessed during the year ended September 30, 2004.

Cause: The cause of the above condition is that 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 and interest receivable were overstated.

Recommendation: We recommend that MIDB adopt policies and procedures on determining the adequacy of the allowance for loan and interest 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 2003.

Auditee Response and Corrective Action Plan: MIDB's Management in coordination with the Loans Department and Finance Department will come up with a policy on grading loans in order to identify and measure allowance for loan losses both for performing and non-performing loans. One of the policies is providing allowance based on number of days delinquent. The following will show how much should be provided for probable losses on loans based on number of days outstanding:

a. Current	0-30 days	1.5%
b. Non-current	31-90 days	5%
c. Sub-standard	91-180 days	30%
d. Doubtful	181-270 days	50%
e. Charged-off	270days and above	100%

MIDB Management has agreed to periodically review and evaluate loan and interest receivable to come up with a sound estimate of probable losses.

MARSHALL ISLANDS DEVELOPMENT BANK

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Liabilities

Finding No. 2004-5

Criteria: The savings supporting pledge account should be reconciled on a regular basis.

Condition: The savings supporting pledge account included debit balances totaling \$279,512 at September 30, 2004, which represented advances and overpayments to borrowers and depositors, respectively. Audit adjustments were proposed to reclassify the amount to loans and other receivables.

Cause: The cause of the above condition is the lack of timely reconciliation of the savings supporting pledge account.

Effect: The effect of the above condition is the misstatement of loans and customer overpayment.

Recommendation: We recommend that management ensure the timely reconciliation of the savings supporting pledge account.

Prior Year Status: Lack of timely reconciliation of the savings supporting pledge account was reported to management in our letters dated November 9, 2006 and October 13, 2006 and was reported as a finding in the Single Audit of MIDB for fiscal year 2001.

Auditee Response and Corrective Action Plan: Management has discussed the subject matter with the Finance Department to ensure timely reconciliation of the Savings Supporting Pledge acct.

MARSHALL ISLANDS DEVELOPMENT BANK

Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2004

External Financial Reporting

Finding No. 2004-6

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 (RepMar). 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 2003.

Auditee Response and Corrective Action Plan: The Accounting System (MIP) is currently structured to classify Loans Receivable by Fund. MIDB has contacted its MIP Business Partner to find a way to set up MIP System and enable it to classify loan receivables by Industry. Classifying loan receivables by Industry would only be a sub classification under classification by Fund, this is because MIDB is a Government Entity and its initial capital was funded by the US Government and the RMI Government. MIDB uses the Fund Accounting System, since funds are importantly accounted as to usage, therefore, chart of accounts should be classified by Fund.

MARSHALL ISLANDS DEVELOPMENT BANK

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

External Financial Reporting

Finding No. 2004-7

Criteria: Adequate accounting controls necessitate that journal entries and adjustments be approved and recorded in the general ledger by separate individuals to ensure accuracy and authorization.

Condition: Journal entries and adjustments during the year ended September 30, 2004 were initiated and recorded by the same accounting personnel with no independent review.

Cause: The cause of the above condition is the lack of policies and procedures to ensure adequate segregation of duties pertaining to journal entries and adjustments.

Effect: The effect of the above condition is the possible misstatement of the financial statements.

Recommendation: We recommend that MIDB adopt policies and procedures to ensure adequate segregation of duties pertaining to journal entries and adjustments.

Prior Year Status: Lack of appropriate segregation of duties pertaining to journal entries and adjustments was reported as a finding in the Single Audits of MIDB for fiscal years 2002 and 2003.

Auditee Response and Corrective Action Plan: Management has discussed the subject matter with the Finance Department to ensure proper segregation of duties on the proposal, recording and approval of Journal Vouchers.

MARSHALL ISLANDS DEVELOPMENT BANK

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Insurance Coverage

Finding No. 2004-8

Criteria: Operations should be insured by adequate general liability insurance in the event of accidents. Additionally, premises and equipment should be insured against losses.

Condition: As of and during the year ended September 30, 2004, MIDB did not maintain general liability insurance and fire, lightning and typhoon insurance for its office building and properties.

Cause: The cause of the above condition is the lack of policies requiring such insurance coverage.

Effect: The effect of the above condition is the possibility of substantial losses.

Recommendation: We recommend that MIDB consider obtaining general liability insurance and fire, lightning and typhoon insurance for its office building and properties.

Prior Year Status: Lack of general liability insurance and fire, lightning and typhoon insurance for office building and properties was reported as a finding in the Single Audit of MIDB for fiscal year 2003.

Auditee Response and Corrective Action Plan: The Bank's policy is to insure all company properties against future losses. Management will review all bank properties and make sure that each property has adequate general liability insurance and fire, lightning and typhoon insurance.

MARSHALL ISLANDS DEVELOPMENT BANK

**Unresolved Prior Year Findings and Questioned Costs
Year Ended September 30, 2004**

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 24).

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