

UTRIK ATOLL LOCAL GOVERNMENT

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

YEAR ENDED SEPTEMBER 30, 2002



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

Mayor Joe Saul
Utrik Atoll Local Government
Republic of the Marshall Islands:

We were engaged to audit the general purpose financial statements of the Utrik Atoll Local Government (UALGOV) as of and for the year ended September 30, 2002. Our report dated August 8, 2003, stated that the scope of our work was not sufficient to enable us to express, and we did not express, an opinion on the general purpose financial statements due to our inability to obtain written representations from management of UALGOV.

Compliance

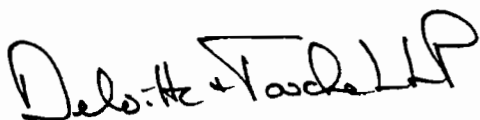
Auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, require that an audit be planned and performed in order to obtain reasonable assurance about whether the general purpose financial statements are free of material misstatement. We performed tests of UALGOV's compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of the general purpose financial statement amounts. The results of our tests disclosed one instance of noncompliance that is required to be reported under *Government Auditing Standards* and which is described in the accompanying Schedule of Findings and Questioned Costs (pages 7 through 13) as item 2002-6. We also noted one immaterial instance of noncompliance, which we have reported to management of UALGOV in a separate letter dated August 8, 2003.

Internal Control Over Financial Reporting

In planning the audit, we considered UALGOV's internal control over financial reporting in order to determine the auditing procedures for the purpose of expressing our opinion on the general purpose 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 UALGOV's ability to record, process, summarize, and report financial data consistent with the assertions of management in the general purpose financial statements. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items 2002-1 through 2002-5.

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 general purpose 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, we believe the reportable conditions described above to be material weaknesses. We also noted other matters involving the internal control over financial reporting, which we have reported to management of UALGOV in a separate letter dated August 8, 2003.

This report is intended solely for the information and use of the Council, federal awarding agencies, and the cognizant 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, appearing to read "Deloitte & Touche LLP". The signature is stylized and cursive, with the letters "D" and "T" being particularly prominent.

August 8, 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**

Mayor Joe Saul
Utrik Atoll Local Government
Republic of the Marshall Islands:

Compliance

We have audited the compliance of the Utrik Atoll Local Government (UALGOV) 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, 2002. UALGOV's major federal program is identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs (pages 7 through 13). Compliance with the requirements of laws, regulations, contracts, and grants applicable to its one major federal program is the responsibility of UALGOV's management. Our responsibility is to express an opinion on UALGOV'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 UALGOV'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 UALGOV's compliance with those requirements.

As described in item 2002-6 in the accompanying Schedule of Findings and Questioned Costs, UALGOV did not comply with requirements regarding special tests and provisions relating to the Compact of Free Association that are applicable to its one major federal program. Compliance with such requirements is necessary, in our opinion, for UALGOV to comply with requirements applicable to that program.

In our opinion, except for the noncompliance described in the preceding paragraph, UALGOV 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, 2002.

Internal Control Over Compliance

The management of UALGOV is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered UALGOV'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.

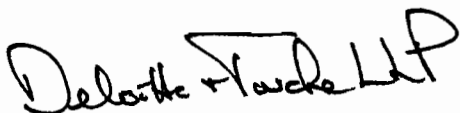
We noted one matter involving the internal control over compliance and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect UALGOV's ability to administer a major federal program in accordance with applicable requirements of laws, regulations, contracts, and grants. The reportable condition is described in the accompanying Schedule of Findings and Questioned Costs as item 2002-6.

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. Our consideration of the internal control over compliance 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, we consider the reportable condition described above to be a material weakness.

Schedule of Expenditures of Federal Awards

We were engaged to audit the general purpose financial statements of UALGOV as of and for the year ended September 30, 2002. Our report dated August 8, 2003, stated that the scope of our work was not sufficient to enable us to express, and we did not express, an opinion on the general purpose financial statements due to our inability to obtain written representations from management of UALGOV. 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 general purpose financial statements. This schedule is the responsibility of UALGOV's management. The scope of our work was not sufficient to enable us to express, and we do not express, an opinion on that schedule.

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



August 8, 2003

UTRIK ATOLL LOCAL GOVERNMENT

Schedule of Expenditures of Federal Awards
Year Ended September 30, 2002

	<u>Total Authorization</u>	<u>2002 Funds Received</u>	<u>Prior Year Expenditures</u>	<u>2002 Funds Expended</u>	<u>Excess Authorization Over Funds Expended</u>
<u>U.S. Department of the Interior</u>					
<u>CFDA #15.875</u>					
Funds passed through the Republic of the Marshall Islands:					
The agreement between the Government of the United States and the Government of the Marshall Islands for the implementation of Section 177 of the Compact of Free Association					
	\$ 375,000	\$ 375,000	\$ -	\$ 180,000	\$ 195,000
Operations Maintenance and Improvements Program	<u>20,000</u>	<u>10,000</u>	<u>20,000</u>	<u>-</u>	<u>-</u>
	\$ <u>395,000</u>	\$ <u>385,000</u>	\$ <u>20,000</u>	\$ <u>180,000</u>	\$ <u>195,000</u>

Of funds received, \$195,000 remains invested in the Utrik Claims Trust Fund, a nonexpendable trust fund of UALGOV. Additionally, \$604,440 was transferred to UALGOV from the Utrik Claims Trust Fund which is added to funds expended in determining total federal funds expended of UALGOV.

See accompanying notes to schedule of expenditures of federal awards.

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Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 2002

(1) Organization and Compact of Free Association

The Utrik Atoll Local Government (UALGOV) is a subrecipient of funds received through the Compact of Free Association, Section 177, from the Republic of the Marshall Islands (RepMar). These funds must be distributed in accordance with the agreement concerning procedures for the implementation of United States economic assistance, programs and services provided in the Compact of Free Association between the Government of the United States and the Government of RepMar, dated July 31, 1986. Additionally, it has been determined these funds are not subject to general U.S. federal requirements such as OMB Circular A-102 and A-87, but rather must be expended in compliance with local laws and regulations and Compact intent.

(2) Summary of Significant Accounting Policies

a. Basis of Accounting

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of UALGOV and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

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Schedule of Findings and Questioned Costs Year Ended September 30, 2002

Section I - Summary of Auditor's Results

1. The Independent Auditors' Report on the general purpose financial statements expressed a disclaimer of opinion due to an inability to obtain written representation from management.
2. Reportable conditions in internal control over financial reporting were identified, all of which are considered to be material weaknesses.
3. One instance of noncompliance considered material to the general purpose financial statements was disclosed by the audit.
4. One reportable condition in internal control over compliance with requirements applicable to the one major federal award program was identified.
5. The Independent Auditors' Report on compliance with requirements applicable to major federal award programs expressed a qualified opinion.
6. The audit disclosed findings required to be reported by OMB Circular A-133.
7. UALGOV's major program is as follows:

Name of Federal Program or Cluster	CFDA Number
Compact of Free Association, Title I, Article VII, Section 177	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. UALGOV did not qualify as a low-risk auditee as that term is defined in OMB Circular A-133.

Section II - Financial Statement Findings

Reference Number	Findings	Questioned Costs	Refer Page #
2002-1	Cash	\$ -	8
2002-2	Disbursements	\$ -	9
2002-3	Investments	\$ -	10
2002-4 - 5	External Financial Reporting	\$ -	11 - 12

Section III - Federal Award Findings and Questioned Costs

Reference Number	Findings	Questioned Costs	Refer Page #
2002-6	Special Tests and Provisions	\$ 284,440	13

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Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2002

Section II - Financial Statement Findings

Cash

Finding No. 2002-1

Criteria: Bank reconciliations should be performed on a monthly basis and in a timely manner

Condition: Bank reconciliations for the Local Distribution Authority Fund were not performed on a monthly basis. At September 30, 2002, the General Fund bank reconciliation (A/c # 0039-010275) and the Local Distribution Authority Fund bank reconciliation (A/c # 0039-007789) included outstanding checks, totaling \$7,440 and \$36,458, respectively, that have been outstanding for more than six months. Of the \$36,458 outstanding checks of the Local Distribution Authority, \$16,870 were unreleased at September 30, 2002.

Cause: The cause of the above condition is the lack of established policies and procedures requiring the reconciliation of bank accounts.

Effect: The effect of the above condition is the possible misstatement of bank account balances.

Recommendation: We recommend that management establish policies and procedures requiring monthly reconciliation of all bank accounts in a timely manner. In addition, we recommend that management determine whether the outstanding checks are valid.

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Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2002

Disbursements

Finding No. 2002-2

Criteria: Disbursements from the Distribution Authority should be made to the designated payee.

Condition: Of fifty-three disbursements to the people of Utrik tested, the following exceptions were noted:

- 1) Seventeen disbursements (check #s 7739, 7741, 7901, 7923, 8084, 8150, 8190, 9530, 9522, 9644, 10064, 10320, 10391, 10416, 10445, 10587 and 10631) were received by financial institutions or individuals other than the designated payee. An approved assignment agreement was not available for review for these disbursements authorizing the assignment.
- 2) Seventeen disbursements (check #s 7317, 7373, 7525, 7526, 7563, 7617, 7933, 7946, 8384, 9794, 9909, 9911, 9976, 9978, 9979, 10480 and 10491) showed no indication of the recipient signing as evidence of receipt of the check.
- 3) One check (# 10649), issued to replace a check that was voided, was not listed in the claims register.

Cause: The cause of the above condition is the lack of adequate controls over the disbursement of per capital distribution payments.

Effect: The effect of the above condition is the inability to determine whether the designated payee actually received per capital distribution payments.

Recommendation: We recommend that UALGOV obtain written authorizations and that such be kept on file before per capital distribution checks are released to individuals other than the designated payee. In addition, we recommend that the designated payee, upon receipt, acknowledge all disbursements received in writing.

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Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2002

Investments

Finding No. 2002-3

Criteria: Reconciliation of investment accounts should be performed on a timely basis.

Condition: UALGOV did not reconcile the Claims Trust Fund and the General Fund investment accounts, totaling \$2,570,119 and \$1,049,710, respectively, for the entire fiscal year. Audit adjustments were proposed to record investment transactions for the year ended September 30, 2002.

Cause: The cause of the above condition is the lack of established policies and procedures requiring the reconciliation and recording of investment balances.

Effect: The effect of the above condition is the possible misstatement of investment balances and related transactions.

Recommendation: We recommend that management ensure that investment balances are reconciled and recorded on a timely basis.

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Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2002

External Financial Reporting

Finding No. 2002-4

Criteria: Interfund balances recorded in the General Fund should reconcile and agree to the corresponding balances recorded in the respective individual funds.

Condition: The interfund balances were not reconciled at September 30, 2002. A net variance of \$598,789 was corrected through a proposed audit adjustment.

Cause: The cause of the above condition is the lack of established policies and procedures requiring the reconciliation of interfund balances.

Effect: The effect of the above condition is the possible misstatement of interfund balances and related transactions.

Recommendation: We recommend that management establish policies and procedures to ensure that interfund balances are reconciled.

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Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2002

External Financial Reporting

Finding No. 2002-5

Criteria: The Appropriation Ordinance, as passed by the UALGOV Council, should reflect all budgeted expenditures for the year.

Condition: The Appropriation Ordinance for fiscal year 2002 did not include a property distribution of \$150,000. No subsequent resolution was passed by the Council to amend the operating budget for the \$150,000 property compensation that was distributed in December 2002. An audit adjustment was proposed to record a liability for this amount.

Cause: The cause of the above condition is unknown.

Effect: The effect of the above condition is that UALGOV cannot ensure effective budgetary control and accountability over available funds.

Recommendation: We recommend that management ensure that the Appropriation Ordinance, as passed by the UALGOV Council, includes all budgeted expenses for the fiscal year.

UTRIK ATOLL LOCAL GOVERNMENT

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Section III - Federal Award Findings and Questioned Cost

Special Tests and Provisions

Finding No. 2002-6

<u>Program</u>	<u>Reason for Questioned Cost</u>	<u>Questioned Costs</u>
<p>U.S. Department of the Interior / Compact of Free Association / Article II / Section 5 / Utrik Distribution Authority / CFDA #15.875</p>	<p><u>Criteria:</u> In accordance with Article II, Section 5.1, of the Utrik Claims Trust Agreement, UALGOV may invade up to 3% of the corpus of the Claims Trust Fund. Such invasion may occur in the event of an unforeseen natural disaster or other similar circumstance, as determined by the sole discretion of UALGOV, in order to prevent hardship to the people of Utrik. An invasion of the corpus shall not occur more frequently than once every three years.</p> <p><u>Condition:</u> UALGOV invaded 3% of the corpus of the Claims Trust Fund, totaling \$604,440 during the year of which, \$270,000 was distributed to the people of Utrik. Of the remaining \$334,440, \$50,000 was deposited in the Local Distribution Authority's bank account, while \$284,440 was utilized for General Fund expenditures.</p> <p><u>Cause:</u> The cause of the above condition is a lack of funds in the General Fund.</p> <p><u>Effect:</u> The effect of the above condition is that the entire 3% corpus was not distributed to the people of Utrik.</p> <p><u>Recommendation:</u> We recommend that UALGOV distribute the remaining \$334,440 to the people of Utrik to comply with the intent of the 3% corpus invasion which is to prevent hardship to the people of Utrik.</p>	<p>\$ 284,440</p>
<p>Total Questioned Costs</p>		<p>\$ <u>284,440</u></p>

UTRIK ATOLL LOCAL GOVERNMENT

Unresolved Prior Year Findings and Questioned Costs Year Ended September 30, 2002

Questioned Costs

The prior year Single Audit report on compliance with laws and regulations noted the following questioned costs that were unresolved at September 30, 2002:

Questioned costs of UALGOV, as previously reported	\$ 1,396,798
Less questioned costs considered resolved in fiscal year 2002:	
Questioned costs of fiscal year 1996 Single Audit (1)	<u>(676,798)</u>
	720,000
Questioned costs for fiscal year 2002 Single Audit	<u>284,440</u>
Unresolved questioned costs of UALGOV at September 30, 2002	\$ <u>1,004,440</u>

(1) OMB Circular A-133, Section .315(b)(4) – questioned costs resolved as UALGOV considers these findings are no longer valid as they were reported to federal agencies on October 24, 2000, which is in excess of the two year threshold as of the date of this report.

Unresolved Findings

The status of unresolved findings is discussed in the Schedule of Findings and Questioned Costs section of this report (pages 7 through 13).