

REPUBLIC OF THE MARSHALL ISLANDS

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

YEAR ENDED SEPTEMBER 30, 2005

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

His Excellency Kessai Note
President
Republic of the Marshall Islands:

We have audited the financial statements of the Republic of the Marshall Islands (RepMar) as of and for the year ended September 30, 2005, and have issued our report thereon dated June 9, 2006, which report was qualified due to the inability to determine the propriety of RepMar's governmental activities capital assets, net assets invested in capital assets, net of related debt and depreciation expense; and the inability of the Ministry of Education Head Start Program, Air Marshall Islands, In., the Kwajalein Atoll Joint Utilities Resources, Inc. and the Marshall Islands Development Bank to produce audited financial statements. 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 RepMar'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 RepMar'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 14 through 36) as items 2005-1 and 2005-11.

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, we consider the reportable conditions described above to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether RepMar'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 instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Findings and Questioned Costs as items 2005-2 through 2005-13.

This report is intended solely for the information and use of the management of RepMar, federal awarding agencies, pass-through entities 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.

The image shows a handwritten signature in cursive script that reads "Deloitte & Touche LLP". The signature is written in black ink and is positioned above the date.

June 9, 2006

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS
APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER
COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133 AND ON THE
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**

His Excellency Kessai Note
President
Republic of the Marshall Islands:

Compliance

We have audited the compliance of the Republic of the Marshall Islands (RepMar) 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 each of its major federal programs for the year ended September 30, 2005. RepMar's major federal programs are identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs (pages 14 through 36). Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of RepMar's management. Our responsibility is to express an opinion on RepMar'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 RepMar'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 of RepMar's compliance with those requirements.

As described in items 2005-4 through 2005-13 in the accompanying Schedule of Findings and Questioned Costs, RepMar did not comply with requirements regarding allowable costs/cost principles, cash management, equipment and real property management, matching, level of effort, earmarking, period of availability of funds, procurement and suspension and debarment, and subrecipient monitoring that are applicable to its major federal programs. Compliance with such requirements is necessary, in our opinion, for RepMar to comply with the requirements applicable to those programs.

In our opinion, except for the noncompliance described in the preceding paragraph, RepMar complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended September 30, 2005.

Internal Control Over Compliance

The management of RepMar 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 RepMar'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 internal control over compliance in accordance with OMB Circular A-133.

We noted certain matters involving the internal control over compliance 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 compliance that, in our judgment, could adversely affect RepMar's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items 2005-4 through 2005-13.

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 the 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. 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, of the reportable conditions described above, we consider items 2005-4, 2005-9, and 2005-11 through 2005-13 to be material weaknesses.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of RepMar as of and for the year ended September 30, 2005, and have issued our report thereon dated June 9, 2006, which report was qualified due to the inability to determine the propriety of RepMar's governmental activities capital assets, net assets invested in capital assets, net of related debt and depreciation expense; and the inability of the Ministry of Education Head Start Program, Air Marshall Islands, Inc., the Kwajalein Atoll Joint Utilities Resources, Inc., and the Marshall Islands Development Bank to produce audited financial statements. Our audit was performed for the purpose of forming an opinion on the financial statements that collectively comprise RepMar's basic financial statements. The accompanying Schedule of Expenditures of Federal Awards (pages 7 through 11) 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 RepMar. 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 expenditures pertaining to the Ministry of Education Head Start Program been included, 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 management of RepMar, federal awarding agencies, pass-through entities, 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 LLP

June 9, 2006

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Programs Selected for Audit
in Accordance with OMB Circular A-133
Year Ended September 30, 2005

The following list specifies programs selected for detailed compliance testing in accordance with applicable OMB Circular A-133 requirements.

| <u>Grantor</u> | <u>CFDA #</u> | <u>Description</u> | <u>Amount of Expenditures</u> |
|---------------------------------|--|---|-------------------------------|
| U.S. Department of Education | 84.027 | IDEA Special Education - Grants to States | \$ <u>1,761,194</u> |
| | 84.336 | Teacher Quality Enhancement Grant | <u>369,757</u> |
| U.S. Department of the Interior | 15.875 | Economic, Social, and Political Development of the Territories and the Freely Associated States: Compact of Free Association, As Amended, Public Law 99-239, Sector Grants: | |
| | | Education | 12,205,626 |
| | | Supplemental Education Grant | 1,803,700 |
| | | Health | 6,995,425 |
| | | Private Sector Development | 326,154 |
| | | Capacity Building | 75,964 |
| | | Environment | 195,658 |
| | | Kwajalein Environment | 179,694 |
| | | Public Infrastructure | 4,716,520 |
| | | Infrastructure Maintenance | <u>719,224</u> |
| | Total CFDA #15.875 | <u>27,217,965</u> | |
| | Total program expenditures tested | \$ <u>29,348,916</u> | |
| | Total federal program expenditures | \$ 55,817,278 | |
| | Less: Section 216 Trust Fund transferred to the Intergenerational Trust Fund | <u>(7,588,500)</u> | |
| | | \$ <u>48,228,778</u> | |
| | % of total federal program expenditures tested | <u>61%</u> | |

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Expenditures of Federal Awards
 General Fund and Reimbursable Fund
 Year Ended September 30, 2005

| <u>CFDA#</u> | <u>Agency/Program</u> | Accrued (Deferred) Balance at October 1, 2004 | Federal Cash Receipts and Adjustments | Federal Expenditures | Accrued (Deferred) Balance at September 30, 2005 |
|--|-----------------------------------|---|---|-------------------------|--|
| <u>U.S. Department of Commerce:</u> | | | | | |
| 11.460 | Weather Observation Services | \$ 167,722 | \$ 268,977 | \$ 325,428 | \$ 224,173 |
| | Total U.S. Department of Commerce | \$ 167,722 | \$ 268,977 | \$ 325,428 | \$ 224,173 |
| TOTAL GENERAL FUND AND REIMBURSABLE FUND | | \$ 167,722 | \$ 268,977 | \$ 325,428 | \$ 224,173 |

See accompanying notes to schedule of expenditures of federal awards.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Expenditures of Federal Awards
U.S. Federal Grants Fund
Year Ended September 30, 2005

| CFDA# | Agency/Program | Accrued (Deferred) Balance at October 1, 2004 | Federal Cash Receipts and Adjustments | Federal Expenditures | Accrued (Deferred) Balance at September 30, 2005 |
|---|--|---|---|-------------------------|--|
| <u>U.S. Department of Agriculture:</u> | | | | | |
| 10.567 | Food Donations Appropriations | \$ 17,245 | \$ 108,345 | \$ 81,415 | \$ (9,685) |
| 10.664 | Cooperative Forestry Assistance | - | 6,748 | 29,417 | 22,669 |
| 10.766 | Community Facilities Grant | (6,266) | (6,266) | - | - |
| | Total U.S. Department of Agriculture | \$ 10,979 | \$ 108,827 | \$ 110,832 | \$ 12,984 |
| <u>U.S. Department of the Interior:</u> | | | | | |
| 15.875 | Audit Training Grant | \$ - | \$ 15,539 | \$ 15,539 | \$ - |
| 15.875 | Anti-money Laundering | - | - | 63,997 | 63,997 |
| 15.875 | Economic Policy, Planning and Statistics Office (EPPSO) | 8,851 | 8,851 | - | - |
| 15.875 | EPA Environmental Standards Conference | 7,596 | 7,596 | 47,622 | 47,622 |
| 15.875 | EPA Travel | - | 9,362 | 13,779 | 4,417 |
| 15.875 | EPA Environmental Standards Conference - USAKA | - | - | 10,377 | 10,377 |
| 15.875 | Feasibility of Fiber Optic Cable for RMI and FSM | 35,998 | 35,998 | - | - |
| 15.875 | FMIP Interns | 59,025 | 56,639 | 7,308 | 9,694 |
| 15.875 | FMIS Project Manager | (932) | - | 795 | (137) |
| 15.875 | FMIS HR Module | - | - | 9,401 | 9,401 |
| 15.875 | Four Atoll Health Care | - | 493,000 | 493,000 | - |
| 15.875 | Infrastructure Data Development | (15,448) | (15,448) | - | - |
| 15.875 | Internship Project | - | - | 7,273 | 7,273 |
| 15.875 | Land Survey Registration | 26,009 | 48,027 | 29,419 | 7,401 |
| 15.875 | MTBIF/Performance Budgeting | 258,946 | 596,505 | 341,225 | 3,666 |
| 15.875 | OMIP - MOE Procurement | 8,287 | 8,287 | - | - |
| 15.875 | OMIP - Outer Islands Solar System | - | - | 711 | 711 |
| 15.875 | OMIP - Solid Waste Reduction | 64,028 | 64,028 | - | - |
| 15.875 | PIRAAP - Waan Aelon in Majol | 13,270 | 33,223 | 6,637 | (13,316) |
| 15.875 | Project Manager - FMIP | 49,668 | 80,000 | 26,560 | (3,772) |
| 15.875 | RMI Passport Personalization System Upgrade | - | 274,690 | 481,564 | 206,874 |
| 15.875 | Fixed Asset System | - | 33,593 | 33,601 | 8 |
| 15.875 | Single Audit FY99 | 12,259 | 12,259 | - | - |
| 15.875 | Single Audit FY00 | 55,020 | 131,362 | 76,342 | - |
| 15.875 | Single Audit FY01 | - | 60,172 | 59,724 | (448) |
| 15.875 | Single Audit FY02 | 106,600 | 127,850 | 21,250 | - |
| 15.875 | Single Audit FY03 | 105,863 | 178,820 | 90,957 | 18,000 |
| 15.875 | Tax Enhancement System | - | 68,327 | 48,638 | (19,689) |
| 15.875 | Tax Financial Consultant | - | - | 70,098 | 70,098 |
| 15.875 | Customs Tax System | - | - | 32,268 | 32,268 |
| 15.875 | Trust Fund Committee | - | - | 28,407 | 28,407 |
| 15.875 | Utrik Atoll Local Government Fiscal Management Improvement | - | 48,448 | 42,508 | (5,940) |
| 15.875 | Washington DC Embassy Network | - | 4,500 | 3,008 | (1,492) |
| 15.875 | Youth to Youth in Health | (8,500) | - | 8,500 | - |
| | Sub-total CFDA # 15.875 | 786,540 | 2,381,628 | 2,070,508 | 475,420 |
| 15.904 | National Park Service - Historic Preservation Fund | 52,962 | 53,414 | 170,422 | 169,970 |
| | Total U.S. Department of the Interior | \$ 839,502 | \$ 2,435,042 | \$ 2,240,930 | \$ 645,390 |

See accompanying notes to schedule of expenditures of federal awards.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Expenditures of Federal Awards
U.S. Federal Grants Fund, Continued
Year Ended September 30, 2005

| CFDA# | Agency/Program | Accrued (Deferred) Balance at October 1, 2004 | Federal Cash Receipts and Adjustments | Federal Expenditures | Accrued (Deferred) Balance at September 30, 2005 |
|--|---|---|---|-------------------------|--|
| <u>U.S. Department of Labor:</u> | | | | | |
| 17.250 | Pacific Regional WIA Services Project | \$ 49,820 | \$ 607,165 | \$ 557,345 | \$ - |
| | Total U.S. Department of Labor | \$ 49,820 | \$ 607,165 | \$ 557,345 | \$ - |
| <u>U.S. Small Business Administration:</u> | | | | | |
| 59.005 | Small Business Development Grant | \$ 3,576 | \$ 21,320 | \$ 18,174 | \$ 430 |
| | Total U.S. Small Business Administration | \$ 3,576 | \$ 21,320 | \$ 18,174 | \$ 430 |
| <u>U.S. Department of Homeland Security</u> | | | | | |
| 83.505 | Hazard Mitigation Grant Program | \$ (11,977) | \$ 25,002 | \$ 16,448 | \$ (20,531) |
| | Total U.S. Department of Homeland Security | \$ (11,977) | \$ 25,002 | \$ 16,448 | \$ (20,531) |
| <u>U.S. Department of Education:</u> | | | | | |
| 84.027 | IDEA Special Education - Grants to States | \$ 162,929 | \$ 1,793,614 | \$ 1,761,194 | \$ 130,509 |
| 84.048 | Pacific Vocational Education Improvement Project | 102,837 | 305,474 | 133,298 | (69,339) |
| 84.194 | Bilingual Education Support Services | - | - | 264 | 264 |
| 84.256 | Territories Freely Associated with State Education Grants | (78,910) | 261,854 | 359,932 | 19,168 |
| 84.276 | Goals 2000 - State and Local Education Systemic Improvement | (79,608) | - | 35,173 | (44,435) |
| 84.287 | 21st Century Community Learning Centers | (175,184) | 77,815 | 253,000 | 1 |
| 84.326 | IDEA Special Education - TA and Dissemination | (20,708) | - | 4,424 | (16,284) |
| 84.336 | Teacher Quality Enhancement Grant | (64,207) | 287,398 | 369,757 | 18,152 |
| 84.346 | Career Resource Network State Grant | (31,767) | (6,436) | - | (25,331) |
| | Total U.S. Department of Education | \$ (184,618) | \$ 2,719,719 | \$ 2,917,042 | \$ 12,705 |
| <u>U.S. Department of Health and Human Services:</u> | | | | | |
| 93.110 | MCH Services Community Based Health Education and Systems Development Initiative | \$ 6,778 | \$ 171,261 | \$ 320,104 | \$ 155,621 |
| 93.116 | Tuberculosis Elimination and Laboratory | 1,384 | 78,524 | 88,748 | 11,608 |
| 93.136 | Rape Prevention and Education | - | 1,740 | 5,852 | 4,112 |
| 93.163 | Pacific Basin Initiative | (2,182) | 310,698 | 433,542 | 120,662 |
| 93.217 | Title X Family Planning Services Program | 15,629 | 135,635 | 122,097 | 2,091 |
| 93.230 | Mental Health Data Infrastructure Grant | 224 | 6,808 | 4,167 | (2,417) |
| 93.268 | Immunization and Vaccines for Children Grants | 6,185 | 217,281 | 230,751 | 19,655 |
| 93.283 | Public Health Preparedness and Response for Bioterrorism | (70,095) | 581,245 | 381,476 | (269,864) |
| 93.917 | HIV Care Grant | - | 17,569 | 27,595 | 10,026 |
| 93.938 | School Health Program to Prevent Serious Health Problems | 15,478 | 49,762 | 50,922 | 16,638 |
| 93.940 | HIV Prevention Project | 1,017 | 93,218 | 109,640 | 17,439 |
| 93.958 | Block Grant for Community Mental Health Services | (34,186) | 39,452 | 52,571 | (21,067) |
| 93.959 | SAPT Block Grant | (208,131) | 61,999 | 291,220 | 21,090 |
| 93.977 | Comprehensive STD Prevention Systems (CSPS) | 43,102 | 155,086 | 76,357 | (35,627) |
| 93.988 | State-Based Diabetes Program | 11,917 | 99,320 | 91,311 | 3,908 |
| 93.991 | Preventive Health Services | (18,400) | 1,330 | 34,987 | 15,257 |
| 93.994 | MCHS Title V Block Grant | 76,226 | 76,226 | - | - |
| | Total U.S. Department of Health and Human Services | \$ (155,054) | \$ 2,097,154 | \$ 2,321,340 | \$ 69,132 |
| | TOTAL U.S. FEDERAL GRANTS FUND | \$ 552,228 | \$ 8,014,229 | \$ 8,182,111 | \$ 720,110 |

See accompanying notes to schedule of expenditures of federal awards.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Expenditures of Federal Awards
 Compact of Free Association, Public Law 99-239
 U.S. Department of the Interior - CFDA # 15.875
 Year Ended September 30, 2005

| <u>CFDA#</u> | <u>Agency/Program</u> | Prior Year Funds Carried Over October 1, 2004 | Federal Cash Receipts and Adjustments | Federal Expenditures | Available Funds September 30, 2005 |
|--------------|--|---|---|-------------------------|---|
| 15.875 | <u>Compact of Free Association Program</u> | | | | |
| | Section 215(a)(1) Communications | 818,565 | - | 758,185 | 60,380 |
| | Section 216(a)(1) Surveillance and Enforcement | 690 | - | - | 690 |
| | Section 216(a)(3) Scholarship | 1,593 | - | - | 1,593 |
| | Section 221(b) Health and Education | (4,280) | - | - | (4,280) |
| | Section 111(d) Investment Development | 472,253 | - | - | 472,253 |
| | Section 211(a)/217 Capital Account | 450,276 | 16,300 | 466,576 | - |
| | Section 211(a) Current Account and 231/232 Military Use and Operating Rights Agreement (MUORA) Extension - Kwajalein Landowners | 875,223 | - | - | 875,223 |
| | Total U.S. Department of the Interior | \$ 2,614,320 | \$ 16,300 | \$ 1,224,761 | \$ 1,405,859 |

See accompanying notes to schedule of expenditures of federal awards.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Expenditures of Federal Awards
 Compact of Free Association, As Amended, Public Law 99-239
 U.S. Department of the Interior - CFDA # 15.875
 Year Ended September 30, 2005

| CFDA# | Agency/Program | Prior Year Funds Carried Over October 1, 2004 | Federal Cash Receipts and Adjustments | Local Expenditures | Federal Expenditures | Available Funds September 30, 2005 |
|--------|--|---|---|-----------------------|-------------------------|---|
| 15.875 | <u>Compact of Free Association Program, As Amended</u> | | | | | |
| | Section 211(a)(1) Education Sector | \$ - | \$ 12,200,037 | \$ - | \$ 12,205,626 | \$ (5,589) |
| | Section 211(a)(2) Health Sector | - | 6,994,200 | - | 6,995,425 | (1,225) |
| | Section 211(a)(3) Private Sector Development | - | 326,154 | - | 326,154 | - |
| | Section 211(a)(4) Public Sector Capacity Building | - | 61,764 | - | 75,964 | (14,200) |
| | Section 211(a)(5) Environment Sector | - | 230,094 | - | 195,658 | 34,436 |
| | Section 211(b)(1) Kwajalein Environment | - | 145,276 | - | 179,694 | (34,418) |
| | Section 211(d)(1) Public Infrastructure Development | - | 4,716,520 | - | 4,716,520 | - |
| | Section 211(d)(2) Infrastructure Maintenance | 1,124,723 | 1,348,574 | 719,225 | 719,224 | 1,034,848 |
| | Section 212 Kwajalein Impact and Use | 3,857,487 | 15,207,550 | - | 11,169,586 | 7,895,451 |
| | Section 213 Audit | - | 217,854 | 108,927 | 108,927 | - |
| | Section 216 Trust | - | 7,588,500 | - | 7,588,500 | - |
| | Supplemental Education Grant | - | 1,803,700 | - | 1,803,700 | - |
| | Total U.S. Department of the Interior | \$ 4,982,210 | \$ 50,840,223 | \$ 828,152 | \$ 46,084,978 | \$ 8,909,303 |

See accompanying notes to schedule of expenditures of federal awards.

REPUBLIC OF THE MARSHALL ISLANDS

Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 2005

(1) Scope of Review

The Republic of the Marshall Islands (RepMar) is a governmental entity governed by its own Constitution. All significant operations of RepMar are included in the scope of the OMB Circular A-133 audit (the "Single Audit"). The U.S. Department of the Interior has been designated as RepMar's cognizant agency for the Single Audit.

a. Programs Subject to Single Audit

Schedules of Expenditures of Federal Awards are presented for each Federal program related to the following agencies:

- U.S. Department of Agriculture
- U.S. Department of Commerce
- U.S. Department of Education
- U.S. Department of Health and Human Services
- U.S. Department of Homeland Security
- U.S. Department of the Interior
- U.S. Department of Labor
- U.S. Small Business Administration

(2) Summary of Significant Accounting Policies

a. Basis of Accounting

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of RepMar 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. For federal direct assistance grants, authorizations represent the total allotment or grant award received. For Compact of Free Association programs, authorizations represent total current year allotments plus any prior year excess over program expenditures. All expenses and capital outlays are reported as expenditures.

b. Reporting Entity

RepMar, for purposes of the general purpose financial statements, includes all of the funds of the primary government as defined by Governmental Accounting Standards Board (GASB) Statement No. 14, *The Financial Reporting Entity*. The Schedule of Expenditures of Federal Awards excludes the federal awards received by the College of the Marshall Islands, the Marshalls Energy Company, Inc., and the Marshall Islands National Telecommunications Authority as these entities have separately satisfied the audit requirements of OMB Circular A-133.

The following entities have not satisfied audit requirements of OMB Circular A-133:

Marshall Islands Development Bank
Ministry of Education Head Start Program

RepMar is considered to have responsibility for any questioned costs that could result from Single Audits of these entities.

REPUBLIC OF THE MARSHALL ISLANDS

Notes to Schedule of Expenditures of Federal Awards, Continued
Year Ended September 30, 2005

(2) Summary of Significant Accounting Policies, Continued

c. Subgrantees

Certain program funds are passed through RepMar to subgrantee organizations. The Schedule of Expenditures of Federal Awards does not contain separate schedules disclosing how the subgrantees, outside of RepMar's control, utilized the funds. The following is a summary of program funds that are passed through to subgrantee organizations:

| <u>Grantor/Grant Title CFDA No.</u> | <u>Subgrantee</u> | <u>2005 Amount of Pass-through</u> |
|---|--|--|
| <u>U.S. Department of the Interior - CFDA #15.875</u> | | |
| Compact of Free Association Title II, Article I, Section 211 | Air Marshall Islands, Inc. | \$ 450,000 |
| Compact of Free Association, As Amended, Sector Grant | College of the Marshall Islands | \$ 1,641,111 |
| Compact of Free Association, As Amended, Sector Grant | Kwajalein Atoll Joint Utilities Resources, Inc. | \$ 434,069 |
| Compact of Free Association, As Amended, Sector Grant | Ministry of Education Head Start Program | \$ 857,574 |

d. Indirect Cost Allocation

RepMar has not entered into an approved indirect cost negotiation agreement covering fiscal year 2005. RepMar did not charge federal programs for indirect costs during fiscal year 2005.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs
Year Ended September 30, 2005

Section I - Summary of Auditor's Results

1. The Independent Auditors' Report on the financial statements expressed a qualified opinion due to the inability of the Ministry of Education Head Start Program, Air Marshall Islands, Inc., the Kwajalein Atoll Joint Utilities Resources, Inc., and the Marshall Islands Development Bank to produce audited financial statements; and the inability to determine the propriety of RepMar's governmental activities capital assets, net assets invested in capital assets, net of related debt and depreciation expense.
2. Reportable conditions in internal control over financial reporting were identified, some of which are considered to be material weaknesses.
3. Instances of noncompliance considered material to the financial statements were disclosed by the audit.
4. Reportable conditions in internal control over compliance with requirements applicable to major federal award programs were identified, some of which are considered to be material weaknesses.
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. RepMar's major programs were as follows:

| <u>Name of Federal Program</u> | <u>CFDA Number</u> |
|---|--------------------|
| Economic, Social and Political Development of the Territories and the Freely Associated States: | |
| Compact of Free Association, As Amended, Sector Grants | 15.875 |
| IDEA Special Education - Grants to States | 84.027 |
| Teacher Quality Enhancement Program | 84.336 |

8. A threshold of \$1,446,863 was used to distinguish between Type A and Type B programs as those terms are defined in OMB Circular A-133.
9. RepMar did not qualify as a low-risk auditee as that term is defined in OMB Circular A-133.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Section II - Financial Statement Findings

| <u>Reference Number</u> | <u>Findings</u> | <u>Refer Page #</u> |
|-------------------------|--|---------------------|
| 2005-1 | External Financial Reporting | 17 - 18 |
| 2005-2 - 3 | RepMar Local Noncompliance | 19 - 20 |
| 2005-4 - 6 | Allowable Costs/Cost Principles | 21 - 25 |
| 2005-7 | Cash Management | 26 - 27 |
| 2005-8 | Period of Availability of Funds | 28 |
| 2005-9 - 10 | Procurement and Suspension and Debarment | 29 - 33 |
| 2005-11 | Equipment and Real Property Management | 34 |
| 2005-12 | Matching, Level of Effort, Earmarking | 35 - 36 |
| 2005-13 | Subrecipient Monitoring | 37 |

Section III - Federal Award Findings and Questioned Costs

| <u>Reference Number</u> | <u>Findings</u> | <u>Questioned Costs</u> | <u>Refer Page #</u> |
|-------------------------|--|-------------------------|---------------------|
| 2005-1 | Subrecipient Monitoring | \$ - | 17 - 18 |
| 2005-4 - 6 | Allowable Costs/Cost Principles | \$ 355,258 | 21 - 25 |
| 2005-7 | Cash Management | \$ - | 26 - 27 |
| 2005-8 | Period of Availability of Funds | \$ 50,000 | 28 |
| 2005-9 - 10 | Procurement and Suspension and Debarment | \$ 251,135 | 29 - 33 |
| 2005-11 | Equipment and Real Property Management | \$ - | 34 |
| 2005-12 | Matching, Level of Effort, Earmarking | \$ 369,757 | 35 - 36 |
| 2005-13 | Subrecipient Monitoring | \$ 1,125,696 | 37 |

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No. 2005-1

External Financial Reporting

Subrecipient Monitoring

U.S. Department of the Interior - CFDA # 15.875

Compact of Free Association, As Amended, Supplemental Education Grant

Criteria: Governmental Accounting Standards Board (GASB) Statement No. 14, *The Financial Reporting Entity*, requires that the financial statements of the reporting entity include component units for which the primary government is either financially accountable, or for which exclusion would cause the reporting entity's financial statements to be misleading or incomplete. Furthermore, in accordance with the provisions of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, non-Federal entities that expend \$500,000 or more in a year in Federal awards shall have a single or program-specific audit conducted for that year.

Condition: The following component units were unable to produce audited financial statements in time for inclusion into RepMar's financial statements for 2005:

Governmental Funds

Ministry of Education Head Start Program

Component Units

Air Marshall Islands, Inc.
Kwajalein Atoll Joint Utilities Resources, Inc.
Marshall Islands Development Bank

Instead, the Ministry of Finance included unaudited financial information for these entities in RepMar's financial statements for 2005. As the Ministry of Education Head Start Program was a sub-recipient of Federal awards during the year ended September 30, 2005 in the amount of \$857,574 under the Supplemental Education Grant, we were unable to determine whether these funds were expended in accordance with the Fiscal Procedures Agreement (FPA) and the intent of the Compact.

Furthermore, no contract or Memorandum of Understanding (MOU) was executed with the Ministry of Education Head Start Program. The FPA requires that sub-grantee MOUs be established to ensure that Sub-Grantees are aware of requirements imposed upon them by the Compact, as amended, the sector Grants and the FPA; and that the Sub-Grantee can meet the financial management standards of the FPA.

Cause: The cause of the above condition is the lack of audited financial statements for the respective entities and the lack of adequate internal control policies and procedures requiring the execution of contracts or MOUs with Sub-Grantees and ensuring compliance with special tests and provisions.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No. 2005-1, Continued

Effect: The effect of the above condition is nonconformity with GASB Statement No. 14 resulting in a qualification in the opinion on the financial statements of RepMar, noncompliance with the single audit requirements of OMB Circular A-133, and noncompliance with specific provisions of the FPA.

Recommendation: We recommend that RepMar conform to GASB Statement No. 14 by obtaining audited financial statements of the above entities for inclusion within the financial statements. Furthermore, we recommend that RepMar ensure a single or program-specific audit of the Ministry of Education Head Start Program is performed, and ensure compliance with the specific provisions of the FPA by executing contracts or MOUs with all Sub-Grantees.

Prior Year Status: The lack of including component units' in RepMar's financial statements was reported as a finding in the Single Audits of RepMar for fiscal years 1998 through 2004.

Auditee Response and Corrective Action Plan: In a letter dated June 23, 2006, the Ministry of Finance provided the following response.

We agree with the finding and recommendation. As in the past, the Ministry of Finance continues to urge government agencies and component units to get their audits completed in a timely manner. There have been some improvements in this light as all of the mentioned entities are becoming more up to date with their audits, with the removal of the Health Care Revenue Fund, the Marshall Islands Health Fund, the Marshall Islands Scholarship, Grant and Loan Board, the RMI Environmental Protection Authority, and the Marshall Islands Visitor Authority from the audit qualification. We also expect the audits of Air Marshall Islands and Kwajalein Atoll Joint Utility Resources, Inc. to be completed by September 2006. Moreover, a component unit technical assistance grant has been approved for the purpose of engaging services of a consultant to assist component units, prioritizing the component units identified in the audit finding in rectifying their accounting books and records. Our corrective action plan will involve the Ministry of Finance through the Secretary of Finance, Mr. Jefferson Barton, continuing to liaise with these entities to ensure that all of them are audited and are included in the RMI's financial statements within the next two years and hire the Consultant. The anticipated completion date of our corrective action plan is September 30, 2006.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No. 2005-2

RepMar Local Noncompliance

Criteria: Section 902 of the Over-expenditure and Over-obligation of Appropriated Funds Act of 1977 stipulates that no person shall authorize or expend any governmental funds in excess of appropriated amounts except in emergencies and only pursuant to procedures provided by law.

Condition: The Appropriations (Financial Year 2005) Act of 2005, as passed by the Nitijela of RepMar, provided appropriated amounts for fiscal year 2005 from the General Fund of \$34,328,565. The following program areas recorded in the DILOG accounting system reported expenditures in excess of budget appropriations for the year ended September 30, 2005. The over-expenditures of the subsidy to Air Marshall Islands, Inc. results from a proposed audit adjustment to correctly record 2005 expenditures:

| <u>Program Area</u> | <u>Budgeted Expenditures</u> | <u>Budgetary Expenditures</u> | <u>Over-Expenditure</u> |
|---|------------------------------|-------------------------------|-------------------------|
| Government electric bills - Ebeye | \$ 46,769 | \$ 47,761 | \$ 992 |
| Land leases | \$ 866,677 | \$ 874,819 | \$ 8,142 |
| ADB Loan Repayment | \$ 894,600 | \$ 1,572,914 | \$ 678,314 |
| Sport and Youth Development | \$ 99,031 | \$ 100,997 | \$ 1,966 |
| Air Marshall Islands, Inc. subsidy | \$ - | \$ 400,000 | \$ 400,000 |
| Council of Iroij | \$ 424,779 | \$ 425,104 | \$ 325 |
| Ministry of Resources and Development | \$ 567,028 | \$ 1,829,685 | \$ 1,262,657 |
| Ministry of Internal Affairs | \$ 1,745,067 | \$ 1,911,393 | \$ 166,326 |
| Ministry of Finance | \$ 2,000,631 | \$ 2,023,686 | \$ 23,055 |
| Ministry of Foreign Affairs and Trade | \$ 2,432,733 | \$ 2,544,881 | \$ 112,148 |
| Infrastructure Maintenance (Compact matching) | \$ 667,576 | \$ 674,287 | \$ 6,711 |
| Transportation Services Fund | \$ - | \$ 48,124 | \$ 48,124 |
| Section 213 Audit Fund | \$ - | \$ 108,927 | \$ 108,927 |
| Section 211 Compact Capital Account Fund | \$ - | \$ 16,300 | \$ 16,300 |
| Other Capital Projects Fund | \$ - | \$ 18,080 | \$ 18,080 |
| Postal Services Fund | \$ 30,450 | \$ 42,418 | \$ 11,968 |

Cause: The cause of the above condition is the authorization of expenditures within the respective funds in excess of amounts available for appropriation.

Effect: The effect of the above condition is noncompliance with Section 902 of the Over-expenditure and Over-obligation of Appropriated Funds Act of 1977.

Recommendation: We recommend that the Ministry of Finance's Budget Office only authorize expenditures within appropriated amounts.

Prior Year Status: The lack of compliance with Section 902 of the Over-expenditure and Over-obligation of Appropriated Funds Act of 1977 was reported as a finding in the Single Audits of RepMar for fiscal years 2000 through 2004.

Auditee Response and Corrective Action Plan: In a letter dated June 23, 2006, the Ministry of Finance provided the following response.

We agree with the finding and recommendation. The Ministry of Finance, with utmost efforts, shall continue strict adherence to Section 2 of the Over-expenditure and Over-obligation of Appropriated Funds Act of 1977. Towards this end, the Ministry has instituted in fiscal year 2006 a Quarterly Allotment Scheme and the ministry providing respective Ministries and agencies monthly budget status report. Our corrective action plan will involve the Ministry of Finance through Mr. Smith Michael, Assistant Secretary for Budget to continuously implement the system above. The anticipated completion date of our corrective action plan is September 30, 2006.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No. 2005-3

RepMar Local Noncompliance

Criteria: Section 702(a) of the General Fund Investment Act of 1979 stipulates that public money shall not be deposited with any financial institution that is not a member of the Federal Deposit Insurance Corporation (FDIC) of the United States or the Federal Savings and Loan Insurance Corporation (FSLIC) of the United States unless the Secretary of Finance is satisfied, on the advice of the Banking Commissioner, that a financial institution that is not a member of the FDIC or FSLIC, owns sufficient assets to cover the total amount of the investment.

Condition: As of September 30, 2005, the General Fund of RepMar maintained bank deposits, totaling \$560,602, with the Marshall Islands Development Bank (MIDB), which is not a member of the FDIC or FSLIC. Furthermore, the Intergenerational Trust Fund maintained bank deposits, totaling \$7,000,000 with MIDB. No advice from the Banking Commissioner was sought in order to determine whether MIDB has sufficient assets to cover the total amount of the deposits. Additionally, audited financial statements for MIDB were not available to determine the asset coverage sufficiency.

Cause: The cause of the above condition is the lack of adequate internal control policies and procedures to ensure compliance with local laws and regulations.

Effect: The effect of the above condition is noncompliance with Section 702(a) of the General Fund Investment Act of 1979.

Recommendation: We recommend that the Ministry of Finance comply with Section 702(a) of the General Fund Investment Act of 1979.

Prior Year Status: The lack of compliance with Section 702(a) of the General Fund Investment Act of 1979 was reported as a finding in the Single Audits of RepMar for fiscal years 2000 through 2004.

Auditee Response and Corrective Action Plan: In a letter dated June 23, 2006, the Ministry of Finance provided the following response.

We agree with the finding and recommendation. Our corrective action plan will involve the Ministry of Finance through the Minister of Finance, Honorable Brenson S. Wase, seeking the assistance of the Cabinet and Nitijela in the possibility of amending the General Fund Investment Act of 1979. The anticipated completion date of our corrective action plan is September 30, 2006.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No. 2005-4

Allowable Costs/Cost Principles

U.S. Department of the Interior - CFDA # 15.875

Compact of Free Association, As Amended, Education Sector Grant

Questioned Costs: \$342,660

Criteria: Article VI, Section 1(a)(2)(v) of the Fiscal Procedures Agreement (FPA) states that applicable cost principles and Grant terms shall be followed in determining the reasonableness and allowability of costs. Specifically, expenditures incurred under the Compact of Free Association should be in accordance with allowable costs and should be directly related to and in accordance with Compact intent and objectives.

Condition: During the year ended September 30, 2005, RepMar provided grants-in-aid to private schools in the Marshall Islands totaling \$342,660. The supporting documentation relative to these payments was a listing of elementary and secondary schools within the Marshall Islands that were considered eligible by the Ministry of Education to receive payments. The amount of payment received by each school was based on the number of students enrolled. No Memoranda of Understanding or sub-Grant award agreements between the Ministry of Education and the respective schools were evident indicating what the responsibility of the schools are, including applicable reporting requirements. Accordingly, we are unable to determine whether these funds were expended in accordance with the FPA and the intent of the Compact.

Cause: The cause of the above condition is the failure by the Ministry of Education of establishing MOUs or sub-Grant award agreements with the respective private schools.

Effect: The effect of the above condition is unallowable costs incurred that do not follow the intent of the Compact.

Recommendation: We recommend that the Ministry of Education establish MOUs or sub-Grant award agreements with the respective private schools indicating what the responsibility of the schools are, including compliance with the FPA. Furthermore, we recommend that the Ministry of Education obtain financial statements from these schools indicating how the funds received during the year ended September 30, 2005 were spent.

Auditee Response and Corrective Action Plan: In a letter dated June 23, 2006, the Ministry of Finance provided the following response.

We agree with the finding and recommendation. Our corrective action plan will involve the Ministry of Finance through the Secretary of Finance, Mr. Jefferson Barton, liaising with the Secretary of the Ministry of Education, Biram Stege in obtaining financial reports for FY2005 from the said schools on the expenditures incurred related to the grant. We will seek the services of the Auditor-General to perform follow-up procedures on the aforementioned financial reports to determine whether they meet the objectives of the Education Sector Grant. Going forward, the Ministry of Finance will ensure that there are MOUs for all sub-grantees prior to disbursements of funds. The anticipated completion date of our corrective action plan is August 31, 2006.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No. 2005-5

Allowable Costs/Cost Principles

U.S. Department of Education - CFDA # 84.027

IDEA Special Education-Grants to States, Grant No. H027B030003

Questioned Costs: \$12,598

Criteria: Expenditures incurred under federal programs should be in accordance with allowable costs and should be directly related to and in accordance with program intent and objectives.

Condition: Of \$711,346 in non-payroll expenditures of the IDEA Special Education - Grants to States program, fifty-five non-payroll expenditures, totaling \$277,437, were tested. We noted the following expenditures that did not appear to be reasonable and necessary costs that meet the overall needs of the program:

| <u>Item #</u> | <u>PO #</u> | <u>Check #</u> | <u>G/L Account Name</u> | <u>Amount</u> |
|---------------|-------------|----------------|-------------------------|---------------|
| 1 | A0337901 | 21902 | International Travel | \$ 2,892 |
| 2 | A0337601 | 21902 | International Travel | \$ 2,892 |
| 3 | T0204901 | 23067 | International Travel | \$ 3,558 |
| 4 | T0204401 | 24005 | International Travel | \$ 3,256 |

Item #s 1 and 4 relate to travel costs for the Assistant Secretary of Education - Administration and Logistics in attending the IDEA Leadership Conference Implementation Workshop Pacific Meeting. Based on examination of trip reports, attendance at the conference appears to be generally beneficial to the Ministry of Education; however, no documentation was maintained indicating the benefits of these travel costs for a Ministry of Education employee not directly related to the Special Education program. Accordingly, questioned costs of \$6,148 are reported.

Item #s 2 and 3 relate to travel costs for RepMar's Budget Officer within the Ministry of Finance in attending the IDEA Leadership Conference Implementation Workshop Pacific Meeting. Based on examination of trip reports, attendance at the conference appears to be generally beneficial to the Ministry of Education; however, no documentation was maintained indicating the benefits of these travel costs for a Ministry of Finance employee not directly related to the Special Education program. Accordingly, questioned costs of \$6,450 are reported.

Cause: The cause of the condition is the lack of adequate internal control policies and procedures to ensure expenditures charged to a Federal program are directly related to the program and are in accordance with program intent and objectives.

Effect: The effect of the above condition is noncompliance with allowable costs/cost principles as required by the Common Rule.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No. 2005-5, Continued

Recommendation: We recommend that costs incurred under federal programs be in accordance with allowable costs per the program grant award and that such be necessary and in accordance with program intent. Furthermore, for costs incurred for a common or joint purpose benefiting more than one cost objective, we recommend that these costs be allocated based on an approved cost allocation plan.

Auditee Response and Corrective Action Plan: In a letter dated June 23, 2006, the Ministry of Finance provided the following response.

We agree with the finding and recommendation. Our corrective action plan will include seeking the approval and final determination of the grantor agency of these expenditures. In addition, the Ministry of Finance will institute tighter controls, adequate documentation and strict adherence to the allowable cost requirement stipulated in the federal fiscal procedures. A standard form containing approval of the grantor agency on the incurrence of expenditures indirectly related to the Program's intent and objectives will be included as part of the documentation in the incurrence of such expenditures. Expenditures indirectly related to the Federal Program's intent and objectives but benefits the said program, will be charged to the indirect cost budget of the federal grant. Our anticipated completion date of our corrective action plan is on September 30, 2006.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No. 2005-6

Allowable Costs/Cost Principles

U.S. Department of Education - CFDA # 84.336

Teacher Quality Enhancement Grant, Grant No. P336A030001

Questioned Costs: \$0

Criteria: Expenditures incurred under federal programs should be in accordance with allowable costs and should be directly related to and in accordance with program intent and objectives.

Condition: Of \$340,787 in non-payroll expenditures of the Teacher Quality Enhancement Grant program, thirty-seven non-payroll expenditures, totaling \$267,054, were tested. We noted the following expenditures that did not appear to be reasonable and necessary costs that meet the overall needs of the program:

| <u>Item #</u> | <u>PO #</u> | <u>Check #</u> | <u>G/L Account Name</u> | <u>Amount</u> |
|---------------|-------------|----------------|--------------------------------|---------------|
| 1 | A0383701 | 24362 | International Travel | \$ 1,373 |
| 2 | A0442901 | 26774 | Training and Staff Development | \$ 1,996 |
| 3 | A0442801 | 26774 | Training and Staff Development | \$ 1,996 |
| 4 | T0277201 | 27743 | Training and Staff Development | \$ 2,062 |
| 5 | T0277101 | 27792 | Training and Staff Development | \$ 2,117 |

Item # 1 relates to travel costs of return airfare for a Ministry of Education contracted employee. Based on examination of this contracted employee's contract, this person was employed to assist the Ministry of Education with financial planning, budgeting, and maintaining detailed and accurate records of funds authorized, committed, obligated, disbursed and accrued by the Ministry. Although this employee provided services to the Ministry of Education, these services do not appear to be directly related to the intent and objectives of the program.

Item #s 2 through 5 relate to travel costs for the TQE Program Director and the Ministry of Education Fiscal Officer to attend the Pacific Islands Indirect Cost Conference in San Francisco. Based on examination of trip reports, attendance at the conference appears to be generally beneficial to the Ministry of Education; however, the costs of attendance at the conference do not appear to be directly related to the intent and objectives of the program. Furthermore, examination of the U.S. Department of Education approved budget for this grant did not include travel costs associated with this conference.

Accordingly, these exceptions, totaling \$9,546, have been extrapolated to determine potential questioned costs, which exceed the \$10,000 threshold; however, no questioned costs are reported as the above amounts are included in the questioned cost amount of \$367,757 relating to noncompliance with matching requirements, as outlined in Finding No. 2005-12.

Cause: The cause of the above condition is the lack of adequate internal control policies and procedures to ensure expenditures charged to a Federal program are directly related to the program and are in accordance with program intent and objectives.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No. 2005-6, Continued

Condition, Continued:

Effect: The effect of the above condition is noncompliance with allowable costs/cost principles as required by the Common Rule.

Recommendation: We recommend that costs incurred under federal programs be in accordance with allowable costs per the program grant award and that such be necessary and in accordance with program intent. Furthermore, for costs incurred for a common or joint purpose benefiting more than one cost objective, costs should be allocated to the Federal award based on an approved cost allocation plan.

Auditee Response and Corrective Action Plan: In a letter dated June 23, 2006, the Ministry of Finance provided the following response.

We agree with the finding and recommendation. Our corrective action plan will include seeking the approval and final determination of the grantor agency of these expenditures. In addition, the Ministry of Finance will institute tighter controls, adequate documentation and strict adherence to the allowable cost requirement stipulated in the federal fiscal procedures. A standard form containing approval of the grantor agency on the incurrence of expenditures indirectly related to the Program's intent and objectives will be included as part of the documentation in the incurrence of such expenditures. Expenditures indirectly related to the Federal Program's intent and objectives but benefits the said program, will be charged to the indirect cost budget of the federal grant. Our anticipated completion date of our corrective action plan is on September 30, 2006.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No. 2005-7

Cash Management

U.S. Department of Education - CFDA # 84.027

IDEA Special Education - Grants to States, Grant No. H027B030003

Questioned Costs: \$0

U.S. Department of Education - CFDA # 84.336

Teacher Quality Enhancement Grant, Grant No. P336A030001

Questioned Costs: \$0

Criteria: Section 80.21 of 34 CFR 80, *Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments*, prescribes the basic standard and the methods under which a Federal agency will make payments to grantees, and grantees will make payments to subgrantees and contractors. Methods and procedures for payment shall minimize the time elapsing between the transfer of funds and disbursement by the grantee or subgrantee, in accordance with Treasury regulations at 31 CFR 205.

Condition No. 1: Of \$711,346 in non-payroll expenditures of the IDEA Special Education - Grants to States program, fifty-five non-payroll expenditures, totaling \$277,437, were tested. We noted eleven instances where Federal funds were received prior to payments being disbursed to vendors:

| <u>Check #</u> | <u>Amount</u> | <u>Reimbursement Date</u> | <u>Check Clearance Date</u> | <u>Excess Days</u> |
|----------------|---------------|---------------------------|-----------------------------|--------------------|
| 23811 | \$ 33,500 | 05/16/05 | 06/03/05 | 18 |
| 20626 | \$ 4,320 | 01/27/05 | 01/31/05 | 4 |
| 20947 | \$ 12,375 | 03/03/05 | 03/21/05 | 18 |
| 21653 | \$ 3,877 | 03/03/05 | 03/09/05 | 6 |
| 24005 | \$ 3,256 | 05/16/05 | 06/03/05 | 18 |
| 24230 | \$ 3,590 | 05/16/05 | 06/10/05 | 25 |
| 25536 | \$ 8,985 | 07/28/05 | 09/01/05 | 35 |
| 26078 | \$ 3,000 | 07/28/05 | 09/15/05 | 49 |
| 26364 | \$ 3,365 | 08/17/05 | 08/25/05 | 8 |
| 26364 | \$ 3,365 | 08/17/05 | 08/25/05 | 8 |
| 26364 | \$ 3,365 | 08/17/05 | 08/25/05 | 8 |

The total amount of estimated interest liability is below \$10,000; hence, no questioned costs are reported.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No. 2005-7, Continued

Condition No. 2: Of \$340,787 in non-payroll expenditures of the Teacher Quality Enhancement Grant program, thirty-seven non-payroll expenditures, totaling \$267,054, were tested. We noted nine instances where Federal funds were received prior to payments being disbursed to vendors:

| <u>Check #</u> | <u>Amount</u> | <u>Reimbursement Date</u> | <u>Check Clearance Date</u> | <u>Excess Days</u> |
|----------------|---------------|---------------------------|-----------------------------|--------------------|
| 22151 | \$ 40,030 | 05/16/05 | 06/24/05 | 39 |
| 26701 | \$ 88,493 | 08/26/05 | 09/16/05 | 21 |
| 26108 | \$ 1,068 | 08/09/05 | 08/29/05 | 20 |
| 26343 | \$ 2,031 | 08/18/05 | 08/22/05 | 4 |
| 26535 | \$ 4,449 | 08/24/05 | 08/30/05 | 6 |
| 26667 | \$ 1,561 | 08/31/05 | 09/07/05 | 7 |
| 26774 | \$ 1,996 | 08/29/05 | 09/12/05 | 14 |
| 26774 | \$ 1,996 | 08/29/05 | 09/12/05 | 14 |
| 26836 | \$ 2,534 | 09/09/05 | 09/19/05 | 10 |

The total amount of estimated interest liability is below \$10,000; hence, no questioned costs are reported.

Cause: The cause of the above condition is the lack of a formal methodology and procedures over the draw down of Federal funds to ensure compliance with cash management requirements.

Effect: The effect of the above condition is noncompliance with cash management requirements.

Recommendation: We recommend that the Ministry of Finance establish a formal methodology governing the draw down of Federal funds to minimize the time elapsed between the receipt of Federal funds and the date the applicable payments clear the bank.

Auditee Response and Corrective Action Plan: In a letter dated June 23, 2006, the Ministry of Finance provided the following response.

We agree with the finding and recommendation. Our corrective action plan will involve Junior Patrick, Assistant Secretary of Accounting and Smith Michael, Assistant Secretary of Budget & OIDA to establish a spending pattern and a draw down schedule for all Federal programs grants to minimize time elapsed between receipt of funds and disbursement. The anticipated completion of this corrective action plan is September 30, 2006.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No. 2005-8

Period of Availability of Funds

U.S. Department of the Interior - CFDA # 15.875

Compact of Free Association, As Amended, Education Sector Grant

Questioned Costs: \$50,000

Criteria: Article VI, Section 1(c)(1) of the Fiscal Procedures Agreement (FPA) states that funding for each Operational Sector grant shall generally be available for one year. Where a funding period is specified, a grantee may charge to the award only costs resulting from obligations of the funding period. Furthermore, section 1(c)(2) of the FPA states that all outstanding obligations must be liquidated not later than 90 days after the end of the funding period.

Condition: Of \$4,864,340 of non-payroll expenditures of the Education Sector Fund, twenty non-payroll expenditures, totaling \$766,648, were tested. We noted one \$50,000 item (PO # P1002701 - Check # 24124) paid to the Kili/Bikini Local Government for the reimbursement for expenditures incurred by the local government in the construction of a school on Ejit. However, the documentation attached to the check voucher indicated that the school was constructed in 1995. Hence, the provision of services was obligated outside the period of availability, which results in a questioned cost of \$50,000.

Cause: The cause of the above condition is the obligation of Education Sector funds for services that were incurred outside of the funding period.

Effect: The effect of the above condition is noncompliance with period of availability requirements.

Recommendation: We recommend that RepMar comply with period of availability requirements.

Auditee Response and Corrective Action Plan: In a letter dated June 23, 2006, the Ministry of Finance provided the following response.

We agree with the finding and recommendation. Our corrective action plan will include seeking the approval and final determination of the grantor agency of this expenditure. Moreover, the Ministry of Finance will exert its best efforts to practice strict compliance to the period of availability requirements as stipulated under the Fiscal Procedures Agreement (FPA) and other federal requirements. The anticipated completion of this corrective action plan is September 30, 2006.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No. 2005-9

Procurement and Suspension and Debarment

U.S. Department of the Interior - CFDA # 15.875

Compact of Free Association, As Amended, Education Sector Grant; Health Sector Grant; Public Infrastructure Sector Grant; Supplemental Education Grant

Questioned Costs: \$227,366

Criteria: Article VI, Section 1(j)(1) of the FPA states that RepMar may use its own procedures for procurement, whether done by government or its Sub-Grantees, provided that they meet the standards identified in the FPA.

RepMar's Procurement Code states the following:

- (a) Section 124 - unless otherwise authorized by law, all Government contracts shall be awarded by competitive sealed bidding.
- (b) Section 127 - procurement of goods and services not exceeding \$25,000 may be made in accordance with small purchase procedures. Small purchases procedures are those relatively simple and informal methods for securing services, supplies, or other property that do not cost more than \$25,000. If small purchase procedures are used, price or rate quotations shall be obtained from an adequate number of qualified sources.
- (c) Section 128 - a contract may be awarded for a supply, service, or construction item without competition when it is determined in writing that there is only one source for the required supply, service, or construction item.

Condition No. 1: Of \$4,864,340 in non-payroll expenditures of the Education Sector Grant Fund, twenty non-payroll expenditures, totaling \$766,648, were tested. We noted one \$31,597 item (PO # P1150801 - Check # 27840) where documentation was inadequate to evidence that competitive bid procedures occurred. Specifically, the Ministry of Education purchased foodstuffs for the Jaluit High School and the Northern Islands High School. Documentation supporting the procurement process was limited to price quotations from three local vendors (equivalent to small purchases procedures); however, since the purchase price exceeds \$25,000, the procurement should have been awarded by competitive sealed bidding, as required by Section 124. As no documentation was maintained indicating compliance with Section 124, a questioned cost of \$31,597 is reported.

Condition No. 2: Of \$568,512 in non-payroll expenditures of the Supplemental Education Grant Fund, twelve non-payroll expenditures, totaling \$342,172, were tested. We noted two items in the amount of \$6,396 (PO # P1131001 - Check # 27707) and \$11,813 (PO # C0088301 - Check # 26894) where documentation was inadequate to evidence the sole-source procurement process, as required by Section 128. In both instances, no formal documentation was noted to indicate the sole-source selection basis. Specifically, for PO # P1131001, the Ministry of Education sole-sourced the purchase of food stuffs from a local vendor. For PO # C0088301, the Ministry of Education entered into a sole-source contract with a contractor for the provision of consulting services for the development of an English Literacy Test for Teachers. As no documentation was maintained indicating the history of procurement, including the rationale for and method of procurement, the contractor selection or rejection, and the basis for the contract price, questioned costs of \$18,209 are reported.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No. 2005-9, Continued

Condition No. 3: Of \$4,715,776 in non-payroll expenditures of the Public Infrastructure Sector Grant Fund, forty-nine non-payroll expenditures, totaling \$3,942,161, were tested. Documentation supporting use of sole-source procurement was not available for the following expenditures, as required by Section 128:

1. PO # P1089101 on Check # 29534 for \$43,871: The Ministry of Education sole-sourced the purchase of hardwood oak tables and chairs for the Rita Elementary School; however, no formal documentation was locatable to indicate the vendor selection basis. As no documentation was maintained indicating the history of procurement, including the rationale for and method of procurement, the contractor selection or rejection, and the basis for the contract price, a questioned cost of \$43,871 is reported.
2. PO # P0888301 on Check # 21682 for \$17,125: The Ministry of Health sole-sourced the purchase of an ambulance for the Majuro hospital, which was funded by a 25% match from Compact sector funds as approved by CM 184(2004); however, no formal documentation was locatable to indicate the vendor selection basis. As no documentation was maintained indicating the history of procurement, including the rationale for and method of procurement, the contractor selection or rejection, and the basis for the contract price, a questioned cost of \$17,125 is reported.

Furthermore, documentation was inadequate to evidence the competitive bid procurement process for the following expenditures, as required by Section 124:

3. PO # Q0082801 on Ebeye Check # 13210 for \$33,883: The Ministry of Health purchased medical supplies for the Ebeye Hospital ICU. Documentation supporting the procurement process was limited to price quotations from three local vendors (equivalent to small purchases procedures); however, since the purchase price exceeded \$25,000, the procurement should have been awarded by competitive sealed bidding. As no documentation was maintained indicating compliance with Section 124, a questioned cost of \$33,883 is reported.
4. PO # K0702401 on Ebeye Check # 6917 for \$25,575: The Ministry of Health purchased an ambulance for the Ebeye Hospital. Documentation supporting the procurement process was limited to price quotations from three local vendors (equivalent to small purchases procedures); however, since the purchase price exceeded \$25,000, the procurement should have been awarded by competitive sealed bidding. As no documentation was maintained indicating compliance with Section 124, a questioned cost of \$25,575 is reported.

Condition No. 4: Of \$1,912,042 in non-payroll expenditures of the Health Sector Grant, forty-nine non-payroll expenditures, totaling \$299,682, were tested. We noted two items in the amount of \$7,106 (PO # K0690201 - Ebeye Check # 12989 for the purchase of medical supplies) and \$50,000 (PO # Q0068201 - Ebeye Check # 13125 for the installation and upgrade of the PEACESAT at Ebeye hospital) where no evidence supporting sole-source procurement was on hand. As no supporting documentation was maintained indicating the history of procurement, including the rationale for and method of procurement, the contractor selection or rejection, and the basis for the purchase price, questioned costs of \$57,106 are reported.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No. 2005-9, Continued

Cause: The cause of the above condition is the lack of adequate internal control policies and procedures requiring the documentation of procurement procedures to ensure compliance with federal procurement requirements.

Effect: The effect of the above condition is noncompliance with procurement standards.

Recommendation: We recommend RepMar ensure supporting documentation is adequate to comply with federal procurement requirements as stipulated in the FPA. Specifically, supporting documentation should indicate the history of procurement, including the rationale for and method of procurement, the contractor selection or rejection, and the basis for the contract price.

Auditee Response and Corrective Action Plan: In a letter dated June 23, 2006, the Ministry of Finance provided the following response.

We agree with the finding and recommendation. For FY 2006, tighter controls are being instituted and adequate documentation is being maintained to ensure compliance to the federal and RMI procurement requirements. Our corrective action plan will involve the Chief of Procurement & Supply, Mr. Douglas Anjain together with the newly established Compliance Unit within the Accounting Department in the Ministry of Finance to check all the Purchase Requisitions Contracts and other related documents to ensure compliance with the Procurement requirements set forth in RMI's Procurement Code prior to disbursements.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No. 2005-10

Procurement and Suspension and Debarment

U.S. Department of Education - CFDA # 84.027

IDEA Special Education-Grants to States, Grant No. H027B030003

Questioned Costs: \$23,769

Criteria: Section 80.36 of 34 CFR 80, *Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments*, states that RepMar may use its own procedures for procurement, whether done by government or its Sub-Grantees, provided that they meet the standards identified in this section.

Condition: Of \$711,346 in non-payroll expenditures of the IDEA Special Education - Grants to States program, fifty-five non-payroll expenditures, totaling \$277,437, were tested. We noted the following expenditures where documentation was inadequate to evidence the procurement process:

| <u>Item #</u> | <u>PO #</u> | <u>Check #</u> | <u>G/L Account Name</u> | <u>Amount</u> |
|---------------|-------------|----------------|--------------------------------|---------------|
| 1 | P1004401 | 26969 | Vehicle | \$ 17,850 |
| 2 | P0891301 | 21653 | Equipment | \$ 3,877 |
| 3 | P1150001 | 26804 | Training and Staff Development | \$ 3,600 |

For item #s 1 and 3, we noted only one price quotation from a local vendor for each purchase. Accordingly, RepMar appears to have sole-sourced these purchases. Section 128 of RepMar's Procurement Code states that a contract may be awarded for a supply, service, or construction item without competition when it is determined in writing that there is only one source for the required supply, service, or construction item. No supporting documentation was noted to indicate the sole-source procurement basis. As documentation was not maintained indicating the history of procurement, including the rationale for and method of procurement, the contractor selection or rejection, and the basis for the contract price, questioned costs of \$21,450 are reported.

For item # 2, we noted two price quotations from local vendors for the purchase of three air conditioners for the Rita Elementary School. Section 127 of RepMar's Procurement Code states that any procurement not exceeding \$25,000 may be made in accordance with small purchase procedures. Small purchase procedures are those relatively simple and informal methods for securing services, supplies, or other property that do not cost more than \$25,000. If small purchase procedures are used, price or rate quotations shall be obtained from an adequate number of qualified sources. No evidence of obtaining price quotations from an adequate number of vendors was noted. Furthermore, of the price quotations obtained, RepMar selected the higher priced unit of \$1,272 versus the lower price of \$499. As no documentation was maintained indicating the history of procurement, including the rationale for and method of procurement, the contractor selection or rejection, and the basis for the contract price, a questioned cost of \$2,319 is reported, being the difference between the two purchase prices.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No. 2005-10, Continued

Cause: The cause of the above condition is the lack of adequate internal control policies and procedures requiring the documentation of procurement procedures to ensure compliance with federal procurement requirements.

Effect: The effect of the above condition is noncompliance with procurement standards as required by the Common Rule.

Recommendation: We recommend RepMar ensure supporting documentation is adequate to comply with federal procurement requirements as required by the Common Rule. Specifically, supporting documentation should indicate the history of procurement, including the rationale for and method of procurement, the contractor selection or rejection, and the basis for the contract price.

Auditee Response and Corrective Action Plan: In a letter dated June 23, 2006, the Ministry of Finance provided the following response.

We agree with the finding and recommendation. For FY 2006, tighter controls are being instituted and adequate documentation is being maintained to ensure compliance to the federal and RMI procurement requirements. Our corrective action plan will involve the Chief of Procurement & Supply, Mr. Douglas Anjain together with the newly established Compliance Unit within the Accounting Department in the Ministry of Finance to check all the Purchase Requisitions Contracts and other related documents to ensure compliance with the Procurement requirements set forth in RMI's Procurement Code prior to disbursements.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No. 2005-11

Equipment and Real Property Management - All Federal Programs

Questioned Costs: \$0

Criteria: The Common Rule states that procedures for managing equipment, whether acquired in whole or in part with grant funds, will meet the following requirements:

- a. Property records must be maintained;
- b. A physical inventory of the property must be taken and the results reconciled with the property records at least every two years;
- c. A control system must be developed to ensure adequate safeguards to prevent loss, damage, or theft of the property;
- d. Adequate maintenance procedures must be developed to keep the property in good condition; and
- e. If the grantee or subgrantee is authorized or required to sell the property, proper sales procedures must be established to ensure the highest possible return.

Condition: The Ministry of Finance has recorded certain fixed asset acquisitions for fiscal years 1999 through 2005 as well as acquisitions through fiscal year 1988. No inventory of fixed assets has been performed to ensure that all capital assets are correctly recorded in the financial statements.

Cause: The cause of the above condition is the lack of adequate internal control policies and procedures to ensure compliance with federal property rules and regulations.

Effect: The effect of the above condition is noncompliance with federal property standards as required in the Common Rule and the lack of presentation of all capital assets within the financial statements.

Recommendation: We recommend that the Ministry of Finance perform an inventory of RepMar's fixed assets as a basis for recording all assets in the financial statements and to ensure that it is in compliance with applicable federal property rules and regulations.

Prior Year Status: Lack of a complete fixed assets listing was reported as a finding in the Single Audits of RepMar for fiscal years 1988 through 2004.

Auditee Response and Corrective Action Plan: In a letter dated June 23, 2006, the Ministry of Finance provided the following response.

We agree with the finding and recommendation. The Ministry of Finance through the Office of Procurement & Supply Division performed a physical inventory of RMI's fixed assets. However, due to time constraints, they were not able to physically count all the fixed assets that the RMI is accountable with. Our corrective action plan will include a continuation of the physical inventory count that would involve the Ministry of Finance, through the Procurement and Supply Division taking the lead, and the other Ministries and Agencies of the RMI. In addition, the Ministry of Finance will obtain services of a qualified Consultant to do the valuation of RMI's fixed assets. The anticipated completion of our corrective action plan will be on December 31, 2006.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No. 2005-12

Matching, Level of Effort, Earmarking

U.S. Department of Education - CFDA # 84.336

Teacher Quality Enhancement Grant, Grant P336A030001

Questioned Costs: \$369,757

Criteria: Section 80.24 of 34 CFR 80, *Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments*, states that a matching or cost sharing requirement may be satisfied by allowable costs incurred by the grantee. Furthermore, section 80.20 states that fiscal control must be sufficient to permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes.

Condition: During the year ended September 30, 2005, the Ministry of Education expended \$369,757 under the Teacher Quality Enhancement Grant, which was recorded by RepMar under two cost centers (F43362 and F53362) in the amounts of \$201,798 and \$167,959, respectively. Based on discussions with RepMar's Federal Grants personnel, it was determined that the matching requirement of 50% under this award was funded from the following cost centers:

| <u>Fund #</u> | <u>Org. #</u> | <u>Org. Description</u> | <u>Cost Center</u> |
|---------------|---------------|-----------------------------|--------------------|
| 100100 | 2210 | MOE Administration | GG2210 |
| 100100 | 2230 | MOE Development Staff | GG2230 |
| 410100 | 2113 | National Training Council | C52113 |
| 410100 | 2410 | National Standards Office | C52410 |
| 410100 | 2550 | Elementary Schools – Majuro | C52550 |

Upon examination of the expenditures recorded in these cost centers, it was apparent that expenditures that satisfied the matching requirement were not differentiated from other non-grant related expenditures. Accordingly, we were unable to verify that the matching requirement was satisfied and that cost sharing expenditures were: (i) not included as contributions for any other federally assisted program, (ii) necessary and reasonable for proper and efficient accomplishment of project or program objectives, and (iii) allowed under the applicable cost principles. Accordingly, questioned costs of \$369,757 are reported.

Cause: The cause of the above condition is the lack of establishing a specific cost center within RepMar's financial management designated for the purpose of recording non-Federal expenditures specifically to satisfy the matching requirement of the Teacher Quality Enhancement Grant.

Effect: The effect of the above condition is noncompliance with matching or cost sharing requirements as required by the Common Rule.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No. 2005-12, Continued

Recommendation: We recommend that RepMar establish a designated cost center within DILOG into which non-Federal expenditures are recorded that satisfy the matching requirement of the Teacher Quality Enhancement Grant.

Auditee Response and Corrective Action Plan: In a letter dated June 23, 2006, the Ministry of Finance provided the following response.

We agree to the finding and recommendation. Our corrective action plan will involve the Ministry of Finance, through the Senior Federal Grants Coordinator and the Ministry of Education, through the TQE Program Director, preparing a detailed report on the expenditures representing RMI's 50% matching requirement. We will seek the services of the Auditor-General to perform follow-up procedures on the aforementioned financial report to determine whether RMI has complied with the 50% matching requirement.

REPUBLIC OF THE MARSHALL ISLANDS

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Subrecipient Monitoring

Finding No. 2005-13

| Program | Reason for Questioned Costs | Questioned Costs |
|--|---|------------------|
| U.S. Department of the Interior / Enewetak Food and Agricultural Support Program / CFDA # 15.875 | <p><u>Criteria:</u> OMB's "Questions and Answers on the Single Audit provisions of OMB Circular A-128", question number twenty-three states that prime recipients of federal funding are expected to establish a system to assure that audits of subrecipients meet the requirements of Circular A-128 and such a system should include a desk review of each subrecipient report to ensure it conforms to A-128.</p> <p><u>Condition:</u> The following questioned costs of subrecipients remain unresolved for more than six months after issuance of the audit reports.</p> <p><u>Enewetak/Ujelang Local Government Food Program</u></p> <p>Fiscal Year 2003</p> <p>Details of the above questioned costs are contained in the separately issued report of the subrecipient.</p> <p>In addition, A-128/A-133 audits of the following subrecipients have not yet been released for the noted fiscal years.</p> <p>Enewetak/Ujelang Local Government: 1992 and 2000 - 2004 Kili/Bikini Local Government: 2001 - 2004 Kwajalein Atoll Development Authority: 2003 Kwajalein Atoll Joint Utilities Resources, Inc.: 2004 Marshall Islands Development Bank: 2002 - 2004 Ministry of Education Head Start Program: 2002 - 2004 Rongelap Atoll Local Government: 1991, 1992, 2003 and 2004 Utrik Atoll Local Government: 1992, 1994, 2003 and 2004</p> <p>Due to the unavailability of these reports, the questioned costs relating to this condition cannot presently be determined.</p> <p><u>Cause:</u> The cause of the above condition is the lack of timely resolution of questioned costs by RepMar as the primary recipient of the funding.</p> <p><u>Effect:</u> The effect of the above condition is the possibility of disallowed costs.</p> <p><u>Recommendation:</u> We recommend that RepMar establish procedures to ensure timely follow-up of questioned costs for subrecipients.</p> <p><u>Prior Year Status:</u> Monitoring of subrecipients was reported as a finding in the Single Audits of RepMar for fiscal years 1988 through 2004.</p> <p><u>Auditee Response and Corrective Action Plan:</u> In a letter dated June 23, 2006, the Ministry of Finance provided the following response.</p> <p>We agree with the finding and recommendation. Our corrective action plan will involve the Ministry of Finance through Jefferson Barton, the Secretary of Finance and the Chairman of the Audit Resolutions Committee, to regularly meet with the Audit Resolutions Committee and sub recipients to develop procedures in monitoring and addressing the sub recipients' questioned costs. Our anticipated completion date of our corrective action plan is on September 30, 2006.</p> | \$ 1,125,696 |

REPUBLIC OF THE MARSHALL ISLANDS

Unresolved Prior Year Questioned Costs
Year Ended September 30, 2005

Questioned Costs

The prior year Single Audit report on compliance with laws and regulations noted the following questioned costs and comments that were unresolved at September 30, 2005:

| | <u>Questioned Costs</u> | | <u>Total</u> |
|--|-------------------------|---------------------|----------------------|
| | <u>RepMar</u> | <u>Subrecipient</u> | |
| Questioned costs of RepMar as previously reported: | | | |
| Fiscal year 2001 Single Audit | \$ 298,948 | \$ 4,075,962 | \$ 4,374,910 |
| Fiscal year 2002 Single Audit | 644,666 | 571,126 | 1,215,792 |
| Fiscal year 2003 Single Audit | 873,325 | 4,498,234 | 5,371,559 |
| Fiscal year 2004 Single Audit | <u>1,128,841</u> | <u>3,523,507</u> | <u>4,652,348</u> |
| | 2,945,780 | 12,668,829 | 15,614,609 |
| Less questioned costs resolved in fiscal year 2005: | | | |
| Questioned costs of fiscal year 2001 Single Audit (1) | (298,948) | (4,075,962) | (4,374,910) |
| Questioned costs of fiscal year 2002 Single Audit (1) | (644,666) | (571,126) | (1,215,792) |
| Questioned costs of fiscal year 2003 Single Audit (2) | <u>(135,198)</u> | <u>(34,215)</u> | <u>(169,413)</u> |
| | 1,866,968 | 7,987,526 | 9,854,494 |
| Questioned costs of fiscal year 2005 Single Audit | <u>1,026,150</u> | <u>1,125,696</u> | <u>2,151,846</u> |
| Unresolved questioned costs of RepMar at September 30, 2005 | \$ <u>2,893,118</u> | \$ <u>9,113,222</u> | \$ <u>12,006,340</u> |

- (1) OMB Circular A-133, Section .315(b)(4) - questioned costs resolved as RepMar considers these findings are no longer valid as they were reported to federal agencies on October 14, 2003, which is in excess of the two year threshold.
- (2) Questioned costs considered resolved as RepMar received a final determination letter from the U.S. Department of Education.

Unresolved Findings

The status of unresolved findings is discussed in the Schedule of Findings and Questioned Costs section of this report (pages 14 through 36).