

# **Diagnostic Study of Accounting and Auditing Practices in the Marshall Islands**

Prepared Under Regional Technical Assistance (RETA)  
5980: *Diagnostic Study of Accounting and Auditing Practices  
in Selected Developing Member Countries*

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## Preface

**T**his report was prepared under Regional Technical Assistance (RETA) 5980: *Diagnostic Study of Accounting and Auditing Practices in Selected Developing Member Countries* for the Asian Development Bank by Francis B. Narayan, Lead Financial Management Specialist, ADB; Sarath Lakshman Athukorala, Financial Management Specialist, ADB; Barry C. Reid, Consultant, ADB; and Aileen H. Pangilinan, Research Assistant.

This report describes accounting and auditing arrangements in the Republic of the Marshall Islands (RMI), identifies deficiencies in those arrangements, and presents recommendations to address those deficiencies. It is part of the ADB series of country Diagnostic Studies of Accounting and Auditing (DSAAAs). In 2000, DSAAAs were completed and published for Cambodia, Mongolia, Pakistan, Papua New Guinea, People's Republic of China, Uzbekistan, and Viet Nam. In 2001-02, DSAAAs were prepared for five further countries, including RMI.

The contents of the draft report were discussed and debated with representatives from the government, the private sector and international organizations at a workshop held at Majuro on 11 October 2001. The issues and recommendations were further discussed at an international workshop at ADB headquarters in Manila on 5-6 March 2002.

This report should be read in conjunction with the Summary Report, which identifies and examines selected issues in relation to accounting and auditing.<sup>1</sup>

The authors would like to offer their appreciation to the officials and agencies that gave up their valuable time and made materials available during the course of the research. In particular, we would like to thank: Tilak Sen (Senior Programs Officer, ADB) and Saeko Shoniber (Secretary for Finance) for their ongoing support; Robert Y. Siy Jr. (Director, ADB Pacific Operations Division) for moderating the Manila workshop session at which this report was discussed; and Erma W. Myazoe (Chief Accountant, Accounting Division, Ministry of Finance) and Franklin Henry (Federal Grants Coordinator, Budget Division, Ministry of Finance) for their representation at the Manila conference.

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<sup>1</sup> ADB. 2002. *Accounting and Auditing Issues in Selected Developing Member Countries: A Diagnostic Study of Azerbaijan, Fiji Islands, Marshall Islands, Philippines and Sri Lanka*. Manila: ADB.

For further information, please visit ADB's website at [www.adb.org](http://www.adb.org) or contact:

Sarath Lakshman Athukorala  
Financial Management Specialist  
Asian Development Bank  
6 ADB Avenue  
Mandaluyong City, Metro Manila  
P. O. Box 789  
0980 Manila, Philippines

Tel. (632) 632-6626  
Fax: (632) 636-2365  
E-mail: [slathukorala@adb.org](mailto:slathukorala@adb.org)

## ADB Diagnostic Studies of Accounting and Auditing

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**T**he Asian Development Bank (ADB) publishes this series to: (i) provide reference materials on accounting and auditing for government officials, ADB officials, officials from other donor agencies, and other interested parties; (ii) identify potential actions that the participating government can take to rectify weaknesses, in partnership with donor agencies where appropriate, and (iii) provide the participating country with a benchmark against which to measure their progress in improving financial management and governance arrangements.

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### Summary Reports

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Accounting and Auditing Practices in Selected Developing Member Countries (DMCs): A Diagnostic Study of Azerbaijan, Fiji Islands, Marshall Islands, Philippines and Sri Lanka. 2002.

Financial Management and Governance Issues in Selected Developing Member Countries (DMCs): A Study of Cambodia, People's Republic of China, Mongolia, Pakistan, Papua New Guinea, Uzbekistan, and Viet Nam. 2000.

### Individual Reports: By ADB Region

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All ADB DMCs are listed by region. Economies for which a DSAA has been prepared are bolded and the year of publication is shown in brackets:

East and Central Asia: **Azerbaijan** (2002); **People's Republic of China** (2000); Hong Kong, China; Kazakhstan; Kyrgyz Republic; Republic of Korea; **Mongolia** (2000), Tajikistan; Taipei, China; Turkmenistan; and **Uzbekistan** (2000).

Mekong: **Cambodia** (2000), Lao People's Democratic Republic, Myanmar; Thailand, **Viet Nam** (2000).

Pacific: Cook Islands, Democratic Republic of East Timor, **Fiji Islands** (2002), Kiribati, Republic of the **Marshall Islands** (2002), Federated States of Micronesia, Nauru, **Papua New Guinea** (2000), Samoa, Solomon Islands, Tonga, Tuvalu, Vanuatu.

South Asia: Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, **Pakistan** (2000), **Sri Lanka** (2002).

Southeast Asia: Indonesia, Malaysia, **Philippines** (2002), Singapore.

## **CURRENCY EQUIVALENTS**

The RMI unit of currency is the US dollar.

## **ABBREVIATIONS**

ADB	Asian Development Bank
AICPA	American Institute of Certified Public Accountants
AMI	Air Marshall Islands
APIPA	Association of Pacific Islands Public Auditors
AusAID	Australian Agency for International Development
BCC	Budget Coordinating Committee
BoMI	Bank of the Marshall Islands
CA	Chartered Accountant
CAFR	Comprehensive Annual Financial Report
CAP	Country Assistance Plan
CAPA	Confederation of Asian and Pacific Accountants
CFA	Compact of Free Association
CFAA	Country Financial Accountability Assessment
CIDA	Canadian International Development Agency
CMI	College of the Marshall Islands
CPA	Certified Public/Practising Accountant
CPE	Continuing Professional Education
DMC	Developing Member Country
DOI	US Department of the Interior
DSAA	Diagnostic Study of Accounting and Auditing
ED	Exposure Draft
EPPSO	Economic Policy, Planning and Statistics Office
FASAB	US Federal Accounting Standards Advisory Board
FASB	US Financial Accounting Standards Board
FATF	Financial Action Task Force on Money Laundering
FFMRP	Fiscal and Financial Management Reform Program
FSM	Federated States of Micronesia
GAAP	Generally Accepted Accounting Principles
GAGAS	US Generally Accepted Government Auditing Standards
GAO	US General Accounting Office
GASAC	US Governmental Accounting Standards Advisory Council
GASB	US Government Accounting Standards Board
GATS	General Agreement on Trade in Services
GDP	Gross Domestic Product

GNP	Gross National Product
IAASB	International Auditing and Assurance Standards Board
IAPC	International Auditing Practices Committee
IAPS	International Auditing Practice Statement
IAS	International Accounting Standard
IASB	International Accounting Standards Board
IASC	International Accounting Standards Committee
IEG	International Education Guideline
IES	International Education Standard
IFAC	International Federation of Accountants
IIA	Institute of Internal Auditors
IMF	International Monetary Fund
INCOSAI	International Conference of Supreme Audit Institutions
INTOSAI	International Organization of Supreme Audit Institutions
IOSCO	International Organization of Securities Commissions
IPSAS	International Public Sector Accounting Standard
ISA	International Standard on Auditing
ISAR	Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting of the UNCTAD
JBIC	Japan Bank for International Cooperation
JICA	Japan International Cooperation Agency
KADA	Kwajalein Atoll Development Authority
KAJUR	Kwajalein Authority Joint Utility Resource
MD&A	Management's Discussion and Analysis
MIDA	Marshall Islands Development Authority
MIDB	Marshall Islands Development Bank
MIITF	Marshall Islands Intergenerational Trust Fund
MISSA	Marshall Islands Social Security Administration
MIVA	Marshall Islands Visitors Authority
MOF	Ministry of Finance
MOHE	Ministry of Health and Environment
MTBF	Medium-Term Budget Framework
NCCT	Non-Cooperative Country or Territory
NES	National Economic Summit
NFRM	New Financial Reporting Model
NTA	National Telecommunications Authority
NZODA	New Zealand Overseas Development Assistance
OAG	Office of the Auditor-General
OECD	Organisation for Economic Cooperation and Development

OIDA	Office of International Development Assistance
OPS	Office of Planning and Statistics
PDMC	Pacific Developing Member Country
PFTAC	Pacific Financial Technical Assistance Center
PIER	Pacific Islands Economic Report
PITI	Pacific Islands Training Initiative
PSC	Public Sector Committee
PSE	Private Sector Enterprise
PSRP	Public Sector Reform Program
RETA	Regional Technical Assistance
RMI	Republic of the Marshall Islands
ROSC	Report on the Observance of Standards and Codes
RSI	Required Supplementary Information
SAI	Supreme Audit Institution
SOE	State-Owned Enterprise
SPASAI	South Pacific Association of Supreme Audit Institutions
TA	Technical Assistance
TTPI	Trust Territory of the Pacific Islands
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
US	United States
USAID	United States Agency for International Development
USP	University of the South Pacific
WTO	World Trade Organization

## Notes

- ( i ) The fiscal year of the Government ends on 30 September. ‘FY’ before a calendar year denotes the year in which the fiscal year ends.
- ( ii ) In this report, \$ refers to US dollars.

# Contents

EXECUTIVE SUMMARY .....	1
I. INTRODUCTION .....	7
1. Study Background .....	7
2. Objectives .....	7
3. Scope .....	8
4. Country Case Studies and Workshop .....	8
5. The Republic of Marshall Islands (RMI) .....	9
6. ADB Focus on RMI Financial Governance .....	17
7. International Guidelines and Surveillance .....	19
8. Report Structure .....	20
II. ACCOUNTING AND AUDITING IN RMI .....	21
Part One. Accounting .....	22
1. Introduction .....	22
2. Issues and Responses since 1986 .....	22
3. The ‘Marshallese Accounting System’ .....	23
4. Bookkeepers and Accountants .....	25
Part Two. Auditing .....	25
5. Introduction .....	25
6. Audit Requirements .....	26
7. Auditor Qualifications .....	27
8. Office of the Auditor-General (OAG) .....	27
9. Accounting and Auditing Firms .....	30
10. Issue Synopsis: Accounting and Auditing Arrangements .....	30
III. PROFESSIONAL INFRASTRUCTURE .....	31
1. Introduction .....	31
2. Components of a Professional Accounting Qualification .....	31
3. Issue Synopsis: Professional Infrastructure .....	32
IV. ACCOUNTING AND AUDITING STANDARDS .....	33
Part One. Accounting Standards .....	34
1. Introduction .....	34
2. Legal Status of US GAAP in RMI .....	34

3.	An Overview of US GAAP .....	34
4.	US GAAP for Nongovernment Entities .....	35
5.	Comparison with International Accounting Standards .....	35
6.	US GAAP for Government Entities .....	37
7.	Implementing the New Financial Reporting Model .....	37
	Part Two. Auditing Standards .....	44
8.	Introduction .....	44
9.	Legal Status of US GAAS in RMI .....	44
10.	US GAAS for Nongovernment Audits .....	44
11.	Generally Accepted Government Auditing Standards .....	44
12.	Issue Synopsis: Accounting and Auditing Standards .....	45
V.	ACCOUNTING AND AUDITING TRAINING .....	47
1.	Introduction .....	47
2.	International Guidance on Accountancy Education .....	48
3.	Educational Legislation and Coordination .....	49
4.	RMI Scholarship Grant and Loan Board .....	50
5.	Education and Training Institutions .....	50
6.	Other Externally-Supported Training Initiatives .....	55
7.	ADB Experience with Pacific Capacity Building .....	57
8.	Issue Synopsis: Accounting and Auditing Training .....	58
VI.	GOVERNMENT BUDGETING AND ACCOUNTING .....	59
1.	Introduction .....	59
2.	Legal and Institutional Framework and Roles .....	62
3.	Budget Documentation and Process .....	63
4.	Accounting Basis and Accounting Information Systems .....	64
5.	Government Accounting Personnel .....	64
6.	The Fiscal and Financial Management Reform Program (FFMRP) .....	65
7.	Issue Synopsis: Government Budgeting and Accounting .....	70
VII.	DONOR ASSISTANCE .....	73
1.	Overview .....	73
2.	Coordination Mechanisms .....	75
3.	Asian Development Bank .....	75
4.	World Bank .....	80
5.	United Nations Development Programme (UNDP) .....	81

6. International Monetary Fund (IMF) .....	81
7. United States .....	82
8. Taipei, China .....	82
9. Australia (AusAID) .....	82
VIII. ISSUES AND RECOMMENDATIONS .....	83
Part One. Where Donor Assistance Might be Appropriate .....	84
1. Recruit Qualified Accountants to Support Financial Management Improvements .....	84
2. Introduce Bookkeeping and Accounting Manuals .....	84
3. Establish Bookkeeping and Accountancy Certifications .....	85
Part Two. Where External Assistance is Not Required .....	86
4. Defer Implementing the New Financial Reporting Model .....	86
5. Raise the Priority of Scholarships for Accountancy .....	87
6. Strengthen the Auditor-General's Independence .....	88
7. Clarify Laws Regarding Auditor Qualifications .....	88
8. Clarify Laws Regarding Accounting Standards .....	88
9. Clarify Laws Regarding Auditing Standards .....	89
IX. MAIN DEFICIENCIES AND ACTION PLAN .....	91
REFERENCES .....	93

## Appendixes

Table of Appendixes .....	97
Appendix 1. Useful Internet Sites .....	99
Appendix 2. Interviewees .....	102
Appendix 3. RETA-5980 (Regional Study) Information .....	103
Appendix 4. Key Governing Laws and Regulations: Public Sector .....	105
Appendix 5. Key Governing Laws and Regulations: Private Sector .....	108
Appendix 6. The Guam Chapter of AICPA .....	110
Appendix 7. Guidelines on Professional Arrangements .....	115
Appendix 8. US Accounting Standard-Setting Bodies .....	120
Appendix 9. US GAAP for Nongovernment Entities .....	121
Appendix 10. International Accounting Standards .....	124

Appendix 11.	US GAAP for Government Entities .....	125
Appendix 12.	International Standards on Auditing .....	129
Appendix 13.	Generally Accepted Government Auditing Standards (GAGAS) .....	131
Appendix 14.	College of the Marshall Islands (CMI): Courses .....	134
Appendix 15.	USP: Undergraduate Accountancy Courses .....	138
Appendix 16.	USP: Postgraduate Accountancy Courses .....	141
Appendix 17.	USDA PITA: Sample Training Curriculum .....	143
Appendix 18.	Relevant Extracts from the RMI Constitution .....	145
Appendix 19.	Extracts from the Compact of Free Association .....	150

# Executive Summary

## Background

**T**he Republic of the Marshall Islands (RMI) has a population of 51,600. It is situated in the Central Pacific Ocean, between Hawaii and Papua New Guinea. Like several other smaller Pacific countries, RMI is remote from major markets, deficient in both the quality and quantity of land resources, and acutely short of skilled labor, although it does possess potentially rich marine resources built on fish and seabed minerals.

In 1986—after about four decades as a US-administered United Nations (UN) Trust Territory—RMI became a freely associated state with the US, through a Compact of Free Association (CFA). Since then, RMI has received considerable economic and technical assistance from the US. However, the first 15-year CFA expired in September 2001 and a new Compact is currently under negotiation.

In the past 15 years, RMI has made significant progress in developing infrastructure but the economy has been largely stagnant—although GDP increased by 17 percent from 1986 to 1999, the population increased by 35 percent at the same time; the net effect was a decline in per capita income of about 12 percent.

## Challenges and Responses

RMI faces intense internal and external pressures regarding financial governance arrangements. Particular attention focuses on the prudence and effectiveness of government policies and accountability arrangements during the first 15-year CFA period (1986-2001).

Financial governance challenges include: (i) the need to improve basic public sector record-keeping, internal controls and accountability; (ii) addressing low levels of efficiency in public service, weak government financial management, and a slow buildup of funds in the Marshall Islands Intergenerational Trust Fund (MIITF); (iii) renegotiating a favorable and effective CFA with the US; and (iv) being removed from the Financial Action Task Force on Money Laundering (FATF) list of Non-Cooperative Countries or Territories (NCCT) with regards to money laundering.

In response to these challenges, the Government has recently prepared *Vision 2018*, a strategic development framework for the second CFA period (2003-2018). *Vision 2018* sets 10 national goals and objectives, and presents broad strategies to meet them. It recognizes that sound financial manage-

ment is essential to achieving and monitoring progress towards the Government's goals.

## **Accounting and Auditing in RMI**

The 1979 *Constitution* prescribes rights and governance structures; it also sets out high-level budgetary arrangements and establishes the position of Auditor-General. Private sector accounting laws are largely modeled on US corporate laws.

The private sector operates on the accrual basis of accounting. Government accounting is currently on a modified accrual accounting basis, but accounting standards require that the Government move to full accrual accounting starting with the financial year beginning on 1 October 2002.

There is an acute shortage of qualified bookkeepers and accountants in both the public and the private sectors—as of October 2001 there were no professionally qualified Marshallese accountants in RMI. This gap is only partly bridged by foreign Certified Public Accountants (CPAs) employed within the private sector and in government.

RMI laws and regulations are reasonably clear about financial reporting requirements and timeframes. However, public sector financial reports are often years overdue. Furthermore, they are sometimes unauditable due to deficiencies in basic record-keeping and internal control arrangements. To this end, efforts have been made to improve the timeliness of financial reports, but more remains to be done.

The Auditor-General—head of the Office of the Auditor-General (OAG)—is appointed by the President, with the approval of the *Nitijela* (Parliament). Appointees to this position must either have a professional accounting qualification (with practical experience) or have extensive relevant knowledge and experience. With just seven staff, the OAG faces severe resource constraints. In this respect, the Auditor-General's independence could be strengthened.

## **Professional Infrastructure**

There are no professionally qualified Marshallese accountants in RMI; nor is there a professional accountancy body. In contrast, RMI law recognizes and regulates other professions and occupations including health care providers, nurses, land surveyors, notaries public, and the legal profession.

## **Accounting and Auditing Standards**

RMI directly uses US Generally Accepted Accounting Principles (GAAP) for accounting standards. US GAAP—as applied to the nongovernmental (private) sector—represents a detailed framework of principles largely based on accounting standards and guidance issued by the US Financial Accounting Standards Board (FASB). The requirement to report in accordance with US GAAP is enshrined in RMI law (although some laws are ambiguous or silent on this point). US GAAP, as applied to the nongovernmental sector, is largely consistent with International Accounting Standards (IASs).

US GAAP, as applied to the government sector, is based on statements issued by the Government Accounting Standards Board (GASB). Hence, RMI government financial statements must comply with GASB's new financial reporting model (NFRM) starting with the financial year that begins on 1 October 2002. Among other things, this will involve the introduction of full accrual accounting. It also has significant implications for budgetary documentation, accounting arrangements, accounting systems and financial reporting. However, (i) NFRM implementation activities will coincide with the introduction of new computerized information systems and changes brought about by the Fiscal and Financial Management Reform Program (FFMRP); (ii) NFRM budgetary requirements will potentially conflict with those designed as part of the FFMRP; and (iii) comparative implementation progress lags other countries and jurisdictions that have implemented accrual accounting.

RMI audits must be conducted in accordance with US auditing standards. This requirement is enshrined in RMI law with regards to government auditing. However, in relation to nongovernmental auditing, RMI law varies and can be ambiguous or silent on auditing standards.

## **Education and Training**

The Marshallese education system faces funding pressures. Moreover, RMI's 4 percent birthrate is the Pacific region's highest creating further pressures. Finally, as of 2001, nearly half RMI teachers have secondary school diplomas as their highest qualification. Consequently, basic educational attainment levels are comparatively low—particularly in mathematics and English, subjects that are vital for developing accountancy skills.

Two post-secondary educational institutions offer accountancy courses: the College of the Marshall Islands (CMI) and the University of

the South Pacific (USP). However, very few accountancy students graduate from these institutions, or from other universities. In addition, the Graduate School (US Department of Agriculture, USDA) offers training in accounting and financial management, through the Pacific Islands Training Initiative (PITI). ADB and other donors support a range of other capacity-building initiatives.

## **Government Budgeting and Accounting**

The public sector dominates the RMI economy. The national and local governments not only provide an important share of formal employment, but also own and control a large number of corporations and statutory bodies. Many government holdings have been corporatized over the years, and subsidies have been successfully reduced or eliminated in many cases, but public sector dominance of the economy remains.

The ADB-supported Public Sector Reform Program (PSRP), which began in 1997, targeted several economic policy issues. Program achievements included reducing the government payroll by 30 percent, privatizing domestic shipping services, streamlining Foreign Investment Board License applications, and establishing the MIITF to stabilize budget receipts.

Despite these measures, several issues remain, including low efficiency in the public service, weak government financial management, and a slow buildup of funds in the MIITF. RMI's fiscal problems can be directly linked to deficiencies in budgeting and financial management systems that are unable to handle the huge grants forthcoming from the CFA. The budget format provides little information on government expenditure patterns, which limits the Government's ability to make informed decisions about funding priorities and the public's ability to question these spending decisions. The budget is prepared with only the most basic projections on revenues, expenditures, and information on past expenditure trends.

The acute shortage of qualified bookkeepers and accountants in government cannot be overemphasized. Poor record-keeping, inadequate internal controls and financial management are symptomatic of this underlying problem.

A new RMI government was elected in January 2000. It recognized that many current problems are linked to public financial management deficiencies. In response, the Government and ADB developed the FFMRP. The FFMRP, while stabilizing the immediate fiscal situation, aims primarily at longer-term issues of improving overall RMI financial management.

The specific objectives are to (i) ensure a sustainable income flow for future generations, (ii) strengthen public sector financial and economic management, (iii) stabilize the fiscal position, (iv) enhance the policy environment for private sector development to maximize the benefits from future Compact assistance, and (v) increase the effectiveness of the public service. The FFMRP will also improve the annual budget format to internationally accepted practices, improve financial control mechanisms, accounting and reporting systems, and develop a medium-term framework for planning and performance evaluation.

### **Donor Assistance**

RMI relies heavily on foreign assistance with US aid estimated at about \$80 million per annum. This includes direct budgetary support under the CFA to the national government and to the Kwajalein Atoll Development Authority (KADA), and payments to Kwajalein landowners, as well as other forms of assistance through US Federal Government programs.

ADB plays a significant role in improving financial management arrangements. Two program loans have supported fundamental government financial management reforms. Other loans have been provided to support education reforms. Furthermore, ADB has provided around a dozen advisory and capacity-building technical assistance (TA) grants in the financial management field.

### **Issues and Recommendations**

This DSAA identifies issues and presents recommendations associated with gaps or weaknesses in accounting and auditing arrangements. These recommendations are intended to supplement and support existing strategies and projects, particularly *Vision 2018* and the FFMRP. Where actions are already planned or underway (e.g., upgrading information systems), no recommendations are made. Issues are separated into: (i) those that can be resolved without the need for external assistance; and (ii) those that can better be resolved with external assistance.

Recommendations are made regarding legal changes to remove legal ambiguities and inconsistencies, clarify the status of accountants and auditors, and clarify the application of accounting and auditing standards. The Study also recommends deferring implementation of the NFRM, preparing bookkeeping and accounting manuals, and strengthening the Auditor-General's independence.

But the key constraint is the shortage of qualified bookkeepers and accountants. Improving financial management arrangements is impossible without them.

- In the **long term** (10-30 years), this will require an education system that produces numerate, literate and technologically-skilled students. Tertiary and vocational education would supplement this foundation with specialist financial management knowledge. *Vision 2018* and Ministry of Education initiatives intend to address this issue.
- In the **medium term** (three to 10 years), a cadre of Marshallese accountants must be established. To this end, several mutually-supporting recommendations are made regarding professional status and training, i.e., that professional bookkeeping and accountancy certifications be established, preferably as a Pacific-wide initiative.
- In the **short term** basic record-keeping and internal control inadequacies must be addressed, and *Vision 2018* and the FFMRP must be effectively implemented. This cannot be done with existing or planned resources. This report recommends that at least six suitably qualified and skilled accountants be recruited to work with the Ministry of Finance (MOF) and other agencies to develop counterpart capacity, resolve existing problems and support the implementation of the FFMRP and *Vision 2018*.

# I. Introduction

## 1. Study Background

**T**he 1997-1998 Asian financial crisis exposed structural weaknesses in the banking and corporate sectors of affected countries owing largely to poor governance, a lack of transparency, and weak supervision and regulation.<sup>2</sup>

The Asian Development Bank (ADB) has been taking a number of initiatives to assist Developing Member Countries (DMCs) to overcome these structural problems. The focus on improved governance includes enhancing the effectiveness of public administration and development management at the sector level and in national institutions. Where appropriate, institutional development of the local and provincial agencies and the private sector is also covered. A sound regulatory financial framework and its enforcement, capable institutions, skilled human resources, and effective monitoring and supervision are important prerequisites to an efficient financial structure.

In 2000, under ADB Regional Technical Assistance (RETA) 5877<sup>3</sup>, Diagnostic Studies of Accounting and Auditing (DSAAs) were prepared and published for Cambodia, Mongolia, Pakistan, Papua New Guinea, People's Republic of China, Uzbekistan, and Viet Nam. ADB approved RETA 5980—*Diagnostic Study of Accounting and Auditing Practices in Selected DMCs*<sup>4</sup>—for the purpose of carrying out initial studies to identify gaps and weaknesses in accounting and auditing arrangements and to recommend corrective courses of action. It extends the work conducted under RETA 5877.

## 2. Objectives

ADB has demonstrated its stand on the importance of good governance, through effective financial management, for sustained economic development. This RETA involved a diagnostic review of the existing

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<sup>2</sup> Zhuang, Juzhong, David Edwards, David Webb, and Ma. Virginita Capulong. 2000. *Corporate Governance and Finance in East Asia: A Study of Indonesia, Republic of Korea, Malaysia, Philippines, and Thailand*. Manila: ADB.

<sup>3</sup> *Strengthening Financial Management and Governance in Selected DMCs*.

<sup>4</sup> For \$230,000 approved on 20 March 2001.

accounting and auditing support and standards available in the selected DMCs. After carrying out this diagnostic review, the study assessed the need for assistance to improve the current situation. Objectives were to:

- (i) assess the capability and capacity within each country to provide efficient and effective accounting and auditing support to meet international standards and best practices and address the issue of training and capacity enhancement
- (ii) determine the existing accounting and auditing standards of each selected country
- (iii) assess the degree of deviation from International Accounting and Auditing Standards while identifying weaknesses and possible corrective options
- (iv) discuss the fieldwork findings and introduce the concepts of the international standards through workshops, and
- (v) determine the level and type of assistance needed by each country in order to provide acceptable accounting and auditing support to the private and public sectors.

### **3. Scope**

The RETA involved an indepth study of the key issues relating to accounting and auditing support in the selected DMCs, identified gaps and weaknesses that need to be addressed to improve accounting and auditing support, and developed assistance programs in collaboration with other donors to rectify the identified weaknesses. RMI was one of four countries that participated in the RETA.

### **4. Country Case Studies and Workshop**

The first part of the study examined the current accounting and auditing structure and systems in RMI. It also: (i) analyzed the political, institutional, and regulatory and legal framework on accounting and auditing practice and the level of enforcement of existing laws, rules and regulations; (ii) identified gaps and weaknesses in accounting and auditing support and deviations from international standards; and (iii) identified alternative options to remedy the identified weaknesses, with the objective of eventually eliminating them.

The second part of this study disseminated the country-research findings through in-country workshops. Each workshop provided a cross-section of views on the research findings and established ways to improve

financial management and governance in the country. After carrying out the assessment of accounting and auditing support in RMI, the study findings and recommendations were discussed at a workshop in Majuro on 11 October 2001, and at an international workshop at ADB Headquarters in Manila on 5-6 March 2002. This report incorporates feedback from both workshops. Appendix 3 provides further information on the Majuro workshop.

## **5. The Republic of Marshall Islands (RMI)**

### **General<sup>5</sup>**

RMI is situated in the Pacific Ocean, midway between Hawaii and Papua New Guinea. The total land area of RMI's more than 1,000 islands, atolls and reefs is 181 sq km—about the same size as Washington DC. The islands are grouped into two main chains—Ratak in the east and Ralikin in the west—that run from north to south across 1,942,500 sq km of the Central Pacific Ocean.

RMI's population of 51,600 is concentrated in Majuro and Ebeye, the two main urban centers. Marshallese (76 percent) comprise the majority of the predominantly Christian population and most people speak Marshallese and English. Little is known of the origin of the first Micronesian navigators who arrived sometime between 500 and 2000 BC. For many years, RMI was controlled by foreign powers, including Germany (1885–1914), Japan (1914–1944), and the United States (US)(1944–1986). The Japanese developed infrastructure and the US established governmental and educational institutions. Not surprisingly, RMI political and financial governance arrangements are primarily of US origin.

After World War II, the United Nations (UN) established the US-administered Trust Territory of the Pacific Islands (TTPI) comprising the Marshall Islands, the Caroline Islands (now the Federated States of

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<sup>5</sup> Primary Sources:

- ADB. 2001 May. *Report and Recommendation of the President to the Board of Directors on Proposed Loans and Technical Assistance Grant to the Republic of the Marshall Islands for the Fiscal and Financial Management Program*. RRP: RMI 345040. pp. 1-2.
- ADB. 2001. *Asian Development Outlook 2001*. Manila: ADB. pp. 139-140.
- Central Intelligence Agency (CIA). 2000. *The World Factbook 2000: Marshall Islands*. [www.cia.gov/cia/publications/factbook/geos/rm.html](http://www.cia.gov/cia/publications/factbook/geos/rm.html)
- Galbraith, Kate. 2000 September. *Micronesia*. 4th edition. Lonely Planet Publications.
- Marshall Islands Visitors Authority (MIVA). 2001 May. *Guidebook*. MIVA.

Micronesia, FSM) and the Northern Mariana Islands. In 1982, the US and RMI signed a Compact of Free Association (CFA). The CFA came into effect in 1986 when the UN Trusteeship was terminated. The 1979 National Constitution provides for a parliamentary system with legislative, executive and judiciary branches. RMI's political structure is a blend of the US and British systems of government. Legislative power is vested in the House of Representatives (the *Nitijela*). In addition, the traditional Council of Chiefs (*Iroij*) acts as a consultative body that may request reconsideration of any bill affecting customary law, particularly if it relates to land tenure.

During the Trust period, the US was given permission to use the TTPI for military purposes. A naval base was established on Kwajalein atoll, which was later developed as a missile test site as part of the US global system for intercontinental ballistic missiles. Since 1947, the base has employed 300–800 Marshallese who received US-equivalent wages. In the period up to 1986, a small cadre of Marshallese was educated and employed in Majuro, again at US-equivalent wages.

Since the CFA became effective in 1986, RMI has received considerable economic and technical assistance from the US. Although containing specific provisions on bilateral relations, foreign affairs, immigration, defense and environmental protection, the CFA principally revolves around: (i) economic assistance, both grant and program assistance, together with trade and taxation provisions; and (ii) compensation payments (associated with research, medical, agricultural and food programs) for using RMI's territory in the 1940s and 1950s for nuclear tests carried out on the Bikini, Enewetak, Rongelap and Utrik atolls, and for continuing US military operations on Kwajalein atoll. Total CFA payments declined from 70 percent of gross domestic product (GDP) in the late 1980s to below 50 percent in 2001. The first 15-year CFA period expired in September 2001—a new CFA is currently being negotiated.

RMI exports fish, coconut oil and trochus shells. Imports include foodstuffs, machinery and equipment, fuels, beverages, and tobacco. Its major trading partners are Australia, Guam, Japan, New Zealand, Singapore, and the US. Table 1 presents key indicators for RMI and for other selected countries.

Table 1: Key Indicators for Selected ADB DMCs<sup>6,7</sup>

Indicator	RMI	Azerbaijan	Fiji	Philippines	Sri Lanka
<b>General</b>					
Population ( <i>thousands</i> , 2000)	52	8,049	811	78,400	19,359
Population density ( <i>people per km<sup>2</sup></i> , 2000)	282	93	44	263	295
Urban population ( <i>% of total</i> , 2000)	71.9	57.3	42.3	58.6	23.6
Average annual population growth rate ( <i>%, 1995-2000</i> )	1.5	1.0	1.1	2.2	1.3
<b>Social</b>					
Under-five mortality rate ( <i>per 1000</i> , 1999)	63.0	16.0	18.0	31.0	15.0
Life expectancy at birth ( <i>years</i> , 1999)	65.0	71.0	67.0	69.0	74.0
Adult literacy rate ( <i>15+yr+, %, 1999</i> ):					
– Females	97.0	97	90.0	95.0	89.0
– Males	97.0	97	95.0	95.0	94.0
Population in poverty ( <i>%, 1995-99</i> )	...	68.1	25.5	40.0	26.7
Human Development Index (1999)	0.56	0.74	0.76	0.75	0.74
<b>Economic</b>					
Gross National Product (GNP) ( <i>\$million</i> , 1999)	99	3,705	1,848	77,967	15,578
GDP per capita ( <i>\$</i> , 2000)	1,890	654	1,978	959	842
GDP growth rate (%)					
– 2000	-2.3	11.4	-9.3	4.0	6.0
– 1999	0.8	7.4	9.6	3.4	4.3
– 1998	-16.0	10.6	1.4	-0.6	4.7
– 1997	-9.4	8.8	-0.9	5.2	6.3
Consumer Price Index ( <i>Annual % change</i> , 2000)	-1.9	1.9	1.1	4.4	6.2
Fiscal Balance / GDP ( <i>%</i> , 2000)	-35.5	-1.0	...	-4.2	-9.9
Total External Debt / GNP ( <i>%</i> , 1999)	...	30.0	9.3	64.8	60.3
<b>Official Development Flows</b>					
US\$ million (1999)	62.9	207.2	23.2	295.0	343.6
Dollars per capita (1999)	1,219.0	25.7	28.6	3.8	17.7
Percentage of GNP (1999)	63.5	5.6	1.3	0.4	2.2

<sup>6</sup> ADB. 2001. *Key Indicators of Developing Asian and Pacific Countries*. Volume XXXII. Manila: ADB.

<sup>7</sup> ADB. 2001. *Asian Development Outlook 2001*. Manila: ADB. pp. 139-140.

Like several smaller Pacific countries, RMI is remote from major markets, deficient in both the quality and quantity of land resources, and experiences acute skilled labor shortages, although it does possess potentially rich marine resources built on fish and seabed minerals. RMI has a dual economy: a subsistence sector coexists with a modern urban cash economy. It has limited productive potential, particularly in agriculture, while land-based investment opportunities are further constrained by a traditional land tenure system that complicates or precludes secure access to land.

## Recent Economic Trends

RMI's economy has been largely stagnant for the last 15 years: GDP increased by 17 percent from 1986 to 1999, but the population increased by 35 percent during the same period. The net effect was a per capita income decline of about 12 percent.<sup>8</sup>

In 2000, real GDP contracted by 2.3 percent after growing by 0.8 percent in 1999 (see **Figure 1**). This followed three years of recession caused by the effects of drought on agricultural and fisheries production and the short-term impacts of the adjustment process initiated by the public sector reform program (PSRP). The 1999 recovery reflected the impacts of aid-funded road works and construction, the private sector construction of a tuna-processing factory and increased onshore spending by foreign fishing crews.<sup>9</sup>

## Financial Governance: Issues and Challenges

RMI faces intense internal and external pressures regarding financial governance arrangements. Particular attention focuses on the prudence and effectiveness of government policies and accountability arrangements during the first 15-year CFA (1986-2001). This subsection identifies key issues and concludes by reviewing recent government strategies to improve national welfare and financial governance.<sup>10</sup>

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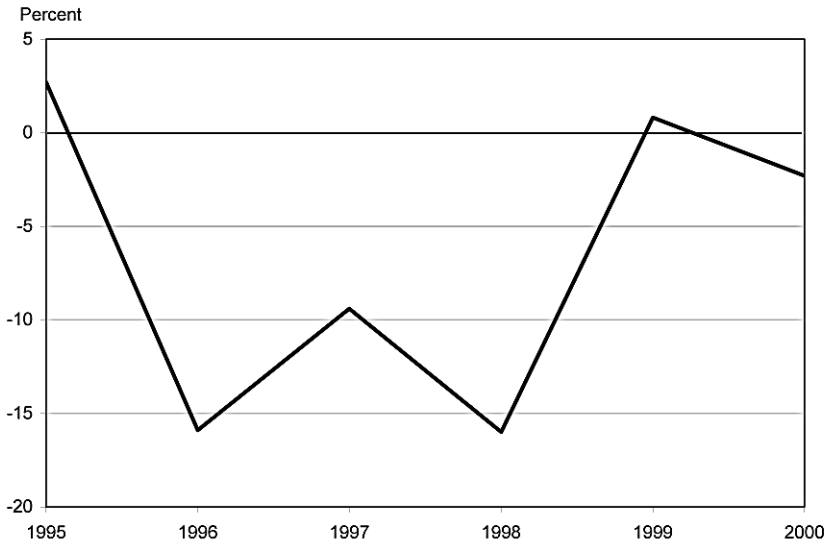
<sup>8</sup> GNP exceeds GDP by over 6 percent due to receipts of fishing license fees.

<sup>9</sup> Primary Sources:

- ADB. 2001. *Asian Development Outlook 2001*. Manila: ADB. pp. 139-140.
- ADB. 2000 December. *Country Assistance Plan: Republic of Marshall Islands*. Manila: ADB. p. 2.

<sup>10</sup> Primary Sources:

- ADB. 2001 May. Report and Recommendation of the President to the Board of Directors on Proposed Loans and Technical Assistance Grant to the Republic of the

Figure 1: Real GDP Growth, RMI, 1995-2000<sup>11</sup>

#### *Public Sector Record-keeping, Internal Controls and Reporting*

A review of audit reports on public sector financial statements makes sobering reading—the extracts cited in Box 1 are the norm rather than the exception. As such, and in contrast to ADB DSAs for other DMCs, this DSA emphasizes basic record-keeping, sound internal control arrangements and good accounting practices. In this respect it should be stressed that auditing is only a final stage in a process that relies on sound accounting arrangements.

#### *Fiscal Management and Public Sector Reform*

For many years, interest and principal payments on public sector debt consumed \$25 million to \$26 million annually (about 27 percent of GDP). In 2001, the largest bond issues were fully repaid, relieving the balance of

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Marshall Islands for the Fiscal and Financial Management Program. RRP: RMI 345040. Manila: ADB. pp. 1-2.

- ADB. 2001. *Asian Development Outlook 2001*. Manila: ADB. pp. 139-140.
- Government of RMI. 2001 June. *Vision 2018: The Strategic Development Plan Framework (2003-2018)*. Majuro.
- ADB. 2000 December. *Country Assistance Plan: Republic of Marshall Islands*. Manila: ADB. p. 2

<sup>11</sup> Source: ADB. 2001. *Asian Development Outlook 2001*. Manila: ADB. p. 140.

payments and providing opportunities for fiscal stabilization. The future fiscal position depends on the outcome of the second CFA negotiations.

**Box 1: RMI Audit Report Extracts<sup>12</sup>**

“The general purpose financial statements ... do not include: the Marshall Islands Scholarship, Grant and Loan Board; the National Environmental Protection Agency; Air Marshall Islands, Inc.; the Marshall Islands Development Bank; the Marshall Islands Alternative Energy Company, Inc.; the Marshall Islands Drydock, Inc.; the Marshall Islands Marine Resources Authority; and the College of the Marshall Islands; which, in our opinion, should be included to conform with accounting principles generally accepted in the United States of America. The entities comprising these material omitted funds were not able to produce financial statements and the effect on the general purpose financial statements is unknown.” p. 1.

“Because of inadequacies in the accounting records and in the internal control over financial reporting, we were unable to form an opinion regarding cash and cash equivalents, receivables, inventories, fixed assets, accounts payable, other liabilities and accruals, and revenues and expenses of Kwajalein Atoll Joint Utilities Resources, Inc. (KAJUR).” p. 2.

The ADB-supported PSRP, which began in 1997, had several objectives, including short-term fiscal stabilization, long-term structural stabilization and improvement of the private sector environment. Achievements included reducing the government payroll by 30 percent, privatizing domestic shipping services, streamlining Foreign Investment Board License applications, and establishing the Marshall Islands Intergenerational Trust Fund (MIITF) to stabilize budget receipts.<sup>13</sup>

Despite these measures, several issues remain, including poor public service efficiency, weak government financial management, and a slow buildup of MIITF balances. With further ADB support<sup>14</sup>, the Government has developed a program for public finance management reform to establish systems of annual and medium-term budgeting, financial control, accounting, internal audit, and reporting to parliament.

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<sup>12</sup> Deloitte Touche Tohmatsu. 2001 May 18. *Independent Auditor's Report on the General Purpose Financial Statements of the Republic of Marshall Islands for the Year ended September 30, 2000*.

<sup>13</sup> Loan 1513-RMI: *Public Sector Reform Program*, for \$12 million, approved on 30 January 1997.

<sup>14</sup> Loan 1829-RMI: *Fiscal and Financial Management Program*, for \$12 million, approved on 7 June 2001.

### *CFA Renegotiation*

The US Department of the Interior (DOI) administers economic assistance to RMI. RMI has also received support in the form of direct government services, such as US Postal Service and National Weather Service assistance, and grants and loans from US domestic agencies. In fiscal years 1987–1999, total US support was estimated at over \$1.1 billion. The CFA expired in September 2001, however funding will be provided for two more years, if negotiations on further assistance are not completed by that time.<sup>15</sup>

### **Box 2: Editorial on Pacific Island Aid<sup>16</sup>**

"In 1986, ... [RMI and FSM] ... signed agreements with Washington providing for millions of dollars in development aid. Now Congress is learning that much of the money was squandered. A GAO official testified that Micronesia and the Marshalls wasted at least \$1.6 billion through poor planning and management.

Susan Westin of the GAO said that instead of using the aid to seek economic self-sufficiency, the island republics spent it "to maintain an artificially high standard of living." She testified that warehouses and factories built with US aid are empty, new equipment is rusting away and half-completed roads go nowhere. Part of the blame was directed at the Interior Department for its failure to monitor the use of the money. Rep. Doug Bereuter, R-Neb., Chairman of the House Subcommittee on Asia and the Pacific, decried what he called "the neglect and indifference of the Interior Department."

Ferdinand Aranza, Director of the Department's Office of Insular Affairs, said the compacts of free association provided no system of goal setting and accountability. The U.S. government took a hands-off approach out of deference to the new governments, he said. In addition, his office lacked the staff to adequately monitor the funds.

In all, it's a discouraging story of failure of a program that was launched with considerable hope as a successor to the former UN trusteeship. The US tried with mixed results to encourage democratic government but had little success in stimulating economic growth.

Since independence the story seems to be much the same, perhaps worse. The islands seem to be floundering without prospect of real development although Washington provided considerable resources for that purpose.

The financial provisions of the compacts expire next year and the State Department has begun negotiations for renewal. It's a safe bet that Congress will be much more skeptical of future requests for funding—as it should be.

Before the CFA, the US provided about \$250 million in compensation for the effects of the 1940s–1950s US nuclear weapons testing program. In a report in May 2000, the US General Accounting Office (GAO) found inaccuracies and inconsistencies in the data used by DOI for supervising

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<sup>15</sup> US GAO. 2001 August. *Foreign Assistance: Lessons Learned From Donors' Experiences in the Pacific Region*. Report to Congress p. 6.

<sup>16</sup> *Honolulu Star Bulletin*. 2000 July 3. Editorial: Pacific Island Aid.

and monitoring federal assistance programs.<sup>17</sup> In its report, GAO recommended that:

“In the event [DOI] retains monitoring and coordination oversight as a result of the current negotiations, we recommend that the Secretary of the Interior direct the Office of Insular Affairs to develop a system to obtain and maintain data on all US financial and program assistance provided to FSM and RMI. Such a system might include making agreements with other agencies to regularly report assistance provided and making use of the annual audit reports from FSM and RMI to help identify how funds are allocated. In addition, we recommend that the Secretary direct the Office of Insular Affairs to reconcile the amounts reimbursed to other agencies shown in the budget justification table to the amounts reported by the agencies that receive reimbursements from [DOI].

Given that negotiations are currently underway on provisions of the Compact of Free Association that expire in 2001, we recommend that the Secretary of State negotiate provisions that require that reliable data be maintained to ensure better accountability of the assistance provided.

Requiring periodic reconciliation of accounts between [DOI], the other agencies providing assistance, and the Islands is one means to achieve this objective.” p. 6.

There is little doubt that the US CFA negotiators will seek to ensure that the second CFA includes mechanisms that support improved transparency and accountability. In this regard, RMI’s negotiating position would be greatly strengthened by pre-empting these requirements. Relevant priorities might include: strengthening record-keeping and internal control arrangements; improving budget and reporting disclosures; and tightening the timeliness and availability of financial reports.

#### *The Government’s Response: Vision 2018*

In preparation for the anticipated agreement of the second CFA, and in response to identified shortcomings in the prudence and effectiveness of government policies and accountability arrangements, the Government has prepared *Vision 2018*, which sets out a strategic development plan framework for the period that will be covered by the second CFA (2003-2018). *Vision 2018* establishes 10 national goals and objectives:

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<sup>17</sup> United States General Accounting Office (GAO). 2000 May 31. *Foreign Relations: Better Accountability Needed Over U.S. Assistance to Micronesia and the Marshall Islands*. RCED-00-67.

(i) operating in an interdependent world; (ii) enhanced socioeconomic self-reliance; (iii) an educated people; (iv) a healthy people; (v) a productive people; (vi) a law-abiding people; (vii) a God-loving people; (viii) respecting individual and fundamental human rights; (ix) respecting culture and traditions; and (x) environmental sustainability. Furthermore, *Vision 2018* presents broad strategies to meet these goals and objectives (see Table 2).

Table 2: *Vision 2018: The Broad Strategies*<sup>18</sup>

Strategies	Relevant Contents and Activities
I. Macroeco- nomic Frame- work	The strategies cover eight areas: policy coordination; govern- ance; the financial and fiscal system; a favorable investment climate; resource allocation; foreign affairs and trade; infra- structure; and environmental sustainability. Many of these strategies depend on strengthening public sector financial management arrangements.
II. Human Re- sources Devel- opment	The strategies recognize the crucial importance of raising educational levels. This will be critical if accounting and financial management departments are to be resourced by Marshalllese nationals in the long term.
III. Productive Sectors	...
IV. Outer Island Development	...
V. Science and Technology	The strategies recognize the opportunities provided by mod- ern communication technologies for improving financial management systems and enhancing human resource devel- opment.
VI. Culture and Traditions	...

## 6. ADB Focus on RMI Financial Governance

ADB released its Pacific Strategy in September 2000.<sup>19</sup> The strategy recognizes that the island atoll Pacific Developing Member Countries (PDMCs)<sup>20</sup> are severely disadvantaged by their small size, isolation, and weak resource base. It supports establishing and expanding trust funds to

<sup>18</sup> Government of RMI. 2001 June. *Vision 2018: The Strategic Development Plan Framework: 2003-2018*. Majuro.

<sup>19</sup> ADB. 2000 September. *A Pacific Strategy for the New Millennium*. Office of Pacific Operations. Manila: ADB.

<sup>20</sup> Kiribati, RMI, Nauru, and Tuvalu.

support the sustainable financing of basic services, supporting exploitation of niche markets for tourism, and the sustainable use of marine resources.

The strategy also stresses the importance of regional cooperation to collectively reap the benefits of economies of scale. ADB is currently supporting regional cooperation in fisheries; air transport; regional financial sector restructuring, including addressing money laundering; public sector management; and governance. The strategy calls for (i) the continued use of program and sector loans to support reform programs in the PDMCs, (ii) project investments on a sector level, and (iii) technical assistance financing, particularly for capacity building and regional cooperation. Performance-based lending will be introduced to link assistance levels to economic, governance and portfolio performance.<sup>21</sup>

ADB's current RMI operational strategy seeks to assist the Government achieve a sustainable and self-reliant economy. It aims at assisting in economic and financial reforms and supporting essential sectors such as education, health and water. The assistance program will target the disadvantaged population in the outer islands.

On this basis, and in the context of recent developments, ADB's medium term program will include: (i) loans for developing the health, education, and water sectors in the outer islands; (ii) skills development and vocational training; (iii) support for sound financial management and the MIITF; (iv) microfinance and small enterprise development to enhance private sector growth, especially to promote self-employment; (v) environment-related projects to support eco-tourism development; and (vi) continued assistance to the private sector through capacity-building TAs and direct assistance for the corporatization and privatization of State-Owned Enterprises (SOEs).

In addition, as part of ADB's Pacific Islands Economic Report (PIER), a new RMI country economic report including a governmental development strategy will confirm the previously mentioned strategic focus and will form the basis determining ADB's assistance program to RMI. The PIER will be strategically oriented and will combine traditional macro-economic and sectoral assessments with a more detailed poverty analysis in the RMI context.<sup>22</sup>

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<sup>21</sup> *Ibid.* Executive Summary.

<sup>22</sup> ADB. 2000 December. *Country Assistance Plan: Republic of Marshall Islands*. Manila: ADB. pp. 5-6.

## 7. International Guidelines and Surveillance<sup>23</sup>

The international community supports the development of guidelines, standards and codes to assess financial management and governance practices (see Table 3). This report compares RMI arrangements and practices against these benchmarks, but recognizes US accounting and auditing practices as equivalent to the relevant international standards.

To varying extents, these guidelines, standards and codes all involve accounting and auditing arrangements. Furthermore, in an attempt to identify and avoid potential crises, the International Monetary Fund (IMF) and the World Bank have together embarked on a series of *Reports on the Observance of Standards and Codes (ROSCs)*, which summarize countries' adherence to certain internationally recognized standards.<sup>24</sup> Although ROSCs are intended to be voluntary, the information provided (or not provided, as the case may be) by each country is likely to influence country dealings with international financial institutions, and the level of confidence that the international financial community has in a country.

**Table 3: Selected International Guidelines, Standards and Codes**

Guideline, Standard or Code	Promulgated By
• Principles of Corporate Governance	Organisation for Economic Cooperation and Development (OECD)
• Code of Good Practices on Fiscal Transparency	IMF
• Code of Good Practices on Transparency of Monetary and Financial Policies	IMF
• Implementation of the Objectives and Principles for Securities Regulation assessment surveys	International Organization of Securities Commissions' (IOSCO)
• International Accounting Standards (IAS)	International Accounting Standards Board (IASB)
• International Standards on Auditing (ISA)	International Auditing and Assurance Standards Board (IAASB)
• Draft Banking Supervision guidelines	Basel Committee on Banking Supervision (BCSB) of the Bank for International Settlements (BIS)

<sup>23</sup> Narayan, Francis B., Ted Godden, Barry Reid, and Maria Rosa Ortega. 2000. *Financial Management and Governance Issues in Selected Developing Member Countries: A Study of Cambodia, People's Republic of China, Mongolia, Pakistan, Papua New Guinea, Uzbekistan, and Viet Nam*. Manila: ADB. pp. 12-13.

<sup>24</sup> IMF. September 2000. Experimental Reports on Observance of Standards and Codes (ROSCs). IMF: Washington D.C. [www.imf.org/external/np/rosoc](http://www.imf.org/external/np/rosoc)

## 8. Report Structure

This report examines financial management and governance issues in RMI, with a focus on accounting and auditing arrangements. In addition to this introduction, the report has the following chapters:

- Chapter II – **Accounting and Auditing in RMI** – presents an overview of RMI accounting and auditing arrangements, and provides context for chapters III-VI.
- Chapter III – **Professional Infrastructure** – describes RMI's professional accountancy infrastructure.
- Chapter IV – **Accounting and Auditing Standards** – describes the accounting and auditing standards that govern the preparation and audit of external financial reports.
- Chapter V – **Accounting and Auditing Training** – describes accounting and auditing education and training, including coordination of accountancy education.
- Chapter VI – **Government Budgeting and Accounting** – describes government budgeting and accounting arrangements.
- Chapter VII – **Donor Assistance** – reviews donor coordination mechanisms and discusses donor activities in relation to financial management and governance arrangements.
- Chapter VIII – **Issues and Recommendations** – presents the issues and recommendations associated with gaps or weaknesses in accounting and auditing arrangements.
- Chapter IX – **Country Action Plan** – summarizes deficiencies and recommends actions to address these deficiencies. Recommendations are divided into actions that would be better achieved with external assistance, and actions that may be achieved without the need for external assistance.

## **II. Accounting and Auditing in RMI**

**T**his chapter presents an overview of RMI accounting and auditing arrangements. It provides context for the following chapters on professional infrastructure, accounting and auditing standards, accounting and auditing training, and government budgeting and accounting arrangements. The chapter comprises the following 10 sections:

### **Part One: Accounting**

- 1 – Introduction – identifies historical factors that have influenced accounting arrangements.
- 2 – Issues and Responses since 1986 – briefly reviews challenges and responses to these challenges since the beginning of the first CFA period in 1986.
- 3 – The ‘Marshallese Accounting System’ – describes RMI accounting arrangements including the legislative and institutional framework, accounting bases and accounting information systems.
- 4 – Bookkeepers and Accountants – discusses the availability of qualified bookkeepers and accountants.

### **Part Two: Auditing**

- 5 – Introduction – introduces RMI auditing arrangements.
- 6 – Audit Requirements – identifies audit requirements for a range of organizations.
- 7 – Auditor Qualifications – briefly describes auditor qualifications.
- 8 – Office of the Auditor-General (OAG) – describes the functions and duties of the Auditor-General and the OAG.
- 9 – Accounting and Auditing Firms – describes the presence of domestic and international accounting firms in RMI.
- 10 – Issue Synopsis: Accounting and Auditing – summarizes the issues identified in this chapter.

## Part One. Accounting

### 1. Introduction

In 1886, the German Colonial Administration levied an annual copra tax of 360,000 pounds on the Marshall Islands. Tax districts were specified according to traditional boundaries—the *Iroij* were ordered to collect the copra and were given one-third of the collected tax. It was arguably through this mechanism that basic accounting arrangements were first introduced to RMI.<sup>25</sup>

Private sector accounting arrangements developed in the following 100 years, mainly in the (comparatively small) private sector. Public sector accounting was predominantly undertaken by US government agencies—it was only in 1982 that the RMI government took control of its own bank accounts. Furthermore, at the time of CFA implementation (1986), the RMI government did not have a single certified public or practising accountant (CPA).<sup>26</sup>

### 2. Issues and Responses since 1986

In the first CFA period (1986-2001), RMI has made some progress in developing a sustainable accounting infrastructure suitable for a modern economy. During this period, legislative arrangements were enhanced, computerized accounting information systems were implemented, internal control systems were improved, financial auditing was strengthened and Marshallese accounting personnel were trained.

But, until three years ago—with the impending end of the first CFA and the release of the hard-hitting GAO report on accountability (see page 15)—the RMI Government paid little serious attention to strengthening financial management arrangements. However—in the wake of the GAO report, with CFA renegotiations underway and although facing severe fiscal pressures—the Government is showing some resolve in improving accounting arrangements.

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<sup>25</sup> Spennemann, Dirk H.R. 2000. *Taxation in the German Marshall Islands*. URL: [http://life.csu.edu.au/marshall/html/History\\_Varia/taxation.html](http://life.csu.edu.au/marshall/html/History_Varia/taxation.html)

<sup>26</sup> Aranza, Ferdinand (Director, Office of Insular Affairs, US DOI). 2000 June 28. Statement before the Subcommittee on Asia and the Pacific Committee on International Relations, US House of Representatives: The US Compacts with the Federated States of Micronesia and the Republic of the Marshall Islands.

### 3. The ‘Marshallese Accounting System’

#### Legislative and Institutional Framework

Although the Marshallese Accounting System is directly influenced by US practices, RMI laws reflect several influences. For instance, the format of the RMI *Revised Code* draws heavily on the English system of compilation and citation.<sup>27</sup>

Appendix 4 identifies and summarizes the laws and regulations that govern public sector financial management arrangements. The *Constitution of the Republic of the Marshall Islands 1979* is RMI's supreme law and stipulates rights and governance structures and arrangements (legislative, executive, judicial, public service and local government). The *Financial Management Act 1990* governs public sector financial management. Among other things, it stipulates that “RMI policy is to provide full disclosure of financial operations and adequate financial information needed in the management of operations, and shall ensure effective control over revenues, multilateral and bilateral grants-in-aid including US federal grants, income, expenditures, monies and other assets, and shall be in accordance with the standards promulgated by the US Government Accounting Standards Board (GASB)” (Sec. 104).

Appendix 5 sets out the key laws and regulations that govern private sector financial management arrangements. The original *Associations Law 1990* was modeled on the corporate laws of the states of Delaware and New York and was modified to include all the necessary characteristics of an offshore jurisdiction, such as bearer shares, facsimile filings, and execution of documents without notary affidavits. Each corporation may be organized in the US style with a President, Secretary and Treasurer, or in the UK style with a Managing Director and Corporate Secretary. The *Associations Law 1990* has recently been restructured into a series of corporate laws.

#### Accounting Bases and Principles

Section 104 of the *Financial Management Act 1990* requires public sector organizations to account in accordance GASB standards. Most government accounting is currently on a modified accrual basis, however GASB 34 (*Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*) requires a move towards full accrual accounting. The

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<sup>27</sup> Republic of the Marshall Islands. 1988. *Marshall Islands Revised Code: Volume I*. Majuro. p. v.

effective date of GASB 34 requirements depends on total annual government revenues in the first fiscal year ending after 15 June 1999—in the year ended 30 September 1999, the RMI government reported revenues of \$90.4 million.<sup>28</sup> So government financial statements will have to comply with GASB 34 requirements starting with the financial year beginning on 1 October 2002. The requirements and implications of the issuance of GASB 34 are described on pages 37-44.

Private sector organizations, state-owned enterprises and statutory authorities use the accrual accounting basis and are required to prepare financial statements in accordance with US generally accepted accounting principles (GAAP).

## Accounting Information Systems

The private sector uses various accounting information systems. In contrast, the public sector primarily uses two computerized accounting systems, which Chapter VI discusses in more detail. It also describes an ADB-supported initiative to upgrade accounting information system.<sup>29</sup>

## Record Keeping and Internal Control Arrangements

Both public and private sector organizations are legally required to maintain adequate books of account and internal control arrangements (see above). A common contention of study interviewees was that arrangements are generally inadequate. This accorded with published information, such as audit and media reports (see Box 1 on page 14).

## Financial Reporting

RMI laws and regulations are reasonably clear on financial reporting requirements and timeframes (see Appendix 4 and Appendix 5). However, public sector financial reports are often years overdue. Furthermore, they are sometimes unauditable due to deficiencies in basic record-keeping and internal control arrangements. To this end, efforts have been made to improve the timeliness of financial reports, but more remains to be done.

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<sup>28</sup> Government of RMI. 2001 May 18. *Republic of the Marshall Islands: General Purpose Financial Statements and Independent Auditors' Report for the year ended 30 September 2000*. Majuro. p. 5.

<sup>29</sup> Loan 1829-RMI: *Fiscal and Financial Management Program*, for \$12 million, approved on 7 June 2001.

## 4. Bookkeepers and Accountants

As of October 2001, there were no professionally-qualified Marshallese accountants in RMI. However, a number of expatriate Certified Practising Accountants (CPAs) are employed within the private sector and in government. Furthermore, the Secretary of Finance is spearheading an initiative to raise standards amongst government financial staff. However, there is an acute shortage of qualified bookkeepers and accountants in the public and private sectors. The key issue of training and qualifications is raised throughout this report and in Chapter VIII (*Issues and Recommendations*).

## Part Two. Auditing

### 5. Introduction

Audit reports receive much media attention in RMI. In some cases, CFA funds are not released until audited financial statements are received. Audits of public sector entities are governed by the *Constitution* and other subsidiary pieces of legislation (see above). Furthermore, Section 233 of the CFA 1982 required audits of all CFA funds expended for services and programs, during the first five years of the CFA (1986-1991) and periodically thereafter. However, as mentioned earlier, these annual audits were not undertaken as required.<sup>30</sup>

#### Box 3: Newspaper Article on Audit Reports<sup>31</sup>

Shocking audits of the Marshall Islands Social Security Administration (MISSA) for 1997 through 1999 show hundreds of thousands of dollars not properly accounted for, a more than \$2 million deficit in the health fund and more than \$200,000 owed to MISSA for unauthorized or unaccounted for credit card use, travel and other expenses of board members and staff. The audits are included in the RMI Auditor General's recently issued report at the Nitijela. The long-delayed audits were prepared at the request of the MISSA board of directors appointed last year by President Kessai Note. A total of 52 "findings" or problems were identified by the auditors over the three-year period. The majority of the problems had been pointed out in previous audits, some dating back as far as 1992 and 1993, without being corrected.

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<sup>30</sup> US GAO. 2000 May 31. *Foreign Relations: Better Accountability Needed Over U.S. Assistance to Micronesia and the Marshall Islands*. RCED-00-67.

<sup>31</sup> *Marshall Islands Journal*. 2001 . Newspaper Article. 19 April.

## 6. Audit Requirements

Table 4 identifies the audit requirements for public and private sector organizations.

**Table 4: Audit Requirements**

Organization Type	Audit Requirements
Public funds and accounts, departments or offices of the legislative, executive and judicial branches of government and of any other public corporation or other statutory authority constituted under RMI law	<ul style="list-style-type: none"> <li>The Auditor-General is responsible for auditing these entities—unless another Act requires that they be audited by another person (<i>Constitution, Article VIII, Sec. 15</i>).</li> <li>Also, the CFA requires that annual audits (for the first five years) and then periodic audits (thereafter) should have been conducted of all CFA funds expended for services and programs (Sec. 233, <i>CFA 1982</i>).</li> </ul>
Cooperatives	The <i>Cooperatives Act 1993</i> requires that the books of associations shall be audited at financial year-end by an experienced bookkeeper or accountant ... and shall be subject to audit by the OAG (Sec. 773).
Local Government	<ul style="list-style-type: none"> <li>The <i>Local Government Financial Memoranda</i> issued under Sec. 118 of the <i>Local Government Act 1980</i> stipulates auditing requirements.</li> <li>Sec. 140 of the <i>Local Government Act 1980</i> gives the Minister of Local Government the power to arrange special audits by the Auditor-General.</li> </ul>
Licensed Banks	<p>In accordance with the <i>Banking Act 1987</i>:</p> <ul style="list-style-type: none"> <li>Every licensed bank must, subject to the Banking Commissioner's approval, appoint an independent financial auditor (Sec. 134)</li> <li>Financial statement audits must be completed within three months of financial year-end in conformity with generally accepted auditing standards (Sec. 134).</li> </ul>
Trust Companies	<p>In accordance with the <i>Trust Companies Act 1994</i>, these entities must:</p> <ul style="list-style-type: none"> <li>Annually appoint independent financial auditors (Sec. 221).</li> <li>Arrange for financial statement audits to be completed within three months of year-end (Sec. 221).</li> </ul>

## 7. Auditor Qualifications

RMI laws vary with regards to auditor qualifications:

- As described in the following section, a range of qualifications or experience, is accepted for appointment as Auditor-General
- The *Cooperatives Act 1993* refers to an “experienced bookkeeper or accountant.”
- The *Banking Act 1987* refers to an “independent financial auditor.”

## 8. Office of the Auditor-General (OAG)

### Introduction

The constitutionally-appointed Auditor-General heads the OAG. With just seven staff members, the OAG faces severe resource constraints—half the OAG workforce was eliminated during the 1986 Reduction-in-Force exercise. However, the office is restaffing and currently subcontracts many of its audits to Deloitte Touche Tohmatsu.

The OAG is a member of three international organizations: the International Organization of Supreme Audit Institutions (INTOSAI), the South Pacific Association of Supreme Audit Institutions (SPASAI) and the Association of Pacific Island Public Auditors (APIPA).

### The Auditor-General: Appointment and Duties

The Constitution establishes the Auditor-General’s position (Article VII, Sec. 13):

- The Speaker shall nominate and, with the approval of the Nitijela, signified by resolution, the President shall appoint an Auditor-General of the Marshall Islands.
- The Auditor-General shall hold office during good behavior until they reach the age of 72 years.
- The Auditor-General may at any time resign their office, but shall not be removed or suspended from office except for similar grounds and in a similar manner as a judge of the High Court or of the Supreme Court.
- If the office of Auditor-General is vacant, or it appears that the Auditor-General is for any reason unable to perform the functions of their office, the Speaker shall nominate and the President shall appoint an Acting Auditor-General; and the Acting Auditor-General shall continue to perform those functions until a new Auditor-General is appointed

and assumes office, or, as the case may be, until the Auditor-General is again able to perform the functions of their office.

- A person who has held office as Auditor-General shall not be eligible for appointment to any other office in the service of the RMI within a period of three years after ceasing to hold the office of Auditor-General.

### The Auditor-General: Qualifications

The *Auditor-General's Compensation Act 1980* prescribes the qualifications and compensation of the Auditor-General. The Auditor-General must be:

- a CPA or Chartered Accountant (CA) with no less than three years practical experience
- a person who has worked in a supervisory capacity in a CPA or CA firm for at least five years
- a person with knowledge of accounting and auditing theory and procedures and experience in government or governmental organizations as an accountant or auditor for not less than 10 years, or
- a person with knowledge of accounting and auditing theory and procedures and experience in private organizations as an accountant or auditor for not less than 20 years.

### The Auditor-General: Duties, Functions, and Powers

In accordance with the *Auditor-General (Definition of Duties, Functions, and Powers) Act 1986*:

- The Auditor-General must provide a semiannual report to each Nitijela member (January and August sessions) (Sec. 3).
- At the request of the Auditor-General, the Public Service Commission may appoint staff as may be necessary or convenient for the effective functioning of the OAG (Sec. 5).
- The Auditor-General may appoint outside specialists to conduct audits (Sec. 6).
- Audit standards shall incorporate the standards for audit of government operations, programs, activities and functions published from time to time by the US GAO, including standards issued by the American Institute of Certified Public Accountants (AICPA) (Sec. 8).
- The Auditor-General shall prepare an annual budget for submission to the Nitijela in the same manner as all other agency budgets (Sec. 13).

## Auditor-General Independence

The *Lima Declaration of Guidelines on Auditing Precepts* was adopted in October 1977 at the IX International Conference of Supreme Audit Institutions (INCOSAI).<sup>32</sup> Among other things, the *Lima Declaration* identifies characteristics associated with Supreme Audit Institution (SAI) independence (see Table 5). RMI arrangements do not appear to fully meet criterion (ii) of the *Lima Declaration*. For example, the staff of the OAG was reduced as part of the Reduction-in-Force exercise during the PSRP. Furthermore, arrangements regarding the Auditor-General's annual budget do not support independence.

**Table 5: Independence of the Auditor-General**

<i>Lima Declaration</i> Criteria	Existing Arrangements
( i ) The SAI and individual auditors should be independent of the executive.	<i>RMI Constitution 1979 (Article VII, Sec. 15)</i> “In the exercise of his functions, the Auditor-General shall not receive any direction from the Cabinet or any other authority or person, but shall act independently.”
( ii ) The legislature should provide the SAI with sufficient resources, for which the SAI is accountable.	<i>Auditor-General (Definition of Duties, Functions and Powers) Act 1986</i> : At the request of the Auditor-General, the Public Service Commission may appoint staff as may be necessary or convenient for the effective functioning of the OAG (Sec. 5). The Auditor-General shall prepare an annual budget for submission to the Nitijela in the same manner as all other agency budgets (Sec. 13).
( iii ) The SAI may advise or make recommendations on correcting administrative deficiencies, but it should not take part in management or instruction of staff and avoid any participation that would reduce its independence and objectivity.	...
( iv ) The legal mandate should allow the SAI full and free access to all premises, records and persons relevant to audited entities and their opera-	<i>RMI Constitution 1979 (Article VII, Sec. 15)</i> “shall have full access to all public records, books, vouchers, documents, cash, stamps, securities, stores or other government property in the possession of any officer.”

<sup>32</sup> International Organization of Supreme Audit Institutions (INTOSAI). 1977. *Lima Declaration of Guidelines on Auditing Precepts*. URL: [www.intosai.org](http://www.intosai.org)

**Table 5: Independence of the Auditor-General** *(continued)*

<i>Lima Declaration</i> Criteria	Existing Arrangements
( v ) Provisions relating to termination of appointment or removal from office should be exercisable only by special process akin to that relating to the holders of judicial office.	<i>RMI Constitution 1979 (Article VII, Sec. 13)</i> “shall not be removed or suspended from office except on the like grounds and in the like manner as a judge of the High Court or of the Supreme Court.”

## 9. Accounting and Auditing Firms

With an office in Majuro, supported from its offices in Guam and Saipan, Deloitte Touche Tohmatsu is the only accountancy firm with a physical presence in RMI. Deloitte Touche Tohmatsu audits many of the public sector organizations.

## 10. Issue Synopsis: Accounting and Auditing Arrangements

Chapter VIII – *Issues and Recommendations* – identifies and describes constraints and proposes corrective actions. These include the following issues from this chapter:

- Basic record keeping and internal control arrangements are generally inadequate.
- There is an acute shortage of qualified bookkeepers and accountants in both the public and private sectors—there were no professionally qualified Marshallese accountants in RMI as of October 2001.
- RMI laws are sometimes ambiguous or silent regarding auditor qualifications.
- Legislative and budgetary arrangements regarding the Auditor-General’s independence differ from international norms.

### III. Professional Infrastructure

**T**his chapter describes the professional accountancy infrastructure in RMI. It is structured as follows:

- 1 – Introduction – provides an overview of RMI’s accountancy profession.
- 2 – Components of a Professional Accounting Qualification – identifies international benchmarks with respect to professional arrangements.
- 3 – Issue Synopsis: Professional Infrastructure – summarizes the issues identified in this chapter.

#### 1. Introduction

There are no professionally qualified Marshallese accountants in RMI; nor is there a professional accountancy body. However, RMI law regulates other professions and occupations including health care providers under the *Health Services Act 1983*, nurses under the *Nursing Practices Act 1995*, land surveyors under the *Land Surveyors Registration Act 1970*, notaries public under the *Notaries Public Act 1966*, and the legal profession under the *Legal Profession Act 1991*.

Notwithstanding this, Guam’s professional accountancy body is relevant to RMI as Guam also operates under US accounting arrangements. Consequently, Appendix 6 briefly describes this body and its membership requirements.

#### 2. Components of a Professional Accounting Qualification

IFAC oversees the professional arrangements and procedures of its member bodies. Appendix 7 describes relevant international standards and guidance. A professional accounting qualification has the following components:

- (i) *Education*. Candidates must complete a recognized education program, such as a university degree.
- (ii) *Examination*. A professional examination must be successfully passed.
- (iii) *Experience*. A minimum of three years practical experience in an appropriate, supervised environment is required.
- (iv) *Continuing Professional Education (CPE)*. To retain the qualification, an annual minimum of 30 hours, or 90 hours over each three-year period, of structured learning activities must be undertaken.

### **3. Issue Synopsis: Professional Infrastructure**

Chapter VIII – *Issues and Recommendations* – identifies and describes constraints and proposes corrective actions. These include the following issues regarding RMI's professional accountancy infrastructure:

- There are no professionally qualified Marshallese accountants in RMI, nor is there a professional accountancy body.
- In contrast to other occupations and professions, RMI law does not recognize the accountancy profession.
- Professional accountancy qualifications are virtually unattainable for Marshallese accountants, at least in the medium term.

## **IV. Accounting and Auditing Standards**

**T**his chapter describes the accounting and auditing standards that govern the preparation and audit of external financial reports. It comprises 12 sections:

### **Part One: Accounting Standards**

- 1 – Introduction – provides an introduction to US Generally Accepted Accounting Principles (GAAP), as applied in RMI.
- 2 – Legal Status of US GAAP in RMI – describes the legal status of US GAAP in RMI.
- 3 – An Overview of US GAAP – provides an overview of US GAAP.
- 4 – US GAAP for Nongovernment Entities – describes US GAAP, as applied to financial reporting by nongovernment entities (i.e., the private sector).
- 5 – Comparison with International Accounting Standards – identifies and examines differences between US GAAP and IASs.
- 6 – US GAAP for Government Entities – describes US GAAP, as applied to financial reporting by government entities (i.e., the public sector).
- 7 – Implementing the New Financial Reporting Model – under current RMI laws, the government and its entities must use the US Government Accounting Standards Board's (GASB) new financial reporting model (NFRM) starting with the financial year that begins on 1 October 2002. The NFRM represents a major change in government accounting including transition to full accrual accounting. This section identifies implications of the changes, key implementation tasks and describes implementation progress.

### **Part Two: Auditing Standards**

- 8 – Introduction – introduces US Generally Accepted Auditing Standards (GAAS), which are applicable in RMI.
- 9 – Legal Status of US GAAS in RMI – reviews the legal status of US GAAS and US Generally Accepted Government Auditing Standards (GAGAS) in RMI.
- 10 – US GAAS for Nongovernment Audits – briefly describes US GAAS and compares it to International Standards on Auditing (ISAs).
- 11 – Generally Accepted Government Auditing Standards – describes US GAGAS.
- 12 – Issue Synopsis: Accounting and Auditing Standards – summarizes the issues identified in this chapter.

## **Part One. Accounting Standards**

### **1. Introduction**

RMI directly uses US GAAP for public and private sector accounting standards. US GAAP, as applied to the nongovernmental (private) sector, represents a detailed framework of principles based on accounting standards and guidance of the US Financial Accounting Standards Board (FASB)(and its predecessor bodies), Statements of Position and Interpretations from the AICPA and, consensuses reached by the Emerging Issues Task Force. Furthermore, listed companies must follow the rules, regulations and releases issued by the Securities and Exchange Commission (SEC).

### **2. Legal Status of US GAAP in RMI**

It is generally accepted that RMI financial statements must be prepared in accordance with US GAAP, but RMI laws are inconsistent in this respect. On one hand, some laws are absolutely clear as to the use of US accounting standards. For instance, the *Financial Management Act 1990* (which governs public sector financial management) stipulates that: “RMI policy is to provide full disclosure of financial operations and adequate financial information needed in the management of operations, and shall ensure effective control over revenues, multilateral and bilateral grants-in-aid including US federal grants, income, expenditures, monies and other assets, and shall be in accordance with the standards promulgated by the US GASB” (Sec. 104).

Conversely, other laws, such as the *Trust Companies Act 1994* require all licensed trust companies, incorporated in RMI, to prepare annual profit and loss accounts and balance sheets (Sec. 220). No statement is made regarding the basis of preparation.

### **3. An Overview of US GAAP**

US GAAP has been expanded and formalized to include statements and decisions of the various standard-setting bodies. The three authoritative bodies for US GAAP are GASB, FASB and sponsors of the Federal Accounting Standards Advisory Board (FASAB). GASB establishes accounting principles and financial reporting standards for state and local government entities. FASB establishes accounting principles and financial reporting standards for nongovernment entities. The FASAB sponsors—

the Secretary of the Treasury, the Director of the Office of Management and Budget, and the Comptroller-General—jointly establish accounting principles and financial reporting standards for the federal government, based on recommendations from FASAB. Appendix 8 provides further details of these accounting-standard-setting bodies.

#### **4. US GAAP for Nongovernment Entities**

US GAAP for nongovernment entities is sourced from: Accounting Research Bulletins (ARB), Accounting Principles Board (APB) Opinions, Statements of Financial Accounting Concepts (SFAC), and Statements of Financial Accounting Standards (SFAS). Appendix 9 provides further details.

#### **5. Comparison with International Accounting Standards**

Although financial statements prepared in accordance with US GAAP will largely comply with IASs, a recent study identified three sources of difference.<sup>33</sup> First, US GAAP may differ from IAS requirements because of less specific US rules, including:

- discounting provisions are not clearly defined IAS 37.45
- the requirement for annual impairment tests IAS 22.56
- when the depreciable lives of goodwill or intangible assets exceed 20 years IAS 38.99
- the requirement for segment reporting of liabilities IAS 14.56

Second, there are inconsistencies between US and IAS rules that could lead to differences for many enterprises in certain areas. Under US rules:

- in the context of an acquisition, part of the purchase price should be allocated to identifiable and measurable in-process research and development costs of an acquired entity; these amounts are then expensed in the post-acquisition period IAS 22.27/40 IAS 38.79
- the classification of business combinations between acquisitions and unitings of interest is based on compliance with a set of criteria rather than whether an acquirer can be identified IAS 22.8

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<sup>33</sup> Source: Nobes, Christopher W. (Ed.). 2001. *GAAP 2000: A Survey of National Accounting Rules in 53 Countries*. PriceWaterhouseCoopers.

- provisions in the context of business combinations can be made under less strict conditions IAS 22.31
- provisions may be recognized on the basis of the probability of resource outflows without there always being an obligation IAS 37.14
- impairment tests use undiscounted cash flows and impairments are measured based on fair value rather than on recoverable amount IAS 36.5/58
- once recognized, an impairment may not be reversed IAS 36.95
- an issuer's financial instruments are classified according to their legal form rather than on the basis of whether they are in substance liabilities, and compound instruments are not split on this basis IAS 32.18/23
- segments are identified and information measured based on management's organization of segments for operational and internal reporting purposes, with no segment reporting on a secondary basis, although certain geographic disclosure is required IAS 14.69-72

Third, in certain enterprises, these other issues could lead to differences from IAS:

- some de facto controlled enterprises that are neither majority-owned nor contractually controlled may be excluded from consolidation IAS 27.6 SIC 12
- the excess of the fair value of identifiable net assets acquired over the cost of an acquisition should be used to reduce the fair values of non-monetary assets with any remainder being recognized as negative goodwill IAS 22.59
- inventories can be valued at replacement cost, if lower than cost IAS 2.6
- financial statements of subsidiaries in hyperinflationary economies are remeasured in the reporting currency of the parent IAS 21.36
- employee benefit past service costs must be amortized even if they are vested and an additional minimum liability may have to be recognized as a deduction of equity IAS 19.96

- discontinuing operations disclosures may be made prior to a formal announcement IAS 35.16
- defined benefit pension plans with flat-benefit formulas generally use a unit credit method to determine the liability and the discount rate for determining pension liabilities reflects the rate at which the liability could be settled IAS 19.64/78
- deferred taxes are calculated using enacted, rather than substantially enacted, rates IAS 12.34/47
- amortization of goodwill is based on the useful life (consistent with IAS) but is limited to 40 years whereas IAS provides a rebuttable presumption that the useful life will not exceed 20 years but does not specify a maximum life IAS 22.44

## 6. US GAAP for Government Entities

US GAAP for government entities primarily comprises the statements issued by GASB (sometimes referred to as GASB Statements, GASBS). Appendix II provides further details.

## 7. Implementing the New Financial Reporting Model<sup>34</sup>

### Introduction

In June 1999, with the issuance of GASB Statement No. 34 (*Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*), GASB completed a project designed to change the financial reporting framework for state and local governments. GASB 34 represents the most important single change in the history of accounting and financial reporting for state and local governments.

As described on page 23, RMI government financial statements will have to comply with the requirements of GASB 34 starting with the financial year beginning on 1 October 2002. This has significant implications for budgetary documentation, accounting arrangements, accounting systems, financial reporting, and accounting personnel.

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<sup>34</sup> Primary Source: Government Finance Officers Association (GFOA). 1999 July. *The GASB’s New Financial Reporting Model: An Overview for Finance Officers*. Technical Bulletin.

## Differences between the Private Sector and the Current Government Financial Reporting Model

In the private sector, externally-reported financial information is organized into a balance sheet, an operating statement and a statement of cash flows. Conversely, governments have traditionally used a financial reporting model that differs in at least three important ways.

- (a) *Fund accounting.* In the private sector, even complex businesses generally are presented as a single entity for financial reporting purposes. In the same way, auditors of private-sector financial reports express their opinion in terms of the financial statements as a whole. Governmental financial reports, on the other hand, traditionally have focused upon groupings of various government funds rather than upon the government as a whole. For this purpose, a fund is a separate accounting entity used to track resources segregated for specific activities or objectives. Fund accounting historically developed out of the desire to demonstrate legal compliance with internal (i.e., budgetary) and external (e.g., grantor) limitations placed on resource usage.
- (b) *Spending focus for tax-supported activities.* In the private sector, financial reporting focuses on earnings and other changes in a business's total net resources. This focus traditionally has been shared by the business-type government activities (e.g., enterprise funds). Governments have always taken a very different approach, focusing on changes in current spendable resources rather than total resources. This more limited approach, which in many ways is reminiscent of checkbook accounting, is consistent with the short-term financing focus that typically characterizes the operating budget.
- (c) *Budgetary reporting.* Private sector businesses adopt budgets, as do state and local governments. However, the role of the budget in the public sector is unique. In the private sector a budget is simply a financial plan; whereas in the public sector, the budget is at the very heart of the system of "checks and balances" between the legislative and executive branches of government. Consequently, demonstrating compliance with the legally adopted budget has traditionally been an integral part of public-sector financial reporting, taking the form of a mandated budget-to-actual comparison statement.

## Key Changes in the NFRM

The NFRM will bring about the following important changes to the current model:

- (a) *Government-wide reporting.* Governments have traditionally focused their reporting on funds groupings rather than on government as a whole. The NFRM, although retaining this traditional focus, will insist that fund financial statements be accompanied for the first time by financial statements focusing on the overall government (i.e., government-wide financial statements).
- (b) *Focus on major funds.* As a practical matter, governments have combined similar individual funds into seven fund types (i.e., general fund, special-revenue funds, debt-service funds, capital-projects funds, enterprise funds, internal-service funds, and trust & agency funds). These fund types, rather than individual funds, have been the focus of the combined financial statements in current financial reports. Under the NFRM, governments will focus on major individual funds rather than fund types (with aggregated information for the total of all non-major funds). Under the specific rules specified in GASB 34, a typical government is likely to have four to six major funds.
- (c) *Additional focus for governmental activities.* Government financial reporting traditionally focused on changes in current spendable rather than total resources. This focus will be retained for fund reporting. However, in the new government-wide financial statements, the focus for governmental activities will be shifted to changes in total resources. In other words, all activities in government-wide financial statements will be reported similarly to private sector accounting. As such, a reconciliation will be required between the governmental-fund and government-wide financial statements.
- (d) *Changes in budgetary reporting.* Traditionally, governments have included a budget-to-actual comparison as one of their basic financial statements. The final amended budget has provided the budgetary amounts used for this presentation. The NFRM brings three important changes to the current practice. First, budgetary comparisons will henceforth need to present the original budget in addition to the final amended budget. Second, budgetary comparisons are currently presented by fund type (e.g., total budgeted special-revenue funds). The NFRM will require a budgetary comparison for the general fund and individual major special-revenue funds. Third,

governments will only be required to present the budgetary comparison as required supplementary information (RSI), after the Notes to the financial statements. By definition, RSI is not audited. (It should be noted that GASB 34 explicitly permits governments to retain the budgetary comparison as a basic financial statement if they wish to do so, thereby retaining it within the audit scope.

- (e) *Requirement for a narrative analysis to accompany the basic financial statements.* GASB 34 requires that financial statements always be accompanied by a narrative introduction and analytical overview of the government's financial activities in the form of "management's discussion and analysis" (MD&A).

### Other Changes Connected with the NFRM

Other important changes are:

- (a) *Limitations on the use of fiduciary funds.* The use of fiduciary funds will be limited to accounting for resources that are not available to support a government's operations and programs. This limitation is expected to result in the nonfiduciary reclassification of numerous expendable and nonexpendable trust funds.
- (b) *Changes in fiduciary funds.* Both expendable and nonexpendable trust funds will be eliminated and replaced by the newly created "private-purpose" trust fund.
- (c) *Creation of permanent funds.* Endowment-like arrangements in support of government operations (e.g., cemetery perpetual care funds) will be accounted for in a newly created governmental fund type, the permanent fund.
- (d) *New equity accounts.* Although governmental funds will preserve their traditional equity classifications (i.e., reserved fund balance, unreserved fund balance), three new accounts will be used to classify equity for proprietary funds and for the government-wide financial statements: (i) invested in capital assets net of related debt; (ii) restricted; and (iii) unrestricted.
- (e) *Elimination of contributed capital.* Under the current model, the equity of proprietary funds is divided between contributed capital and retained earnings. Under the NFRM, such a distinction will not exist.
- (f) *Elimination of account groups.* Now that capital assets and long-term obligations related to governmental activities will henceforth be reported in the government-wide financial statements, there will no

- longer be a need to report either a general fixed assets account group or a general long-term debt account group.
- (g) *Classification of assets and liabilities.* The NFRM will require that proprietary funds distinguish current and non-current assets and liabilities.
  - (h) *Net expense format for the government-wide statement of activities.* The new government-wide statement of activities is designed to highlight both the total expense of each different function and the net expense of that same function (i.e., total expense less related revenues such as fees, charges, and restricted grants).
  - (i) *Single category for transfers.* Currently, residual equity transfers are distinguished from operating transfers. Under the NFRM there will be a single transfers category.
  - (j) *Special items.* The NFRM will create a new category of special items to account for unusual or infrequent transactions or events subject to management control (i.e., which meet at least one criterion of an extraordinary item).

## Key Implementation Challenges

Much in the NFRM is familiar (e.g. traditional fund accounting for governments), but compliance with the new standard will require governments to make a number of important changes. The most significant of them are:

- (a) *Infrastructure reporting.* State and local governments have not been required to report general infrastructure assets (e.g., roads, bridges, dams) in their financial statements. However, the move to a more private-sector-like focus for governmental activities will change that. GASB 34 requires that all capital assets, including general infrastructure assets, be capitalized in the financial statements at their historical cost or estimated historical cost. Furthermore, this requirement, as a rule, will apply retroactively to major general infrastructure assets that were acquired in fiscal years beginning after 15 June 1980, or that received major renovations, restorations, or improvements since that date.
- (b) *Depreciation accounting.* State and local governments have traditionally reported noninfrastructure general capital assets without depreciation expenses. The move to a more private-sector-like focus in government-wide financial statements will change this traditional practice. Governments will now be required to report depreciation

expenses for all their capital assets, including general infrastructure assets. Governments, however, can avoid the mandate to depreciate general infrastructure assets if those assets: (i) are managed through an asset management system meeting certain specifications in GASB 34; and (ii) are documented as preserved at (or above) a condition level established and disclosed by the government. To choose this option, a government would have to perform regular assessments of its infrastructure assets at least every three years, and disclose information on condition levels, as well as anticipated and actual maintenance outlays as RSI.

- (c) *Conversion of data for governmental activities.* Although governmental activities will continue to focus on changes in current spendable resources in governmental fund financial statements, a different focus will be applied to their reporting in the new government-wide financial statements. This change will require that data on governmental activities be converted from the modified accrual basis of accounting to the full accrual basis of accounting. Some of the principal adjustments involved in this conversion from modified accrual accounting (i.e., expenditures) to full accrual accounting (i.e., expenses) include:
- removing capital outlays from the operating statement, and replacing them with depreciation expense
  - removing debt-service principal outlays from the operating statement
  - removing the receipt of the long-term debt proceeds from the operating statement
  - reporting amortizations (e.g., issuance discounts and premiums, issuance costs)
  - reporting interest on debt when incurred rather than “when due”
  - reporting expense in connection with prepaid items (e.g. insurance) and the consumption of inventory
  - reporting revenue not yet “available” for spending (e.g., property taxes collected more than 60 days after the end of the fiscal period)
  - reporting expense related to the noncurrent portion of certain liabilities (e.g., compensated absences, claims and judgments)
- (d) *Reporting cash flows from operating activities for proprietary funds.* Proprietary funds are currently required to present a statement of cash flows. Normally, there is a difference between cash flows provided from operating activities in a proprietary fund and “operating income.” Under current standards, governments may elect

either to: (i) present information on specific cash flows (e.g., cash paid to suppliers, cash paid to employees, cash received from customers); or (ii) reconcile the difference between cash flows from operating activities and operating income (e.g., adjustment for non-cash expenses, adjustment for changes in receivables and payables balances). In practice, a majority of governments currently follow this second (i.e., indirect) approach. Under the NFRM, the direct method will be required in all cases.

### Implementation Timing and Progress

As described on page 23, RMI government financial statements will have to comply with the requirements of GASB 34 starting with the financial year beginning on 1 October 2002. Furthermore, the primary government and its component units must implement GASB 34 simultaneously. However, the RMI Government will not be required to implement the retroactive reporting of infrastructure assets until the financial year beginning on 1 October 2007.

As of October 2001, RMI government organizations, led by the MOF, had made some progress in compiling fixed-asset records. However, computerized accounting information systems had not been reconfigured to support the introduction of accrual accounting. Moreover, few interviewees were aware of the significant pending changes

Other countries have introduced accrual accounting into government. At a similar stage to RMI, most of these countries had already:

- established asset registers
- valued assets and liabilities where appropriate
- prepared opening balance sheets
- obtained audit sign-offs on them
- procured and implemented the computerized accounting information systems to support the introduction of accrual accounting, and
- completed extensive awareness and training programs.

## **Part Two. Auditing Standards**

### **8. Introduction**

As with accounting standards, RMI directly uses US Generally Accepted Auditing Standards (GAAS) for public and private sector auditing standards.

### **9. Legal Status of US GAAS in RMI**

It is generally accepted that RMI financial statement audits must be conducted in conformity with US GAAS, but RMI laws are not clear in this respect. On one hand, some laws are absolutely clear as to the use of US GAAS. For instance, the *Auditor-General (Definition of Duties, Functions and Powers) Act 1986* stipulates that the relevant US auditing standards must be followed for public sector audits. More ambiguously, other laws, such as the *Banking Act 1987* require that financial statement audits be conducted in “conformity with generally accepted auditing standards”.

### **10. US GAAS for Nongovernment Audits**

The Auditing Standards Board (ASB) of the AICPA promulgates Statements on Auditing Standards (SASs), Statements on Standards for Attestation Engagements (SSAEs) and Statements on Standards for Accounting and Review Services (SSARs). These pronouncements are very similar to International Standards on Auditing (ISAs) and International Auditing Practice Statements (IAPs). The list of effective ISAs and IAPs at 30 June 2001 is provided as Appendix 12.

### **11. Generally Accepted Government Auditing Standards**

The GAO issues Generally Accepted Government Auditing Standards (GAGAS) (the Yellow Book). It contains standards for audits of government organizations, programs, activities, and functions, and of government assistance received by contractors, nonprofit organizations, and other nongovernment organizations. These standards pertain to auditors’ professional qualifications, the quality of audit effort, and the characteristics of professional and meaningful audit reports.

Government Auditing Standards in relation to financial audits are closely aligned to auditing standards issued by the AICPA (and IFAC). (See Appendix 13 for the contents of GAGAS)

## 12. Issue Synopsis: Accounting and Auditing Standards

Chapter VIII – *Issues and Recommendations* – identifies and describes constraints and proposes corrective actions. These include the following issues regarding accounting and auditing standards:

- RMI laws are sometimes ambiguous or silent regarding the accounting and auditing standards requirements.
- Under RMI law, the government and government organizations will be required to adopt GASB's new government financial model starting with the financial year beginning on 1 October 2002. However:
  - o The necessary implementation activities will overlap with the implementation of new computerized information systems and changes brought about by the FFMRP.
  - o The budgetary requirements of the NFRM will potentially conflict with those designed as part of the FFMRP.
  - o Comparative implementation progress lags behind other countries and jurisdictions that have implemented accrual accounting: Given the acute shortage of qualified government bookkeepers and accountants, it is difficult to envisage successful implementation in the required timeframe.



## **V. Accounting and Auditing Training**

**O**ther chapters discuss various aspects of good financial management arrangements including legislation, institutional arrangements, professional qualifications, standards and computerized information systems. But, these things must be designed, operated and maintained by people. For RMI, this chapter is the most important. It describes accounting and auditing education and training and is structured as follows:

- 1 – Introduction – provides an introduction to RMI accountancy education.
- 2 – International Guidance on Accountancy Education – describes international standards and guidance in relation to accountancy education and training.
- 3 – Educational Legislation and Coordination – discusses the coordination of RMI education and legislative underpinnings.
- 4 – RMI Scholarship Grant and Loan Board – discusses the activities and priorities of this important board.
- 5 – Education and Training Institutions – discusses the activities and courses of the two post-secondary institutions that offer accountancy education and training—the College of the Marshall Islands (CMI) and the University of the South Pacific (USP)—and the functions of the USDA Pacific Islands Training Initiative (PITI).
- 6 – Other Externally-Supported Training Initiatives – describes other recent and ongoing externally supported training initiatives.
- 7 – ADB Experience with Pacific Capacity Building – identifies lessons that ADB has learned about capacity building in the Pacific.
- 8 – Issue Synopsis: Accounting and Auditing Training – summarizes the issues identified in this chapter.

### **1. Introduction**

In traditional Marshallese society, youth learned essential skills, concepts and attitudes through direct involvement with family and community—those with special knowledge or skills trained selected apprentices to preserve the skills and cultural knowledge.

Missionaries established the first formal schools in 1857. Sustained efforts to create a formal education system began in the 1950s, with the establishment of the Trust Territory Department of Education. These efforts continued into the 1960s and 1970s with the formation of the Marshall Islands Teacher Education Center and the Community College

of Micronesia offering Associate of Science degrees for teachers. This momentum was not sustained in the 1980s due to a rapidly increasing school-age population, deteriorating educational infrastructures and decreasing education funding.<sup>35</sup>

In the past 10 years, efforts to improve educational standards have intensified. As of 2001, nearly half of the teachers have secondary school diplomas as their highest qualification. The Ministry of Education, with the CMI, is introducing new teacher certification regulations, and is encouraging teachers to obtain tertiary degrees. Upgrading the educational system to expand the skill base is important if employment is to move into high-technology areas.<sup>36</sup>

Accountancy education and training arrangements are part of this wider education picture. In this respect, the RMI education system faces serious challenges: (i) RMI's birthrate (4 percent) is the highest in the Pacific region's, putting enormous pressure on education;<sup>37</sup> and (ii) basic educational attainment levels are low—particularly in mathematics and English, subjects that are vital to developing accountancy skills. In this environment, accountancy education might be seen as an unaffordable luxury. However, given the acute shortage of Marshallese accountants in the public and private sectors, and the importance of sound financial management arrangements to development outcomes, this must be seen as essential.

## 2. International Guidance on Accountancy Education

The international community has issued a variety of guidance on accountancy education. This guidance includes:

- *Quality Issues For Internet and Distributed Learning in Accounting Education.* This IFAC Education Committee discussion paper analyses the environment conducive to the design, development and delivery of high-quality Internet and distributed learning in global accounting education, and offers recommendations for assessing their quality.<sup>38</sup>

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<sup>35</sup> [www.rmiembassyus.org/edu.html](http://www.rmiembassyus.org/edu.html)

<sup>36</sup> ADB. 2001. *Asian Development Outlook 2001*. Manila: ADB. pp. 139-140.

<sup>37</sup> World Education Forum (UNESCO). 2000. *EFA 2000 Assessment: Republic of the Marshall Islands*.

<sup>38</sup> IFAC. 2000. *Quality Issues For Internet and Distributed Learning in Accounting Education*. New York: IFAC Education Committee. [www.ifac.org](http://www.ifac.org)

- *Discussion Paper on Assistance Projects in Accountancy Education and Development*. This IFAC Education Committee discussion paper, which is based on the experiences of 15 IFAC member organizations, looks at some common aspects of successful aid and assistance projects and the impediments that can derail the process. It is meant to assist accountancy organizations and consultants involved in aid projects for the development of accountancy education, as well as potential donors.<sup>39</sup>
- *International Education Guideline (IEG) 9: Accounting Education and Experience*. This IFAC guideline sets out high-level curriculum expectations.<sup>40</sup>
- *Guideline for a Global Accounting Curriculum and Other Qualification Requirements*. This UN Conference on Trade and Development (UNCTAD) report sets out requirements for the qualifications of professional accountants, and provides guidelines for national qualification systems.<sup>41</sup>
- *Global Curriculum for the Professional Education of Professional Accountants*. This UNCTAD report sets out curriculum requirements including: (i) organizational and business knowledge; (ii) information technology; and (iii) accounting and accounting-related knowledge.<sup>42</sup>

These materials are extremely relevant to RMI's efforts to build in-country capacity.

### 3. Educational Legislation and Coordination

Under the *Education Act 1991*, the Minister of Education has primary responsibility for all areas of education. The Ministry of Education is responsible for coordinating all primary and secondary education. Among other things, the *Industries Development Act 1991* established the seven-member National Training Council (NTC), which is responsible for advising the Minister on vocational training, arranging or providing training, establishing standards and assessing trainees, and issuing certificates upon satisfactory completion of training courses.

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<sup>39</sup> IFAC. 2000. *Discussion Paper on Assistance Projects in Accountancy Education and Development*. New York: IFAC Education Committee. [www.ifac.org](http://www.ifac.org)

<sup>40</sup> IFAC. 1996. *Guideline 9: Accounting Education and Experience*. New York: IFAC.

<sup>41</sup> UNCTAD. 1999. *International Accounting and Reporting Issues: 1999 Review*. United Nations.

<sup>42</sup> *Ibid.*

#### 4. RMI Scholarship Grant and Loan Board

The *Scholarship Assistance Act 1979* established the eight-member RMI Scholarship Grant and Loan Board. The Board evaluates applications for scholarships and awards scholarship grants and loans. The Scholarship Fund Account is primarily financed by CFA monies [Article 1, Sec. 216(3)(a)]. Three main factors guide the Board's awarding of scholarship grants and loans; demonstrated ability and potential, inability to pay costs, and Cabinet-approved priorities. With regards to the last criterion, some interviewees questioned whether Cabinet placed sufficient priority on accountancy education.

#### 5. Education and Training Institutions

RMI has two post-secondary institutions that offer accountancy education and training: CMI and USP. In addition, the Graduate School (US Department of Agriculture, USDA) offers training in accounting and financial management, through the PITI. The following subsections discuss the activities and courses of these three institutions.

##### College of the Marshall Islands (CMI)<sup>43</sup>

CMI is an autonomous two-year community college for students within the Micronesian region. The College is fully accredited by the Western Association of Schools and Colleges and is designated by law as the post-secondary institution for RMI (*College of the Marshall Islands Act*). CMI offers degree and certificate programs in the areas of education, business, nursing and allied health, liberal arts, and vocational education. The main campus is located on Majuro Atoll.

CMI's Business and Computer Science Department prepares students for working in the private and public sectors. It offers two Associate of Science Degree majors: Business Administration major on both campuses and Business Studies major with a Specialization, on the Kwajalein campus. The program requirements for these two degrees are set out in Table 6 (Appendix 14 provides further course details).

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<sup>43</sup> Primary Source: [www.cmiedu.net](http://www.cmiedu.net)

**Table 6: Program Requirements for Associate of Science Degree**

Major in Business Administration.					
I. General Core Requirements (28 credits)					
II. Business Core Requirements (39 credits):					
BU 101	Introduction to Business	BU 181	Business Law		
BU 105	Business Mathematics	BU 241	Principles of Marketing		
BU 110	Business Economics	BU 251	Small Business Management		
BU 121	Business Communication	BU 261	Principles of Management		
BU 131	Accounting I	CS 103	Word Processing		
BU 132	Accounting II	CS 104	Spreadsheets		
Choice of CS 220/ BU 296/ BU 231					
III. Total Credits Required for Graduation: 67					

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Major in Business Studies and a Specialization					
I. General Core Requirements (28 credits)					
II. Business Core Requirements (21 credits):					
BU 101	Introduction to Business	BU 132	Accounting II		
BU 110	Business Economics	BU 261	Principles of Management		
BU 121	Business Communication	CS 102	Computer Applications		
BU 131	Accounting I				
III. Specialization (15 credits)					
Management Specialization:		Accounting Specialization:		Computer Science Specialization:	
BU 122	Business Communications II	BU 231	Accounting III	CS 120	Computer Science I
BU 251	Small Business Management I	BU 232	Accounting IV	CS 141	Computer Science II
BU 252	Small Business Management II	BU 235	Government Accounting	CS 213	Systems Analysis and Design
BU 262	Management Principles II	MA 101	Algebra and Trigonometry	CS 230	Database Management
Open Elective		Open Elective		CS Open Elective	
IV. Total Credits Required for Graduation: 64					

CMI also provides adult continuing education courses in accounting. Each year, around three students with accounting majors graduate from CMI (see Table 7).

DIAGNOSTIC STUDY OF ACCOUNTING AND AUDITING PRACTICES  
IN THE MARSHALL ISLANDS

**Table 7: CMI Graduates: 1997–2000<sup>44</sup>**

Subject	96-97	97-98	98-99	99-00	00-01	Total
Business Accounting	2	3	4	4	2	23
Office Administration	3	3	..	..	..	10
Computer Science	1	9	6	9	6	36
Management	5	..	7	5	..	38
Nursing	9	8	13	11	8	115
Education	11	18	14	19	10	121
Liberal Arts	6	7	11	6	13	72
Engineering	..	1	4	3	3	16
Total	37	49	59	57	42	431

### University of the South Pacific (USP)<sup>45</sup>

USP has 12 member countries: Cook Islands, Fiji Islands, Kiribati, RMI, Nauru, Niue, Samoa, Solomon Islands, Tokelau, Tonga, Tuvalu, and Vanuatu. It offers undergraduate and postgraduate study programs, including teaching, tourism, journalism, agriculture, science and environmental management, technology, computing and information systems, banking and finance, public administration and management, counseling and social services.

A distance education program, supported by University Centers, delivers academic courses to almost half of USP's total student body in the 12 member countries. The rest study full or part-time at the University's three major campuses in Fiji, Vanuatu and Samoa. Smaller University Centers in each member country offer academic, administrative and communications technology support to distance education students enrolled through the university extension program. Seventy-nine RMI students were enrolled at USP in 2000—however none of these were enrolled in certificate, diploma or degree courses in accounting (see Table 8).

The objectives of USP's Department of Accounting and Financial Management, within the School of Social and Economic Development, are to: meet the region's needs for accounting and banking personnel at the professional and paraprofessional level; and undertake applied research and consultancy in accounting, finance and banking. USP offers undergraduate and postgraduate degrees in accounting and financial

<sup>44</sup> Source: College of the Marshall Islands (CMI). 2000 May 31. CMI Graduates 1993-2000.

<sup>45</sup> Primary Source: [www.usp.ac.fj](http://www.usp.ac.fj)

Table 8: USP Enrolments of RMI Students for 2000

Course	External	Internal
Certificate		
• Accounting Studies	..	..
• Law	6	..
• Librarianship	16	..
• Management Studies	1	..
• Marine Affairs	1	..
	24	..
Diploma		
• Accounting Studies	..	..
• Early Childhood Education and Development	31	..
• Educational Administration	2	..
• Population Studies	..	1
	33	1
Degree		
• Arts	4	2
• Arts (Business Studies)	..	..
• Arts (Environmental Studies)	..	1
• Law	3	1
• Science (Environmental Studies)	..	1
• Technology	..	1
• Unclassified	8	..
	15	6
Total	72	7

management (see Appendix 15 and Appendix 16, respectively, for course details). The postgraduate Diploma in Banking was established to promote specialist skills within the banking community and the Department is currently involved in a dialogue with the Fiji Institute of Accountants to establish a graduate professional orientation program.

USP offers Majuro-based preliminary and foundation accountancy programs that prepare students for undergraduate studies (see Table 9).

DIAGNOSTIC STUDY OF ACCOUNTING AND AUDITING PRACTICES  
IN THE MARSHALL ISLANDS

**Table 9: USP Accountancy Students: Majuro 1996-2001**

	1996	1997	1998	1999	2000	2001
Preliminary Accounting:						
• Semester 1	10	25	16	5	19	4
• Semester 2	8	14	8	5	2	8
Foundation Accounting:						
• Semester 1	2	4	11	3	3	3
• Semester 2 <sup>46</sup>	..	..	..	..	..	3

In 2000, USP received \$15.1 million from member governments. In 2000, RMI nationals represented 0.9 percent of USP students and the RMI government contributed 0.3 percent of assessed government contributions (see Table 10).

**Table 10: Assessed Government Contributions to USP (1994-2000)**

Percent	1994	1995	1996	1997	1998	1999	2000
Cook Islands	1.9	1.5	1.5	1.3	1.0	0.9	1.0
Fiji	72.5	75.6	74.7	73.2	72.9	72.5	74.3
Kiribati	2.9	2.5	3.1	3.2	3.3	3.5	3.3
RMI	0.2	0.2	0.4	0.4	0.2	0.3	0.3
Nauru	0.6	0.6	0.4	0.3	0.3	0.4	0.4
Niue	0.2	0.2	0.3	0.2	0.3	0.3	0.3
Samoa	6.5	5.9	6.0	5.7	5.6	5.5	5.6
Solomon Islands	5.6	5.0	5.5	5.9	6.0	5.9	5.1
Tokelau	0.3	0.2	0.1	0.1	0.1	0.1	0.1
Tonga	4.7	4.0	3.8	3.7	3.7	3.7	3.1
Tuvalu	0.9	0.7	0.8	0.9	0.9	1.2	1.6
Vanuatu	3.7	3.6	3.4	5.0	5.6	5.9	4.7
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

### Graduate School USDA: Pacific Islands Training Initiative (PITI)

Established in 1921, the Graduate School, USDA specializes in public sector education and training. The PITI was established in 1991, and provides training to support efforts in implementing and maintaining sound financial

<sup>46</sup> Foundation accounting was offered as a one-semester course from 1996-2000.

management and program performance to Pacific insular governments. Although primarily funded by DOI, insular governments provide funds targeting specific projects, and make extensive in-kind contributions.

Participating governments include American Samoa, Guam, the Commonwealth of the Northern Mariana Islands, FSM, RMI, and the Republic of Palau. PITI program goals are to assist these participating governments to: (i) improve financial management systems and practices; (ii) strengthen organizational processes to increase effectiveness and improve program results; (iii) build leadership and management capacity to improve government program performance; and (iv) enhance the capacity of human resource development organizations in planning, delivering and evaluating public sector professional development programs.

The Graduate School does not grant degrees but does offer continuing-education curricula for public sector employees. Courses are standard graduate and undergraduate quality, and are taught by experienced and qualified instructors from government, academia, and private sector. Appendix 17 provides a list of representative training courses.

Since 1991, the PITI has trained more than 15,000 participants in 800 training programs. Project staff members have Pacific experience in human-resource development, public sector financial management, and project management. Examples of recent programs include:

- collaborative development of long-range strategic Financial Management Improvement Plans, with several insular governments
- formation of the Insular Government Finance Officers Association to facilitate sharing information, resources, and best practices among the insular governments
- evaluation of mission critical systems, and recommendations which resulted in implementing new management information systems for all insular governments, through the Year 2000 Assessment and Skills Development Project
- training and process documentation for a newly installed financial management system after initial start-up problems (RMI MOF)
- Maintaining CPE requirements for the members of the APIPA.

## **6. Other Externally-Supported Training Initiatives**

Chapter VII describes donor activities. CFA payments from the US have directly supported current and capital education expenditure. Furthermore, the US DOI has supported improvements in budgeting and financial management skills through TA programs. US DOI also supports

the PITI program (see above).<sup>47</sup> Table 11 details other external support to accounting and auditing education and training.

**Table 11: Externally-Supported Training Activities**

Reference	Description	Timing
ADB Loan: 33166-01	Skills Training and Vocation Education Project Loan. <sup>48</sup> The objectives of this project are to improve skills training and provide well-trained skilled workers for economic and social development. In particular, the project will rationalize and strengthen the skills training delivery system to meet the resource needs of industry and improve income-generating and employment opportunities for youth, school dropouts and women.	2001-03
ADB TA: RMI 34504-01	Fiscal, Financial and Economic Advisory Services: This TA for \$950,000 approved on 7 June 2001 will provide for: (i) fiscal and financial advisory services; (ii) economic strategy advice; (iii) capacity building towards a more efficient public service; (iv) support for reform program implementation; (v) short-term consultancy inputs for specific reform initiatives as required.	2000-02
ADB TA: RMI 32209-01	Improving Articulation of Post Secondary Technical and Academic Education in RMI: The objectives of this proposed TA for \$150,000 are to: (i) ensure proper articulation of curriculum and program delivery at the post secondary level; and (ii) improve academic skills of Marshallese. The scope is likely to include developing curricula and course programs, establishing resource requirement and delivering programs and suggesting appropriate organizational needs to sustain the program.	2001 -
ADB TA No. 5967- REG	Countering Money Laundering in the Asian and Pacific Region: This TA will provide training workshops/seminars in relation to anti-money laundering arrangements.	2001-02
ADB TA No. 3418- RMI	Strengthening the Capacity of the MOF: This TA for \$150,000 approved on 21 March 2000, supported the strengthening of MOF in economic and financial management through institutional and capacity development. The TA helped provide on-the-job training to senior MOF staff and developed methodologies to improve work efficiency and flows. The TA also provided training to accounting staff in the MOF and line ministries.	2000-01

<sup>47</sup> Aranza, Ferdinand (Director, Office of Insular Affairs, US DOI). 2000 June 28. Statement before the Subcommittee on Asia and the Pacific Committee on International Relations, US House of Representatives: The US Compacts with the Federated States of Micronesia and the Republic of the Marshall Islands.

<sup>48</sup> Loan: RMI 33166-01: *Skills Training and Vocation Education Project*, for \$6.8 million, approved on 29 November 2000.

**Table 11: Externally-Supported Training Activities** *(continued)*

Reference	Description	Timing
ADB TA No. 2205-RMI	Small Enterprise Development: workshop training in 1995–96 cash-flow forecasting, financial statements, project appraisal and monitoring.	
ADB TA No. 2204-RMI	Institutional Strengthening of the MIDB: Phase II: This 1995–96 TA, for \$202,000 approved on 23 November 1994, focused on upgrading staff training and skills development. It also upgraded the MIDB Operating Manual and supported the development of a Corporate Plan for 1995–1999.	
Australian Agency for International Development (AusAID)	AusAID and NZODA offer annual scholarships for RMI Ongoing students.	
New Zealand Overseas Development Assistance (NZODA)		
UNDP MAS/97/002	Support to Human Resources Development through the 1997–98 National Training Council: This project, for \$21,000, helped the National Training Council to fulfill its mandated role of coordinating training in RMI. It also assisted in finalizing the design of the project and will provide initial training to RMI personnel responsible for managing training programs.	

## 7. ADB Experience with Pacific Capacity Building<sup>49</sup>

The shortage of managerial and technical skills is a major constraint in developing efficient social and economic systems. The human resources and institutional capacity in the PDMCs remain extremely weak, which is in large measure caused by the small labor market and limited local education opportunities.

Weaknesses range from the limited capacities of parliaments to debate policy issues and effectively oversee government administration, to the limited professionalism of the civil service, the weak capacity of sectoral agencies to regulate and manage critical public services, and the insufficient ability of the private sector to engage the necessary business and technical skills. The shortage of skills in the smallest and remotest PDMCs is to be expected, and there is no easy solution. However, although much effort has been expended in building skills in the larger PDMCs (e.g., Fiji and the

<sup>49</sup> ADB. 2000 September. *A Pacific Strategy for the New Millennium*. Office of Pacific Operations. Manila: ADB. p. 11.

Melanesian countries), durable capacity is still lacking. The important lesson so far is the realization that this long-term task requires sustained attention and investments. There are serious risks in being overly ambitious, given the weak base in most countries.

To some extent, providers of external assistance have contributed to the problem of low capacity. Multilateral and bilateral donors design complex projects and programs, and then field a battery of consultants to implement them due to the local inability to cope. Capacity-building programs are often resourced by long-term consultants who often are technical rather than capacity-building specialists, and who end up doing the work themselves rather than transferring relevant skills to the local population. Governments compound the problem by not adhering to a policy that would allow trained incumbents to stay in place over a period of time adequate to impact institutional operations. Finally, although bilateral programs have heavily invested into overseas education and training, they are plagued by the consequent emigration of trainees, seeking more attractive overseas employment.

## **8. Issue Synopsis: Accounting and Auditing Training**

Chapter VIII – *Issues and Recommendations* – identifies and describes constraints and proposes corrective actions. These include the following issues regarding RMI accounting and auditing education and training:

- Low levels of educational attainment in primary and secondary schools—particularly in mathematics and English—mean that students are both averse to, and have trouble with, accountancy studies.
- The RMI Scholarship Grant and Loan Board Scholarship Board awards scholarships partially based on identified Cabinet priorities. Accountancy does not appear to be a priority.
- US accounting practices, particularly with regards to government accounting arrangements, differ from those of other countries. The accountancy courses offered by USP are of a high standard, but pose two problems for Marshallese graduates. First, they may not be adequately versed in US accounting arrangements and practices. Second, their degree will limit the graduate's ability to progress towards a recognized US CPA qualification.

## **VI. Government Budgeting and Accounting**

**T**his chapter describes government budgeting, accounting and auditing arrangements. For the purposes of this report, ‘government’ comprises the national civil service under the responsibility of the Public Service Commission, the Marshall Islands Development Authority (MIDA), the Kwajalein Atoll Development Authority (KADA) and the 24 local governments. The preceding chapters covered many aspects of government budgeting, accounting and auditing arrangements, including staffing constraints, the legal framework, professional arrangements, accounting and auditing standards, and training initiatives. Consequently, this chapter summarizes government accounting and auditing arrangements and issues—much of the material is sourced from the recent ADB RRP on the Fiscal and Financial Management Reform Program (FFMRP).<sup>50</sup> The chapter is structured as follows:

- 1 – Introduction – describes the governmental environment.
- 2 – Legal and Institutional Framework and Roles – sets out the key laws that govern government budgeting and accounting arrangements.
- 3 – Budget Documentation and Process – discusses budgetary documentation and the budget process.
- 4 – Accounting Basis and Accounting Information Systems – describes the basis for government accounting and discusses the status of accounting information systems.
- 5 – Government Accounting Personnel – discusses the government accounting personnel.
- 6 – The Fiscal and Financial Management Reform Program – describes the objectives and components of the FFMRP.
- 7 – Issue Synopsis: Government Budgeting and Accounting – summarizes the issues identified in this chapter.

### **1. Introduction**

The public sector dominates the RMI economy. The national and local governments not only provide an important share of formal employment in the economy, but also own and control a large number of corporations

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<sup>50</sup> ADB. 2001 May. Report and Recommendation of the President to the Board of Directors on Proposed Loans and Technical Assistance Grant to the Republic of the Marshall Islands for the Fiscal and Financial Management Program. RRP: RMI 345040. Manila: ADB.

and statutory bodies. Many government holdings have been corporatized over the years, and subsidies successfully reduced or eliminated in many cases, but public sector dominance of the economy remains.

The TTPI administration left the RMI with a large, costly and poorly-performing public service. In 1994 a Presidential Committee looked at public sector reform and concluded that the service was overstaffed and inefficient, had many unproductive employees, lacked skilled staff, and showed widespread duplication.

The ADB-supported Public Sector Reform Program (PSRP), which began in 1997, had several objectives including short-run fiscal stabilization, long-term structural stabilization and creation of an improved private sector environment.<sup>51</sup> Achievements included reducing the government payroll by 30 percent, privatizing domestic shipping services, streamlining Foreign Investment Board License applications, and establishing the MIITF to stabilize budget receipts.

Despite these measures, several issues remain, including low levels of efficiency in public service, weak government financial management, and a slow buildup of MIITF resources. With further ADB support<sup>52</sup>, the Government has developed a public finance management reform program to establish systems of annual and medium-term budgeting, financial control, accounting, internal audit, and parliamentary reporting.

**Table 12: Central Government Finances, FY1996-FY2001 (\$ million)<sup>53</sup>**

Item	1996	1997	1998	1999	2000 Est.	2001 Budget
Total revenue and grants	78.1	68.8	71.5	65.5	62.1	68.8
Total domestic revenue	36.0	27.8	24.7	26.7	22.5	24.6
Taxes	19.4	18.6	18.7	16.9	16.1	16.9
Income	8.5	8.1	7.6	7.6	8.0	8.5
Gross revenue	3.9	2.7	2.7	2.5	3.1	3.2
Imports	5.7	7.0	7.5	6.2	3.9	4.8
Other	1.3	0.8	0.8	0.5	1.1	0.3

<sup>51</sup> Loan 1513-RMI: *Public Sector Reform Program*, for \$12 million, approved on 30 January 1997.

<sup>52</sup> Loan 1829-RMI: *Fiscal and Financial Management Program*, for \$12 million, approved on 7 June 2001.

<sup>53</sup> ADB. 2001 May. Report and Recommendation of the President to the Board of Directors on Proposed Loans and Technical Assistance Grant to the Republic of the Marshall Islands for the Fiscal and Financial Management Program. RRP: RMI 345040. Manila: ADB. p. 10.

Table 12: Central Government Finances, FY1996-FY2001 (\$ million)

(continued)

Item	1996	1997	1998	1999	2000 Est.	2001 Budget
Non-tax	16.6	9.2	6.0	9.8	6.4	7.7
Fishing rights	1.6	1.9	1.3	2.3	3.4	4.4
Fees and charges	2.8	1.9	0.6	0.6	0.5	0.3
Investment income	1.1	0.8	1.6	0.6	0.3	0.3
Other	11.2	4.6	2.4	6.3	2.2	2.8
Grants	42.1	41.0	46.8	38.8	39.6	44.1
Of which: current grants	14.1	18.0	22.9	15.8	15.8	15.8
CFA	34.6	30.4	30.9	30.9	30.9	30.9
Other	7.5	10.6	15.9	7.9	8.7	13.2
Total expenditure	60.1	60.4	56.6	55.3	57.1	53.8
Current expenditure	53.8	52.9	51.8	48.4	50.1	44.1
Wages and salaries	21.4	18.8	18.0	17.0	17.3	17.5
Goods and services	17.5	17.8	21.6	18.8	19.0	19.1
Interest payments	7.5	6.8	5.4	4.3	1.9	0.9
Public enterprise subsidies	2.6	2.1	2.6	1.4	1.5	1.5
Other subsidies and transfers	4.7	5.4	3.6	6.1	10.3	4.9
RIF payment	0.0	2.1	0.6	0.8	0.1	0.1
Capital expenditure	6.4	7.5	4.8	6.9	7.0	9.7
Current balance	-3.7	-7.1	-4.2	-5.9	-11.8	-3.6
Overall balance	17.9	8.4	14.9	10.2	5.1	15.0
Financing						
Net government borrowing	-12.4	-7.3	-11.0	-27.9	-11.6	-16.0
Gross borrowing	4.1	10.7	7.9	15.0	7.1	9.0
Principal repayment	16.5	17.9	19.0	42.8	18.7	25.0
Asset sales	0.0	0.0	0.0	0.0	1.3	2.5
Government financial assets	-5.6	-3.8	17.7	0.1	-1.6	...
			(percent of GDP)			
Revenue and grants	80.5	74.6	74.7	67.3	64.7	69.6
Revenue	37.1	30.2	25.8	27.4	23.4	24.9
Grants	43.4	44.5	48.9	39.9	41.3	44.7
Expenditure	62.0	65.5	59.2	56.8	59.5	54.4
Current	55.4	57.4	54.2	49.7	52.2	44.6
Capital	6.6	8.1	5.0	7.1	7.3	9.8
Current balance	-3.8	-7.8	-4.4	-6.1	-12.3	-3.7
Overall balance	18.5	9.1	15.5	10.5	5.3	15.2
Memorandum items:			(\$ million)			
Outstanding government debt	115.3	108.1	97.0	70.1	60.5	44.5

## 2. Legal and Institutional Framework and Roles

The *Constitution 1979* underpins government financial arrangements. It establishes budgetary roles and rules, and institutions and offices. The latter include the Auditor-General (see Appendix 4), the Secretary for Finance and the Public Service Commission (PSC). The PSC is the public service employing authority, charged with organization, management, efficiency, and economy of the service.

The *Rules of Procedure of the Nitijela 1989* (Sec. 44) establish the nine-member Committee on Appropriations, which is responsible for considering and reporting on all Bills, resolutions, motions and other matters relating to public expenditure or financial administration of RMI and local government finance, including budget estimates and supplementary estimates. These Rules also establish the seven-member Committee on Public Accounts (Sec. 49), which is responsible for: (i) considering the public funds and accounts of RMI, together with the report of the Auditor-General; (ii) reporting to the *Nitijela* on excess or unauthorized expenditures or funds; (iii) proposing measures to ensure that public monies are properly and economically spent and accounted for; (iv) considering, reporting and making recommendations on the accounts of public corporations and statutory authorities; and (v) reporting to the *Nitijela* as requested.

The *Financial Management Act 1990* governs public-sector financial management arrangements. Among other things, it stipulates that RMI should provide full disclosure of its financial operations and adequate financial information for management of operations, and shall ensure effective control over revenues, multilateral and bilateral grants-in-aid, including US federal grants, income, expenditures, monies, and other assets, and shall be in accordance with the standards promulgated by the US GASB. The Act also sets out the governing principles of the financial management system, including fiscal policy objectives (Sec. 121), and assigns responsibility for maintaining adequate systems of internal control to the Secretary of Finance (Sec. 128).

The *Planning Act 1974* creates the Office of Planning and Statistics (OPS), which advises Cabinet on planning and budgetary matters. In particular, the OPS formulates national and sectoral development plans, including economic policies, development goals and objectives, and development strategies. The OPS is also responsible for reviewing all projects and programs and annual and long-term budget proposals.

The *Local Government Act 1980* requires that Executive Committees provide annual budget estimates of revenues and expenditures to their re-

spective Councils—it also requires that they keep proper accounts and records (Sec. 118). The Act gives the Minister of Internal Affairs, in consultation with the Minister of Finance, the authority to issue instructions (Local Government Financial Memoranda) stipulating requirements with respect to: (i) accounts and auditing; (ii) the maintenance of proper records; and (iii) staff duties and responsibilities.

### **3. Budget Documentation and Process**

The RMI Government uses a simplified Planning, Programming and Budgeting System (PPBS) for public expenditure management.

RMI's fiscal problems can be directly linked to deficiencies in the budgeting and financial management systems that were unable to handle the huge CFA grants. The budget format provides little information for scrutiny of government expenditure patterns, which limits the Government's ability to make informed decisions about funding priorities and the public's ability to question spending priorities. The budget is prepared with only the most basic projections on revenues, expenditures, and information on past expenditure trends. In this environment, fiscal policy decisions often enter the realm of guesswork, and are subject to arbitrary decision making, often to the advantage of vested interests.<sup>54</sup>

Budget preparation for the following year begins in April, with the Cabinet appointment of the Budget Coordinating Committee (BCC). The BCC comprises the Minister of Finance, the PSC, the Attorney-General, the President's Office and OPS. BCC then establishes budget preparation criteria and communicates them to ministries.

BCC conducts budget hearings in late May or early June, during which ministries explain and defend their budget proposals. After this—usually in August—BCC meets to consolidate the adjusted ministry budgets for submission to Cabinet.

Cabinet then considers the draft budget and refers it to the Committee on Appropriations for review. The Committee on Appropriations usually returns the (adjusted) budget to Cabinet for final consideration and approval. The approved budget is usually released during the second or third week of September.

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<sup>54</sup> ADB. 2001 May. Report and Recommendation of the President to the Board of Directors on Proposed Loans and Technical Assistance Grant to the Republic of the Marshall Islands for the Fiscal and Financial Management Program. RRP: RMI 345040. Manila: ADB. pp. 18-19.

## 4. Accounting Basis and Accounting Information Systems

### Basis of Accounting

As described on page 23, most government accounting is currently on a modified accrual basis, however, accounting standards require that the full accrual accounting be adopted starting with the financial year beginning on 1 October 2002 (Also see pages 37-44). State-owned enterprises and statutory authorities use the accrual accounting basis.

### Accounting Information Systems

Two computerized accounting information systems are predominant in government: ADS and MIP. The MOF uses ADS for central government accounting. It is supported from Washington DC. Reconciliation problems occur between the general ledger and subsidiary ledgers, largely due to mistakes in the initial configuration. MIP is used by about a dozen organizations, including the Bank of the Marshall Islands, local governments, the Ministry of Health and Environment (MOHE), and the CMI. Local support is backed up from Austin, Texas.

As part of the FFMRP, the accounting system will be overhauled or replaced. The existing system is not efficient, and requires costly on-site support by installer (a foreign contractor). Daily position statements, weekly cash flow analysis, and monthly statements of account provided to the minister are to be established, consequently leading to semiannual statements to the *Nitijela* comprehensively setting out the government's financial position. Accounting officers will have to reconcile their accounting records with the central government accounts at least monthly.<sup>55</sup>

## 5. Government Accounting Personnel

As outlined throughout this report, the RMI government experiences an acute shortage of qualified bookkeepers and accountants—as of October 2001, there were no professionally qualified Marshallese accountants in

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<sup>55</sup> ADB. 2001 May. Report and Recommendation of the President to the Board of Directors on Proposed Loans and Technical Assistance Grant to the Republic of the Marshall Islands for the Fiscal and Financial Management Program. RRP: RMI 345040. Manila: ADB. p. 52.

RMI. This gap is only partially bridged by foreign CPAs employed within the government. Issues of poor record keeping, inadequate internal controls and financial management are symptoms of this underlying problem.

## **6. The Fiscal and Financial Management Reform Program (FFMRP)<sup>56</sup>**

A new RMI government was elected in January 2000. It recognized that many current problems are linked to deficiencies in public financial management, which has suffered from years of neglect, and is in need of major reform to budgeting, monitoring, and accountability for public funds. Fiscal policy is further constrained by absence of reserves and a narrow revenue base. Long-term revenue prospects remain heavily reliant on continued prospects for renegotiations of economic assistance under the CFA.

To this end, the Government and ADB recognized the opportunity presented by the CFA renegotiations in ensuring long-term economic sustainability of RMI through the prudent use of future CFA assistance. In response, the Government and ADB developed the FFMRP.<sup>57</sup> The FFMRP, while stabilizing the immediate fiscal situation, primarily aims at longer-term issues of improving overall RMI financial management. The specific objectives are to: (i) ensure a sustainable income flow, (ii) strengthen public sector financial and economic management, (iii) stabilize the fiscal position, (iv) enhance the policy environment for private sector development to maximize the benefits from future CFA assistance, and (v) increase public service effectiveness. The following subsections describe FFMRP components.

### **Ensure a Sustainable Income Flow for Future Generations**

The Government intends to build up MIITF balances by using CFA proceeds. It also intends to develop more stringent operational guidelines, revise the MIITF legislation to protect the fund's capital, and strengthen its governance procedures.

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<sup>56</sup> Source: ADB. 2001 May. Report and Recommendation of the President to the Board of Directors on Proposed Loans and Technical Assistance Grant to the Republic of the Marshall Islands for the Fiscal and Financial Management Program. RRP: RMI 345040. Manila: ADB.

<sup>57</sup> Loan 1829-RMI: *Fiscal and Financial Management Program*, for \$12 million, approved on 7 June 2001.

## **Stabilize the Fiscal Position**

The difficult financial position threatens basic government. On the revenue side, the Government intends to strengthen tax collection and address policy anomalies, while on the expenditure side, a range of measures are planned.

## **Enhance the Policy Environment for the Private Sector**

Recent government reforms have improved the policy environment for the private sector. Nevertheless, significant impediments to investment and private sector development still need to be addressed. In this respect, the Government will address land titles, taxation arrangements and will examine the role of MIDB.

## **Increase Public Service Effectiveness**

A large and inefficient public service has historically limited government's ability to deliver services. A review of the service will look at a range of issues. The focus of the reforms will be better management of human resources, including redeployment and retraining, appropriateness of pay scales, conditions of public service, and appropriate delegation of authority. Links will be established between financial and human resource inputs and outputs (delivery and service levels) for each ministry.

## **Strengthen Public Sector Financial and Economic Management**

### *Improving Corporate Governance*

The financial relationships between government and public sector enterprises (PSEs) have in the past contributed to the poor economic performance of the RMI. To overcome existing and potential problems, the Government is committed to completely review the corporate governance of its PSEs. An important part of this review will assess where PSEs merit subsidies, recommend how corporate governance can improve the outcomes delivered by these institutions, and identify measures to strengthen financial planning, management, and reporting for improved delivery. The review will recommend a plan and timetable of reductions in subsidies to minimize the impact on the Government's finances.

*Economic Policy, Planning and Statistics Office (EPPSO) and the National Policy Coordinating Committee (NPCO)*

The Government intends to establish the EPPSO by drawing on existing resources in OPS, MOF and other government policy offices. EPPSO will act as the secretariat for a newly established (NPCC with membership drawn from the senior levels of the civil service, with Cabinet leadership and representation. The NPCC will evaluate policy proposals for the Cabinet, with analysis provided by EPPSO. The NPCC will be responsible for various issues; from formulating the budget to policy and project requests from the ministries. To avoid duplication of effort, the NPCC will assume the responsibility of existing committees such as the BCC and the Loans Committee.

#### *Improving Financial Management*

A top priority is to reform and strengthen public financial management. This involves improving the annual budget format to conform to internationally accepted practices, strengthening financial control mechanisms, improving the accounting and reporting system, and developing a medium-term framework for planning and performance evaluation. The overarching objectives of these reforms will be to ensure transparency, accountability, establishment of input/output relationships, and cost effectiveness of public sector financial management.

A detailed time-bound action plan clearly indicating the specific steps to achieve the objectives will be prepared jointly by ADB-funded consultants and the Pacific Financial Assistance Center (PFTAC) team. In preparing the time schedule for action, due consideration will be given to available institutional capacity to implement these reforms.

Improving fiscal and financial management of the public sector is a critical outcome of the program. Therefore, adequate resources for advisory services have been provided under the loan and supported by the piggy-backed TA. The new budget preparation procedures and systems will be undertaken under the guidance and with the support of the budget advisor from PFTAC who has been involved in the preparatory stage of this project.

To complement these actions, the Secretary of Finance will issue financial instructions and regulations under the *Financial Management Act 1990* to govern accounting procedures, competitive tendering, and any other procedures needed to safeguard public finances. The *Financial Management Act 1990* will be reviewed to ensure that the Act and related legislation continue to meet the needs of the Government. The incorporation of the desired reforms in legislation will reduce the risk of reversal by future administrations.

The following are recommendations of the Government's Task Force on Accountability with inputs from PFTAC. The aim is to establish clear and robust systems of annual and medium-term budgeting, financial control, accounting, internal audit, and reporting to the *Nitijela*.

- (i) *Annual Budget Document*. Detailed estimates are to be presented to the *Nitijela* in support of the annual (and any other) appropriation bill. The estimates will be publicly available and will clearly show: (a) total estimated revenue, expenditure, and expected overall balance; (b) proposal to use any estimated surplus or finance any deficit; (c) expected sources of revenue, with reference to the legislation empowering the collection; (d) allocation of expenditure to heads, subheads, and items in sufficient detail to show clearly how public moneys are to be spent on which government policies and programs; (e) against each head of expenditure, a summary of the policies, programs, and specific performance targets expected to be achieved during the budget year; (f) comparative revenue and expenditure for the current and previous fiscal years; (g) statements of opening and closing balances and flows of funds for all public financial assets and liabilities, including trust and special funds, for the last two fiscal years and the budget year; and (h) statements of external aid programs, balances, proposed disbursements, and commitments.
- (ii) *Medium-term Budget Framework (MTBF)*. The annual budget estimates presented to the *Nitijela* are to be accompanied by an MTBF. The MTBF will present a four-year statement of the government budget, by main heads of revenue, expenditure, and financing, organized in accordance with the government finance statistics format. The first year of the framework will be the current year, showing the latest revised estimates. The second year will be the year for which the estimates are being submitted to the *Nitijela* for appropriation, and the allocations to heads will be as in the estimates. The third and fourth years will show estimated revenues based on current policy, and the allocations of expenditure that would result from implementing policies and programs approved by the Cabinet. Allocations will refer to the appropriate passages in the accompanying economic policy statement.
- (iii) *Financial Control*. Provisions are to be put in place to prevent unauthorized expenditure from the general fund and to limit expenditure from trust or special funds to the unexpended balance of each fund. The power of the Government to authorize expenditure in excess of the total appropriation through supplementary

appropriation bills will be limited to a specified fraction of the original appropriation, and restricted to urgent and unforeseen circumstances. The power of the minister to move funds within the estimates will also be strictly limited and its exercise must be promptly reported to the *Nitijela*. Significant penalties will be imposed for breach of these rules. Authority delegated to accounting officers will be linked to strict reporting and sub-control requirements. For cash flow reasons, the Minister of Finance will retain the power to restrict expenditure. Bank accounts will be consolidated and control/recovery of imprest accounts tightened. The Secretary for Finance will control use of credit facilities. The Public Accounts Committee of the *Nitijela* is to be made effective as the principal forum of Government accountability to Parliament.

- (iv) *Accounting*. The accounting system will be overhauled or replaced. The existing system is not efficient and requires costly on-site support by its installer (a foreign contractor). Daily position statements, weekly cash flow analysis and monthly statements of account to the minister are to be established, leading to semiannual statements to the *Nitijela* comprehensively setting out the government financial position. Accounting officers will be required to reconcile their accounting records with the central Government accounts at least monthly.
- (v) *Reporting*. A comprehensive structure of reporting will be put in place, designed to take up minimum time in preparing reports but detecting and requiring explanation for any significant divergences from the budget, and culminating in an annual report to the *Nitijela* by the Secretary for Finance.

### Allocation of FFMRP Loan Proceeds

The agreed allocation of loan proceeds is presented in Table 13. In addition to the loan proceeds, ADB will provide a TA grant for (i) fiscal and financial advisory services, (ii) economic strategy advice, and (iii) building capacity for a more efficient public service. The TA will fund the services of economic and financial advisers and support the Project Coordinating Unit (PCU) with consultant inputs to ensure compliance with the policy matrix, and undertake benefit monitoring and effective program implementation. The second part of the TA will provide economic management advisory support to the EPPSO, and the third component will assist the Government to develop in-house competencies and capacity for public sector management.

**Table 13: Allocation of FFMRP Program Loan Proceeds<sup>58</sup>**

Item	\$million
Allocation to MIITF	2.0
Health Arrears	3.5
Retire High-Cost Debt	2.5
Fiscal Balance Support	1.5
Accounting System. Adjustment costs associated with required changes in the financial accounting system to make it more responsive to proposed improvements in public financial management to support stronger control, accountability and better governance.	0.6
Revenue Measures. Costs to improve tax collection and enforce tax/customs duties.	0.9
Specialist Inputs/ Project Coordinating Unit. Financing specialist inputs to improve public financial management, supervise establishment and operation of a trust fund, support CFA renegotiation, and other needs to support program implementation.	1.0
<b>Total</b>	<b>12.0</b>

## **7. Issue Synopsis: Government Budgeting and Accounting**

Chapter VIII – *Issues and Recommendations* – identifies and describes constraints and proposes corrective actions. These include the following issues regarding government budgeting and accounting that the FFMRP has not identified, or does not intend to address:

- There is an acute shortage of qualified bookkeepers and accountants within the RMI government—as of October 2001 there were no professionally-qualified Marshallese accountants in RMI. This gap is only partially bridged by foreign CPAs who are employed in government. Issues of poor record keeping, inadequate internal controls and financial management are symptoms of this underlying problem. It is understood that two qualified accountants will be contracted for the period of the FFMRP (from counterpart funds). However, these additional resources are likely to be insufficient to implement the FFMRP (for instance, the overhaul or implementation of computerized accounting information systems).
- Under RMI law, the government, and government organizations, will have to adopt GASB's NFRM in less than 12 months. The necessary

<sup>58</sup> Source: ADB. 2001 May. Report and Recommendation of the President to the Board of Directors on Proposed Loans and Technical Assistance Grant to the Republic of the Marshall Islands for the Fiscal and Financial Management Program. RRP: RMI 345040. Manila: ADB. p. 27.

implementation activities will overlap with the implementation of new computerized information systems and changes brought about by the FFMRP. Furthermore, the budgetary requirements inherent in the NFRM will potentially conflict with those designed as part of the FFMRP. Finally, given the acute shortage of qualified government bookkeepers and accountants, it is difficult to envisage the requirements being successfully implemented in the required timeframe.



## VII. Donor Assistance

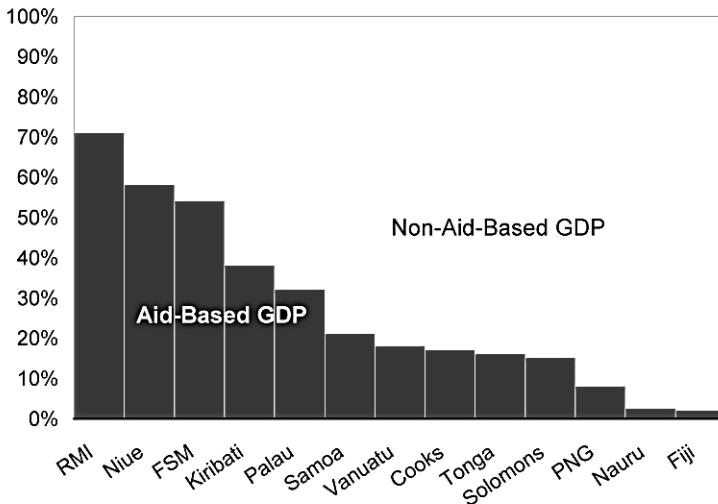
This chapter describes donor coordination mechanisms and discusses donor activities in relation to financial management and governance arrangements. It is structured as follows:

- 1 – Overview
- 2 – Coordination Mechanisms
- 3 – Asian Development Bank
- 4 – World Bank
- 5 – United Nations Development Programme (UNDP)
- 6 – International Monetary Fund (IMF)
- 7 – United States
- 8 – Taipei, China
- 9 – Australia (AusAID)

### 1. Overview

RMI depends heavily on foreign assistance (see Figure 2). US assistance is estimated at about \$80 million per annum and includes direct budgetary support under the CFA to the national government and to the KADA, and

Figure 2: Proportion of Aid in 13 Pacific Islands' GDP, 1998<sup>59</sup>



<sup>59</sup> Source: US GAO. 2001 August. *Foreign Assistance: Lessons Learned From Donors' Experiences in the Pacific Region*. Report to Congressional Requesters. p. 37.

payments to Kwajalein landowners, as well as other forms of assistance through US Federal Government programs.

Japan assists in the transport and fisheries sectors. Significant contributions are made by Taipei, China to the aviation sector and to the MIITF (see Table 14).<sup>60</sup> ADB has provided substantial assistance to improve financial management arrangements.

**Table 14: Overall External Assistance to RMI<sup>61</sup>**

External Source (US\$ million)	1994 – 1998 (annual average)		1999 Approvals	
	Loan	Grant	Loan	Grant
<b>Multilateral</b>				
ADB	6.1	1.6	9.3	0.6
UNDP	0.2	..	..	..
World Bank	..	..	..	..
Subtotal	6.3	1.6	9.3	0.6
<b>Bilateral</b>				
Australia	0.2	..	..	..
Taipei, China	..	..	..	..
Japan	5.4	..	..	..
United States	12.0	60.0	..	60.0
Subtotal	17.6	..	..	..
Total	23.9	1.6	9.3	0.6

A review of ADB's 1996-99 *Pacific Strategy* concluded that "aid was judged to have been unsuccessful in facilitating growth. Aid had supported large public sectors and involved TA that financed line positions without leading to durable capacity building. Additionally, inadequate aid coordination had contributed to weak or nonexistent linkages between aid programs and sound policy environments."<sup>62</sup>

<sup>60</sup> ADB. 2000 December. *Country Assistance Plan 2001-2003: Republic of Marshall Islands*. Manila: ADB. pp. 9-10.

<sup>61</sup> *Ibid.* p. 16. Authors' note: These figures exclude significant donors and understate US contributions.

<sup>62</sup> ADB. 2000 September. *A Pacific Strategy for the New Millennium*. Office of Pacific Operations. Manila: ADB. p. 16.

## 2. Coordination Mechanisms

In 1993, the Office of International Development Assistance (OIDA) was established within the MOF with ADB assistance.<sup>63</sup> Although OIDA is primarily responsible for coordinating external assistance, bilateral agencies tend to deal directly with agencies, the Office of the President or the Ministry of Foreign Affairs to identify projects and initiatives. In addition to government coordination efforts, the World Bank and the Commonwealth Secretariat established a “Joint Task Force on Small States” to address development challenges facing small states. The first annual Small States Forum was held at Prague Congress Center on 25 September 2000. Furthermore, in the last five years, three RMI consultative group meetings were convened.<sup>64</sup>

## 3. Asian Development Bank

Since RMI joined ADB in 1990 to 31 December 2000, ADB provided nine loans totaling \$59.1 million.<sup>65</sup> Project implementation generally proceeds satisfactorily, sufficient counterpart funding is available, but the lack of qualified counterpart staff is problematic. During 2000, audited project accounts and financial statements were due for three loans, of which two complied and one complied late.<sup>66</sup>

### Loan Projects

The following loans are directly related to improving public sector financial management and governance arrangements.

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<sup>63</sup> TA No. 1763-RMI: *Institutional Strengthening of the Ministry of Finance*, for \$350,000, approved on 5 October 1992.

<sup>64</sup> ADB. 2000 September. *A Pacific Strategy for the New Millennium*. Office of Pacific Operations. Manila: ADB. p. 15.

<sup>65</sup> ADB. 2002. *Regional and Country Highlights: Marshall Islands*. Manila: ADB. [www.adb.org/Countries/Highlights/RMI.asp](http://www.adb.org/Countries/Highlights/RMI.asp)

<sup>66</sup> ADB. 2001 October 31. *Semi-Annual Report on Loan and Technical Assistance Portfolio Performance for the Period Ending 31 December 2000*. Manila: ADB. p. 77.

*Fiscal and Financial Management Program Loan (2001-2004)*<sup>67</sup>

The Government requested ADB support to consolidate the gains of the PSRP, avert a fiscal crisis, meet the adjustment cost of the PSRP, and undertake far-reaching changes to improve public financial management and ensure long-term self-reliance. The key objectives of this program are to: (i) stabilize the fiscal position; (ii) strengthen public sector financial and economic management; (iii) ensure a sustainable income flow for future generations; (iv) improve public service effectiveness; and (v) enhance the policy environment for the private sector.

Specifically, the program will help build up MIITF balances to a level where returns will ultimately replace CFA assistance. The program also will help the budgeting and financial management system manage the CFA grants. Furthermore, it will improve annual budget formats to conform to internationally accepted practices, financial control mechanisms and accounting methods.

*Loan: RMI 33166-01 Skills Training and Vocation Education Project Loan (2001–03)*<sup>68</sup>

The objectives of this project are to improve skills training and provide well-trained skilled workers for economic and social development. In particular, the project will rationalize and strengthen the skills training delivery system to meet the resource needs of industry and improve income-generating and employment opportunities for youth, school dropouts and women.

*Public Sector Reform Program Loan (1997–2000)*<sup>69</sup>

The program objectives were to: (i) stabilize government finances; (ii) ensure the long-term structural stability of government finances; and (iii) create an improved enabling environment for the private sector. Major program achievements included: (i) a 30 percent decrease in the number of public servants and a reduction of the number of ministries from 10 to 8; (ii) effective implementation of a well-designed compensation scheme for retrenched employees; (iii) a three-year freeze on public service wage levels; (iv) elimination of direct subsidies to public sector enterprises; (v) tariff structure rationalization and improvements in taxation enforcement and

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<sup>67</sup> Loan 1829-RMI: Fiscal and Financial Management Program, for \$12 million, approved on 7 June 2001.

<sup>68</sup> Loan: RMI 33166-01: *Skills Training and Vocation Education Project*, for \$6.8 million, approved on 29 November 2000.

<sup>69</sup> Loan 1513-RMI: *Public Sector Reform Program*, for \$12 million, approved on 30 January 1997.

compliance; (vi) establishment of the MIITE; (vii) establishment of the private sector unit to review public enterprises and identify privatization options; and (viii) effective action to privatize domestic shipping services, create a conducive environment for fishery sector development, and privatize Kwajalein Atoll Joint Utility Resources Management.<sup>70</sup>

## Technical Assistance

Along with assistance provided to executing agencies to strengthen their financial management capacity,<sup>71</sup> assistance has also been provided to coordinating agencies to improve their loan administration and accounting procedures (in relation to ADB projects).<sup>72</sup> The relevant initiatives supported by ADB in relation to financial management and governance include:

*AOTA: RMI 34504-01: Fiscal, Financial and Economic Advisory Services (2000–02)*  
This TA for \$950,000 approved on 7 June 2001 will provide for: (i) fiscal and financial advisory services; (ii) economic strategy advice; (iii) capacity building towards a more efficient public service; (iv) support reform program implementation; (v) short term consultancy inputs for specific reform initiatives as required.

*AOTA: RMI 32209-01: Improving Articulation of Post Secondary Technical and Academic Education in RMI (2001 – )*

The objectives of this proposed TA for \$150,000 are to: (i) ensure proper articulation of curriculum and program delivery at the post secondary level; and (ii) improve academic skills of Marshallese. The scope is likely to include developing curricula and course programs, establishing resource requirements and delivery programs and suggesting appropriate organizational needs to sustain the program.

*TA No. 5967-REG: Countering Money Laundering in the Asian and Pacific Region (2001–02)*

The objectives of this RETA for \$650,000 approved on 20 December 2000 are to facilitate the adoption and implementation of anti-money laundering

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<sup>70</sup> ADB. 2000 September. *Semi-Annual Report on Loan and Technical Assistance Portfolio Performance for the Period Ending 30 June 2000*. Manila: ADB. p. 78.

<sup>71</sup> See, for instance, TA No. 2204-RMI: *Institutional Strengthening of the Marshall Islands Development Bank-Phase II*, for \$202,000, approved on 23 November 1994.

<sup>72</sup> See, for instance, TA No. 1763-RMI: *Institutional Strengthening of the Ministry of Finance*, for \$350,000, approved on 5 October 1992.

measures based on internationally accepted standards in the selected DMCs, and to accelerate regional cooperation and collaboration against money laundering. The RETA will focus on about nine DMCs in Asia and Pacific Region. The scope of the RETA includes: (i) identifying institutional and regulatory reforms required to make each DMC compliant with the established international standards, taking into account country assessments and evaluations conducted by FATF and APG, and on the basis of this work, developing a comprehensive manual on money laundering issues and anti-money laundering measures; (ii) developing a regional action plan to promote regional cooperation for countering money laundering; (iii) holding a high level conference and training workshops/seminars; and (iv) assisting APG to establish an online database on money laundering with links to other websites.

*TA No. 3418-RMI: Strengthening the Capacity of the MOF (2000–01)*

This TA for \$150,000 approved on 21 March 2000, supported the strengthening of MOF in economic and financial management through institutional and capacity development. The TA helped provide on-the-job training to senior MOF staff and developed methodologies to improve work efficiency and flows. The TA also provided training to accounting staff in the MOF and line ministries.

*TA No. 2757-RMI: Establishment of a Private Sector Unit (1998–2000)*

This TA was designed to help establish a Private Sector Unit (PSU) in the Office of the President. The PSU was intended to promote private sector development through: (i) introducing a sound policy environment; (ii) designing and implementing a privatization strategy; (iii) ensuring that the RMI legislative framework supports private sector growth; (iv) improving competition policy and the regulatory framework; and (v) establishing an Ombudsman.<sup>73</sup>

*TA No. 2710-RMI: Improved Financial Management (1997–99)*

This TA for \$600,000 approved on 13 December 1996 comprised two parts. Part I was to entail the introduction of a government performance-based budgeting system that would enable the efficient allocation of resources to priority activities, and to monitor and evaluate performance. Part II was to focus on reorganizing and strengthening the Revenue and Taxation

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<sup>73</sup> Deloitte Touche Tohmatsu (Canada). 2000 April 1. *TA 2757 Final Report: Establishment of a Private Sector Unit*.

Division (RTD) of the MOF to increase collection efficiency and prepare for the introduction of a value-added tax (VAT). The TA partially achieved these objectives and also provided accounting advice and assistance to the MOF and Air Marshall Islands (AMI).<sup>74</sup>

*TA No. 2599-RMI: Civil Service Reform Implementation (1996–97)*

This TA for \$100,000 approved on 2 July 1996 was intended to: (i) analyze existing civil service arrangements so as to define a starting point for reform implementation; (ii) provide a detailed action plan which shows different actions required, persons or offices responsible together with an indicative time path to guide the implementation of public service reforms as part of the PSRP; and (iii) provide a training and counseling program for retrenched civil servants.

*TA No. 2205-RMI: Small Enterprise Development (1995–96)*

This TA for \$297,000 approved on 23 November 1994, was intended to identify ways of improving the external environment for small enterprises and strengthening the capacity of the Ministry of Resources and Development and the MIDA in the area of project appraisal and supervision. The TA recommended that a “Marshall Islands Private Enterprise Development Corporation” be established, however this recommendation was not acted upon. Furthermore, the TA provided training in cash flow forecasting, financial statements, project appraisal and project monitoring, through a series of workshops.<sup>75</sup>

*TA No. 2204-RMI: Institutional Strengthening of the MIDB: Phase II (1995–96)*

This TA, for \$202,000 approved on 23 November 1994, focused on upgrading staff training and skills development. It also upgraded the MIDB Operating Manual and supported the development of a Corporate Plan for 1995–1999.

*TA No. 1763-RMI: Institutional Strengthening of the MOF (1993–94)*

This TA for \$350,000, approved on 5 October 1992, supported the establishment of the OIDA within the MOF. In this respect, the TA provided advice on organizational design and development, staffing

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<sup>74</sup> Querido, Richard S. 2000 January 7. TA 2710: *Improved Financial Management in the Republic of the Marshall Islands: Final Report*.

<sup>75</sup> Designtec Management Ltd. 1997 March 31. TA 2205-RMI: *Small Enterprise Development Project: Final Report*. p.21.

requirements and operational processes. Training activities supplemented the advice.<sup>76</sup>

*TA No. 1453-RMI: Institutional Strengthening of the MIDB (1991–92)*

This TA, approved in December 1990 supported: (i) the review of MIDB's Act, bylaws, and Statement of Policies and Guidelines; (ii) the preparation of a five-year corporate plan (1991-1995); (iii) the preparation of an Operating Manual covering accounting systems and credit management; (iv) familiarization of staff with this manual; and (v) in-house training to MIDB staff.<sup>77</sup>

#### **4. World Bank**

Included in the World Bank's assistance strategy is a responsive program of country-based economic and sector work.<sup>78</sup> To this end, technical assistance and training was granted to the Bank of Marshall Islands (BoMI) to help expand its business into new market areas and strengthen its capacity to better cope with an expected economic contraction.<sup>79</sup>

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<sup>76</sup> For details see:

- Cowater International Inc. 1994 April. *TA 1763-MAR: Institutional Strengthening of the Ministry of Finance: Final Report*.
- *Ibid. Appendices—Volume 1*.
- *Ibid. Appendices—Volume 2*.

<sup>77</sup> Australian Planning and Training Associates Pty Ltd. 1992. *TA No. 1453MAR: Institutional Strengthening of the MIDB: Final Report*.

<sup>78</sup> World Bank. 2000 April. *Small States: Meeting Challenges in the Global Economy*. Washington DC: World Bank. p. 54.

<sup>79</sup> Project No. 007506: *Marshall Islands-Bank of Marshall Islands*, for \$500,000, approved on 31 December 1996.

**Box 4: The World Bank Group's Pacific Strategy<sup>80</sup>**

The ready availability of other development financing sources, particularly grants from bilateral donors, has enabled the Bank to take a more targeted and strategic approach to lending in the last 2-3 years. The Bank has only accepted a role in lending where it has a proven track record in the sector concerned or where the program of economic and sector work has provided a sound basis for Bank involvement, where the proposed activity has a strong link to a policy reform agenda, is in keeping with the Bank's mission of poverty alleviation and where there are no other sources of finance readily available.

Clearly, the Bank's role in the Pacific is secondary to ADB and is designed to complement ADB's activities. This is reflected in the current portfolio where the four projects currently under supervision, along with the four at advanced stages of preparation, are all in high priority sectors in which the Bank has a proven track record and which all involve large policy reform components.

Lending operations would be open to all member countries. It is expected, however, that lending will continue to concentrate on the larger Pacific economies in line with the economies of scale associated with doing business with the Bank and given availability of grant-based financing opportunities for the smaller Pacific economies.

**5. United Nations Development Programme (UNDP)**

The first RMI-UNDP Country Program was formulated in 1991 for the period 1993-1996. It concentrated on three areas: (i) employment and private sector development; (ii) public sector and macroeconomic reform; and (iii) sustainable resource management. UNDP assistance in the current programming period is targeted towards: sustainable livelihoods, governance and the environment. In the governance area, a project is helping the National Training Council to fulfill its mandated role of coordinating training in RMI. It will assist in finalizing the project design and will provide initial training to RMI personnel responsible for managing the training programs.<sup>81</sup>

**6. International Monetary Fund (IMF)**

The IMF is considering providing technical assistance to RMI to strengthen anti-money laundering arrangements.

<sup>80</sup> World Bank. 2000 May. *Pacific Regional Strategy*. East Asia and Pacific Regional Office. Washington DC: World Bank. p. 30.

<sup>81</sup> MAS/97/002: Support to Human Resources Development through the National Training Council, for \$21,000.

## 7. United States

RMI is one of the largest recipients of US assistance on a per capita basis. US direct financial assistance under the CFA is intended to help RMI move towards economic self-sufficiency. Direct payments, or transfers of CFA funds can be used for general government operations; capital projects (such as building roads or schools); and to support targeted sectors, such as energy and communications, specified in the CFA.<sup>82</sup> The CFA renegotiations, and US assistance to RMI, are discussed in length in Chapter I and elsewhere throughout this report.

## 8. Taipei, China

Annual contributions of \$40 million are being made to the MIITF by Taipei, China.

## 9. Australia (AusAID)

Australian assistance to RMI comprises training scholarships to regional campuses, and small annual grants of up to \$20,000 to support community organizations or to supplement the work of government agencies. A modest level of support through the *Policy and Management Reform Fund* (\$50,000 annually) is also available to provide technical assistance in areas that complement the economic reform activities being undertaken by RMI in conjunction with ADB.<sup>83</sup>

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<sup>82</sup> US GAO. 2000 June 28. *Foreign Assistance: U.S. Funds to Two Micronesian Nations Had Little Impact on Economic Development and Accountability Over Funds was Limited*. p. 1.

<sup>83</sup> Australian Agency for International Development (AusAID). 2001. *Pacific Program Profiles: 2000-01*. p. 22

## VIII. Issues and Recommendations

**T**his chapter presents the issues and recommendations that are associated with gaps or weaknesses in accounting and auditing arrangements. These recommendations are intended to supplement and support existing strategies and projects, particularly *Vision 2018* and the FFMRP. Where actions are already planned or underway—for instance, upgrading information systems—no recommendations are made.

The key constraint identified is the shortage of qualified bookkeepers and accountants. Improving financial management arrangements is impossible without them.

- In the **long term** (10-30 years), this will require an education system that produces students who are numerate and literate. Tertiary and vocational education would supplement this foundation with specialist financial management knowledge. *Vision 2018* and Ministry of Education initiatives intend to address this issue.
- In the **medium term** (three to 10 years), a cadre of Marshallese accountants must be established. To this end, several mutually-supporting recommendations are made regarding professional status and training. For instance, it is recommended that professional bookkeeping and accountancy certifications be established, preferably as a Pacific-wide initiative.
- In the **short term** basic record keeping and internal control inadequacies must be addressed, and *Vision 2018* and the FFMRP must be effectively implemented. This cannot be achieved with existing or planned resources (i.e., through the FFMRP). As such, this report recommends that at least six suitably qualified and skilled accountants be recruited to work with the MOF and other agencies to develop counterpart capacity, resolve existing problems and support the implementation of the FFMRP and *Vision 2018*.

The issues and recommendations are divided into two parts.

- Part One: Where the matter referred to may be considered and, if any action is to be taken, this would be better achieved with external assistance.
- Part Two: Where the matter referred to may be considered and, if any action is to be taken, this may be achieved without the need for external assistance.

## **Part One. Where Donor Assistance Might be Appropriate**

### **1. Recruit Qualified Accountants to Support Financial Management Improvements**

As of October 2001 there were no professionally-qualified Marshallese accountants in RMI. Not surprisingly, there is an acute shortage of qualified bookkeepers and accountants in the RMI government (although the Government employs several qualified expatriate accountants). Issues of poor record keeping, inadequate internal controls and financial management are symptoms of this underlying problem. It is understood that two qualified accountants will be contracted for the period of the FFMRP (from counterpart funds). However, these additional resources are unlikely to be sufficient to implement *Vision 2018* and FFMRP (for instance, to overhaul or implement computerized accounting information systems).

It is **recommended** that at least six additional expatriate qualified accountants be recruited to support the MOF and other government agencies in their efforts to improve basic record keeping and internal control arrangements, and implement *Vision 2018* and the FFMRP. To this end, the expatriates should assist suitable counterparts and understudies to move towards bookkeeping and accountancy certifications—Box 5 is extremely relevant in this respect.

### **2. Introduce Bookkeeping and Accounting Manuals**

In the absence of suitably qualified bookkeepers and accountants, normative manuals provide a sound starting point for improving basic accounting arrangements. Such manuals have been used in the past, but not for national government accounting. The successful implementation of the FFMRP and the new financial reporting model would be supported by these manuals and associated training programs.

It is **recommended** that assistance be provided to develop bookkeeping and accounting manuals for national government organizations along with relevant training.

### Box 5: Important Capacity Building Considerations

#### ADB Lessons Regarding Pacific Assistance

In an assessment of lessons from Pacific assistance, ADB concluded “the use of consultants and external advisers must be more carefully designed. First, given constrained Pacific human resource capacity, the need for consultants is often inevitable. However, there are options for how they can be used: as long-term advisers in line positions; or as providing short-term, periodic inputs. These options must be carefully weighed, remembering that the reform program must be locally owned and managed. A key indicator of consultant effectiveness is the extent of local ownership they are able to engender. Second, it is important to clarify whether the consultant is fulfilling a line function or whether they are building capacity. If it is the latter, technical expertise is not a sufficient qualification. Proven success in transferring skills and supporting participative capacity building are essential. Third, ADB must assure the government that the consultants it offers have the right experience and demonstrated exposure to a variety of reform approaches. Otherwise, there is the substantial risk that reform approaches adopted by the country are dictated not by disciplined needs analysis and option assessments, but by the narrow experience of the advisor. The larger issue is the need for ADB to strengthen its policies and systems for consultant engagement and management. Consulting contracts should be drafted not only in terms of expected inputs and tasks, but also in terms of precise and tangible outputs and expected outcomes. Consultant performance must be more closely monitored by government and ADB staff, on the basis of the outputs delivered. And sanctions for inadequate performance should be specified in contracts, and enforced. Staff must have adequate time to supervise consultants and should be held accountable for TA outputs and outcomes.”<sup>84</sup>

#### ADB Strategy for Pacific Capacity Building

Gradual but systematic and long-term capacity building will be emphasized. In terms of capacity building, there is a need to work with the PDMCs and clients to formulate long-term plans for building the required skills by combining training, exposure to other systems, consultancy, learning-by-doing, and institutional twinning arrangements. Such plans should identify the milestones for each stage of skill development, emphasizing small but successful steps at the start and moving progressively to larger ones. Such plans can guide the activities of various assistance agencies over time, and ensure better aid coordination and planning. At the project level, consultants’ terms of reference should routinely include skill transfer as part of the expected output, with clear indicators for accomplishment of this result. Accordingly, consultants will need to be selected not only for their technical qualifications, but also for their ability to guide, coach, and mentor local counterparts. Domestic consultants should be used more often, for example, as long-term understudies of international consultants.<sup>85</sup>

### 3. Establish Bookkeeping and Accountancy Certifications

There are no professionally qualified Marshallese accountants in RMI; nor is there a professional accountancy body. However, RMI law regulates other professions and occupations including healthcare providers under the *Health*

<sup>84</sup> ADB. 2000 September. *A Pacific Strategy for the New Millennium*. Office of Pacific Operations. Manila: ADB. p. 20.

<sup>85</sup> *Ibid.* p. 25.

*Services Act 1983*, nurses under the *Nursing Practices Act 1995*, land surveyors under the *Land Surveyors Registration Act 1970*, notaries public under the *Notaries Public Act 1966*, and the legal profession under the *Legal Profession Act 1991*.

Guam's professional accountancy body is relevant to RMI (as Guam also operates under US accounting arrangements). But becoming a Guam CPA requires a relevant graduate degree, two years' practical experience in a supervised environment, and successful completion of the AICPA uniform CPA examination. So in the short term, very few Marshallese are likely to attain a US qualification.

In the meantime, the establishment of suitable bookkeeping and accountancy certifications would provide stepping stones to the CPA license, measures to gauge competence to undertake bookkeeping and accountancy tasks, and professional career targets.

It is **recommended** that suitable RMI bookkeeping and accountancy certifications be established and that these certifications focus upon public sector accounting. These certifications should, ideally, be developed as a Pacific-wide initiative.

## **Part Two. Where External Assistance is Not Required**

### **4. Defer Implementing the New Financial Reporting Model**

The *Financial Management Act 1990* governs public sector financial management. It stipulates that RMI government financial reporting shall be in accordance with the standards promulgated by the US GASB (Sec. 104). This report supports continuing the direct use of US GAAP by RMI. Alternatives include adopting IAS or developing national accounting standards. Neither option is desirable given existing RMI knowledge and experience with US GAAP, and likelihood that the US will require financial statements to be prepared in accordance with US GAAP, as a CFA requirement.

RMI government financial statements will have to comply with GASB's NFRM, starting with the financial year beginning on 1 October 2002. Among other things, this will involve introducing full accrual accounting and will have significant implications for budgetary documentation, accounting arrangements and systems, and financial reporting. However:

- Its implementation will coincide with the introduction of new computerized information systems and changes brought about by the FFMRP.

- The budgetary requirements of the new model will potentially conflict with those designed as part of the FFMRP.
- Comparative implementation progress lags behind other countries and jurisdictions that have implemented accrual accounting.

Given the acute shortage of qualified government bookkeepers and accountants, and comparative implementation progress, it is difficult to envisage the NFRM being successfully implemented in the required timeframe. However, deferring implementation of GASB 34 and GASB 35 would provide enough time to improve fundamental accounting arrangements and prepare for the required introduction of accrual accounting.

It is **recommended** that a realistic plan for implementing the requirements of GASB 34 and GASB 35 be prepared in consultation with the FFMRP. Given the far-reaching nature of these requirements, it is likely that the plan will indicate a necessity to defer implementation of these requirements until at least the financial year beginning on 1 October 2003. If this is the case, it is **further recommended** that:

- US DOI be consulted on deferring the NFRM implementation and the relevant government plans, and
- the *Financial Management Act 1990* be amended to state that implementation of GASB 34 and GASB 35 will not apply to the preparation of government financial statements until (at least) the financial year beginning on 1 October 2003.

## **5. Raise the Priority of Scholarships for Accountancy**

Significant numbers of Marshallese accounting graduates will be required if skill shortages are to be addressed and financial management arrangements are to be sustainable (i.e., foreign accountants are to be replaced).

The *Scholarship Assistance Act 1979* established the eight-member RMI Scholarship Grant and Loan Board. The Board evaluates applications for scholarships and awards scholarship grants and loans. The Scholarship Fund Account is primarily financed by CFA monies [Article 1, Sec. 216(3)(a)]. Three primary factors guide the Board in awarding scholarship grants and loans: (i) demonstrated ability and potential; (ii) inability to pay costs; and (iii) Cabinet-approved priorities. With regards to the last criterion, some interviewees questioned whether Cabinet placed sufficient priority on accountancy education.

It is **recommended** that Cabinet raise the priority placed on accountancy courses as a criterion for awarding scholarship grants and loans.

## 6. Strengthen the Auditor-General's Independence

The arrangements that support the Auditor-General's independence do not appear to fully meet the criteria of the *Lima Declaration* regarding the mechanisms for ensuring that adequate resources are provided. For example, OAG staff numbers were reduced as part of the Reduction-in-Force exercise during the PSRP. Furthermore, arrangements regarding the Auditor-General's annual budget do not support independence.

It is **recommended** that the Auditor-General's independence be strengthened through legislative and administrative changes.

## 7. Clarify Laws Regarding Auditor Qualifications

An audit opinion is meaningful only if issued by a suitably-qualified auditor. However, RMI laws are sometimes ambiguous or silent regarding auditor qualifications. For instance: (i) a range of qualifications or experience is accepted for appointment as Auditor-General; (ii) the *Cooperatives Act 1993* refers to an "experienced bookkeeper or accountant"; and (iii) the *Banking Act 1987* refers to an "independent financial auditor." Laws should be explicit as to the acceptable qualifications of auditors.

It is **recommended** that all relevant RMI laws be amended so that they clearly and consistently state acceptable auditor qualifications and/or experience.

## 8. Clarify Laws Regarding Accounting Standards

It is generally accepted that RMI financial statements must be prepared in accordance with US GAAP, but RMI laws are inconsistent in this respect. On one hand, some laws are absolutely clear as to the use of US accounting standards. For instance, the *Financial Management Act 1990* (which governs public sector financial management) stipulates that: "RMI policy is to provide full disclosure of financial operations and adequate financial information needed in the management of operations, and shall ensure effective control over revenues, multilateral and bilateral grants-in-aid including US federal grants, income, expenditures, monies and other assets, and shall be in accordance with the standards promulgated by the US GASB" (Sec. 104). Conversely, other laws, such as the *Trust Companies Act 1994* require all licensed trust companies, incorporated in RMI, to prepare annual profit and loss accounts and balance sheets (Sec. 220). No statement is made regarding the basis of preparation.

It is **recommended** that all relevant RMI laws be amended so that they clearly state that financial statements must be prepared in accordance with either US GAAP or the standards promulgated by the US GASB, as the case may be.

## **9. Clarify Laws Regarding Auditing Standards**

It is generally accepted that RMI financial statement audits must be conducted in conformity with US GAAS, but RMI laws are not clear in this respect. On one hand, some laws are specific as to the use of US GAAS. For instance, the *Auditor-General (Definition of Duties, Functions and Powers) Act 1986* stipulates that the relevant US auditing standards must be followed for public sector audits. More ambiguously, other laws, such as the *Banking Act 1987* require that financial statement audits must be conducted in “conformity with generally accepted auditing standards”.

It is **recommended** that all relevant RMI laws be amended so that they clearly state that audits of financial statements must be conducted in accordance with the relevant US auditing standards.



## IX. Main Deficiencies and Action Plan

**W**hile over the past decade RMI has made some progress in improving its financial management arrangements, basic record-keeping and internal control systems remain inadequate. Moreover, future improvements are unlikely given the critical shortage of suitably qualified bookkeepers and accountants. This study has identified several gaps and weaknesses that may be categorized as follows:

- Those deficiencies that are better able to be resolved with external assistance; and
- Those deficiencies that are able to be resolved without the need for external assistance.

Issue	Priority	Donor Assistance?	Country Support?	2002 - 2006
Recruit Qualified Accountants to Support Financial Management Improvements	High	✓	✓	■
Prepare and Introduce Bookkeeping and Accounting Manuals	High	✓	✓	■■■
Establish Bookkeeping and Accountancy Certifications	High	✓	✓	■■■■■
Defer Implementation of the New Government Financial Reporting Model	High	✗	✓	■
Raise the Priority of Scholarships for Accountancy Students	Medium	✗	✓	■■■
Strengthen the Auditor-General's Independence	Medium	✗	✓	■■■
Clarify Laws Regarding Auditor Qualifications	Medium	✗	✓	■■■
Clarify Laws Regarding Accounting Standards	Medium	✗	✓	■■■
Clarify Laws Regarding Auditing Standards	Medium	✗	✓	■■■



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## **Appendixes**

Appendix 1.	Useful Internet Sites	99
	1. General Information on RMI	99
	2. Regulatory and Standard-Setting Bodies	99
	3. Professional Bodies	99
	4. International Organizations	99
	5. Government Organizations	100
	6. Accounting Firms	100
	7. Financial Institutions	100
	8. Educational Institutions and Providers	100
	9. Donor Organizations	100
Appendix 2.	Interviewees	102
Appendix 3.	RETA-5980 (Regional Study) Information	103
	1. Study Phases	103
	2. Phase I: Case Study on Accounting and Auditing	103
	3. Phase II: Majuro Workshop	103
	4. Phase III: Formulation of Action Plan	104
Appendix 4.	Key Governing Laws and Regulations: Public Sector	105
Appendix 5.	Key Governing Laws and Regulations: Private Sector	108
Appendix 6.	The Guam Chapter of AICPA	110
	1. Introduction	110
	2. Guam Board of Accountancy (GBA)	110
	3. The Guam Certified Public Accountant (CPA) License	110
	4. Guam Chapter of AICPA	113
Appendix 7.	Guidelines on Professional Arrangements	115
	1. Overview	115
	2. Membership Requirements	117
	3. Quality Control and Assurance	118
Appendix 8.	US Accounting Standard-Setting Bodies	120
	1. Financial Accounting Standards Board (FASB)	120
	2. Government Accounting Standards Board (GASB)	120
	3. Financial Accounting Foundation (FAF)	120
	4. Governmental Accounting Standards Advisory Council (GASAC)	120

DIAGNOSTIC STUDY OF ACCOUNTING AND AUDITING PRACTICES  
IN THE MARSHALL ISLANDS

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Appendix 9.	US GAAP for Nongovernment Entities	121
	1. Accounting Research Bulletins (ARB)	121
	2. Accounting Principles Board (APB) Opinions	121
	3. Statements of Financial Accounting Concepts (SFAC)	122
	4. Statements of Financial Accounting Standards (SFAS)	122
Appendix 10.	International Accounting Standards	124
Appendix 11.	US GAAP for Government Entities	125
Appendix 12.	International Standards on Auditing	129
	1. International Standards on Auditing (ISAs)	129
	2. International Auditing Practice Statements (IAPSS)	130
Appendix 13.	Generally Accepted Government Auditing Standards (GAGAS)	131
Appendix 14.	College of the Marshall Islands (CMI): Courses	134
Appendix 15.	USP: Undergraduate Accountancy Courses	138
Appendix 16.	USP: Postgraduate Accountancy Courses	141
Appendix 17.	USDA PITA: Sample Training Curriculum	143
Appendix 18.	Relevant Extracts from the RMI Constitution	145
Appendix 19.	Extracts from the Compact of Free Association	150

## **Appendix 1. Useful Internet Sites**

### **1. General Information on RMI**

Charles Sturt University, Australia	<a href="http://life.csu.edu.au/marshall/politics.html">http://life.csu.edu.au/marshall/politics.html</a>
RMI Online	<a href="http://www.rmiembassyus.org/links.html">www.rmiembassyus.org/links.html</a>
Yahoo Directory	<a href="http://dir.yahoo.com/Regional/countries/marshall_islands/">http://dir.yahoo.com/Regional/countries/marshall_islands/</a>
Yokwe Online	<a href="http://www.yokwe.net">www.yokwe.net</a>

### **2. Regulatory and Standard-Setting Bodies**

American Institute of Certified Public Accountants (AICPA)	<a href="http://www.aicpa.org">www.aicpa.org</a>
Guam Board of Accountancy (GBA)	<a href="http://www.guam.net/gov/gba">www.guam.net/gov/gba</a>
International Accounting Standards Board (IASB)	<a href="http://www.iasc.org.uk">www.iasc.org.uk</a>
International Federation of Accountants (IFAC)	<a href="http://www.ifac.org">www.ifac.org</a>
US Financial Accounting Standards Board (FASB)	<a href="http://www.fasb.org">www.fasb.org</a>
US General Accounting Office (GAO)	<a href="http://www.gao.gov">www.gao.gov</a>
US Government Accounting Standards Board (GASB)	<a href="http://www.gasb.org">www.gasb.org</a>

### **3. Professional Bodies**

American Institute of Certified Public Accountants (AICPA)	<a href="http://www.aicpa.org">www.aicpa.org</a>
Confederation of Asian and Pacific Accountants (CAPA)	<a href="http://www.capa.com.my">www.capa.com.my</a>
Institute of Internal Auditors (IIA)	<a href="http://www.theiia.org">www.theiia.org</a>
National Association of Tax Practitioners	<a href="http://www.natptax.com">www.natptax.com</a>

### **4. International Organizations**

Asia Pacific Economic Cooperation (APEC)	<a href="http://www.apecsec.org.sg">www.apecsec.org.sg</a>
International Federation of Accountants (IFAC)	<a href="http://www.ifac.org">www.ifac.org</a>
International Organization of Securities Commissions (IOSCO)	<a href="http://www.iosco.org">www.iosco.org</a>
International Organization of Supreme	

Audit Institutions (INTOSAI)	<a href="http://www.intosai.org">www.intosai.org</a>
South Pacific Association of Supreme Audit Institutions (SPASAI)	<a href="http://www.oag.govt.nz/HomePageFolders/SPASAI/SPASAIHome.htm">www.oag.govt.nz/HomePageFolders/ SPASAI/SPASAIHome.htm</a>
World Trade Organization (WTO)	<a href="http://www.wto.org">www.wto.org</a>

## 5. Government Organizations

Office of Planning and Statistics	<a href="http://www.rmiembassyus.org/stats.html">www.rmiembassyus.org/stats.html</a>
Marshall Islands National Telecommu- nications Authority (NTA)	<a href="http://www.rmiembassyus.org/nta.html">www.rmiembassyus.org/nta.html</a>
Marshall Islands Government Directory	<a href="http://www.bizconnections.com/MarshallIslands.htm">www.bizconnections.com/ MarshallIslands.htm</a>
US Department of the Interior (DOI)	<a href="http://www.doi.gov">www.doi.gov</a>
US General Accounting Office (GAO)	<a href="http://www.gao.gov">www.gao.gov</a>

## 6. Accounting Firms

Deloitte Touche Tohmatsu (Asia-Pacific)	<a href="http://www.deloitteap.com">www.deloitteap.com</a>
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## 7. Financial Institutions

Bank of the Marshall Islands (BoMI)	<a href="http://www.rmiembassyus.org/bmi.html">www.rmiembassyus.org/bmi.html</a>
Bank of Hawaii	<a href="http://www.boh.com">www.boh.com</a>
Bank of Guam	<a href="http://www.bankofguam.com">www.bankofguam.com</a>
International Registries Incorporated: Corporate and Maritime Administrator for the Republic of the Marshall Islands	<a href="http://www.register-iri.com/content.cfm?catid=2">www.register-iri.com/ content.cfm?catid=2</a>

## 8. Educational Institutions and Providers

College of the Marshall Islands (CMI)	<a href="http://www.cmiedu.net">www.cmiedu.net</a>
Pacific Islands Training Initiative (PITI)	<a href="http://grad.usda.gov/programs_services/ii/piti.cfm">http://grad.usda.gov/ programs_services/ii/piti.cfm</a>
University of Guam	<a href="http://www.uog.edu">www.uog.edu</a>
University of the South Pacific (USP)	<a href="http://www.usp.ac.fj">www.usp.ac.fj</a>

## 9. Donor Organizations

Asian Development Bank (ADB)	<a href="http://www.adb.org">www.adb.org</a>
International Monetary Fund (IMF)	<a href="http://www.imf.org">www.imf.org</a>

Japan Bank for International Cooperation (JBIC)	<a href="http://www.jbic.go.jp">www.jbic.go.jp</a>
Japan International Cooperation Agency (JICA)	<a href="http://www.jica.go.jp">www.jica.go.jp</a>
United Nations Development Programme (UNDP)	<a href="http://www.undp.org">www.undp.org</a>
United States Agency for International Development (USAID)	<a href="http://www.usaid.gov">www.usaid.gov</a>
World Bank	<a href="http://www.worldbank.org">www.worldbank.org</a>

## Appendix 2. Interviewees

Aspects of financial management and governance were discussed with the following people:

Hon. Michael Konelios	Minister for Finance	Government of RMI
Jean Tonyokwe	Auditor-General	OAG
Saeko Shoniber	Secretary of Finance	MOF
Ann Marie Muller	Assistant Secretary	MOF
Casten Nemra	Director	MOF, OIDA
Smith Michael	Director	MOF, OIDA
Biram Stege	Secretary of Education	Ministry of Education
Mark Canny	Educational Advisor	Ministry of Education
Alfred Alfred Jr.	Commissioner of Banking	Banking Commission
Chris Wolseley	Manager	Deloitte Touche Tohmatsu (Saipan)
Efren Gravamen	City Manager	Rongelap Atoll Local Government
Louise Jenkins	Finance Director	Rongelap Atoll Local Government
Don Hess	Professor	CMI
Seyoum Teshome	Instructor	CMI, Business and Computer Science Department
Vimlesh Narayan	Accounting Lecturer	USP
Toru Hayashi	Chargé d’Affairs	Japanese Embassy
Kevin Hart	Political Economics Advisor	US Embassy
Gary Song-huann Lin	Representative	Taipei Economic and Cultural Office in the Republic of Marshall Islands
Chang Yu-chang	Representative	Taipei Economic and Cultural Office in the Republic of Marshall Islands
Elizabeth Moore	Software Consultant	Ztech Incorporated

### **Appendix 3. RETA-5980 (Regional Study) Information**

#### **1. Study Phases**

The study had three broad phases:

Phase I – RMI Case Study on Accounting and Auditing Support and Structures.

Phase II – Majuro Workshop (11 October 2001).

Phase III – Manila Workshop (5-6 March 2002) and Formulation of Action Plan.

#### **2. Phase I: Case Study on Accounting and Auditing**

This phase involved examining RMI's current accounting and auditing structure and systems. It also (i) analyzed RMI's political, institutional, and regulatory and legal framework on accounting and auditing practice and the level of enforcement of existing laws, rules, and regulations; (ii) identified gaps and weaknesses in accounting and auditing support available and deviations from international standards; and (iii) identified options to remedy and eventually eliminate the identified weaknesses.

Barry Reid and Aileen H. Pangilinan conducted the fieldwork for the study from 24 September to 12 October 2001. Financial management and governance arrangements were discussed with the Minister of Finance and representatives from: the MOF, OAG, other government organizations, private sector businesses and educational institutions. A list of interviewees is attached as Appendix 2.

#### **3. Phase II: Majuro Workshop**

Issues arising from the study were discussed and debated at a workshop held in Majuro on 11 October 2001. Saeko Shoniber (Secretary of Finance) and Barry Reid chaired the workshop. Francis B. Narayan, Lead Financial Management Specialist, ADB, participated in the workshop as a resource person and provided overall guidance with respect to the study objectives. Twenty-one participants from the following organizations attended the workshop:

- |   |                                      |
|---|--------------------------------------|
| • Air Marshalls Incorporated  | • MOF                                |
| • Banking Commission  | • Ministry of Health and Environment |
| • CMI   | • National Training Council          |
| • Taipei Economic and Cultural Office in the Republic of Marshall Islands | • Registry of Foreign Corporations   |

- US Embassy
- Marshall Islands Development Bank
- USP
- Rongelap Atoll Local Government
- Ministry of Education

#### **4. Phase III: Formulation of Action Plan**

Phase III assessed the roles that ADB and other funding agencies could play in improving the current situation in the selected DMCs. The roles included policy intervention, projects and program assistance, and mobilization of cofinancing resources to address the identified problems and weaknesses. This activity was undertaken in close consultation with the Government, regulatory authorities, representatives of the accounting and auditing professions, and other local interest groups and funding agencies. At this stage of the RETA, the commitment-in-principle of each selected country to implement the findings and recommendations of the study was agreed. The findings of the RETA were disseminated and debated at a workshop in Manila on 5-6 March 2002 and the action plan was finalized for implementation.

## Appendix 4. Key Governing Laws and Regulations: Public Sector

Title	Description
<i>Constitution of the Republic of the Marshall Islands 1979</i>	<p>The <i>Constitution</i> came into effect on 1 May 1979. It is the supreme law of RMI and stipulates rights and governance structures and arrangements (legislative, executive, judicial, public service and local government). Appendix 18 sets out relevant extracts, which include:</p> <ul style="list-style-type: none"> <li>• Budgetary and appropriation matters.</li> <li>• The appointment and tenure of the Auditor-General (Article VIII, Sec. 13).</li> <li>• The audit of accounts (Article VIII, Sec. 15). Under this section, the Auditor-General is responsible for auditing public funds and accounts of RMI including those of all departments or offices of the legislative, executive and judicial branches of government and of any other public corporation or other statutory authority constituted under the law of RMI (unless, in relation to any such public corporation or other statutory authority, provision is made by Act for audit by any other person).</li> </ul>
<i>The Compact of Free Association 1982</i>	<p>Pages 15-16 describe the first CFA (1986-2001) and its negotiation. Appendix 19 sets out relevant extracts. These include the financial and technical assistance arrangements. With regards to auditing, Sec. 233 requires that annual audits should have been conducted of all CFA funds expended for services and programs, during the first five years of the CFA (1986-1991) and periodically thereafter.</p> <p>However, as the May 2000 GAO report identified, these audits were not undertaken as required.<sup>86</sup></p>
<i>Auditor-General's Compensation Act 1980</i>	This Act stipulates the Auditor-General's qualifications and compensation arrangements (see p. 28).
<i>Auditor-General (Definition of Duties, Functions and Powers) Act 1986</i>	As its title suggests, this Act defines and prescribes the Auditor-General's duties, functions and powers. These are discussed further in section 6 of this chapter. The relevant US auditing standards must be followed for public sector audits.
<i>Ethics in Government Act 1993</i>	This Act sets out principles of ethical conduct and establishes the <i>Government Ethics Board</i> (which comprises the Attorney-General, the Auditor-General and the Chief Secretary, or their representative).

<sup>86</sup> US GAO. 2000 May 31. *Foreign Relations: Better Accountability Needed Over U.S. Assistance to Micronesia and the Marshall Islands*. RCED-00-67.

DIAGNOSTIC STUDY OF ACCOUNTING AND AUDITING PRACTICES  
IN THE MARSHALL ISLANDS

Title	Description
<i>Rules of Procedure of the Nitijela</i> 1989	<p>Sec. 44 of the <i>Rules of the Nitijela</i> establishes the nine-member <i>Committee on Appropriations</i>, which is responsible for considering and reporting on all Bills, resolutions, motions and other matters relating to public expenditure or to the financial administration of RMI and local government finance, including budget estimates and supplementary estimates.</p> <p>The seven-member <i>Committee on Public Accounts</i> is established by Sec. 49 of the <i>Rules of the Nitijela</i>. This Committee is responsible for:</p> <ul style="list-style-type: none"> <li>• Considering the public funds and accounts of RMI, together with the report of the Auditor-General.</li> <li>• Reporting to the <i>Nitijela</i> on excess or unauthorized expenditures or funds.</li> <li>• Proposing measures to ensure that public monies are properly and economically spent and accounted for.</li> <li>• Considering, reporting and making recommendations on the accounts of public corporations and statutory authorities.</li> <li>• Considering and reporting to the <i>Nitijela</i> as requested.</li> </ul>
<i>Local Government Act</i> 1980	<p>Section 118 of this Act requires that Executive Committees provide budget estimates of revenues and expenditures to their respective Councils annually. It also requires that they keep proper accounts and records.</p> <p>The Minister, in consultation with the Minister of Finance, has the authority to issue instructions (Local Government Financial Memoranda) stipulating requirements with respect to: (i) accounts and auditing; (ii) the maintenance of proper records; and (iii) the duties and responsibilities of staff.</p> <p>Section 140 also gives the Minister the power to arrange special audits by the Auditor-General.</p>
<i>Planning Act</i> 1974	<p>This Act creates the Office of Planning and Statistics (OPS), which advises Cabinet on planning and budgetary matters. In particular, the OPS formulates national and sectoral development plans, including economic policies, development goals and objectives, and development strategies. The OPS is also responsible for reviewing all projects and programs and annual and long-term budget proposals.</p>
<i>Industries Development Act</i> 1991	<p>Among other things, this Act establishes the seven-member National Training Council (NTC), which is responsible for: (i) advising the Minister on vocational training; (ii) arranging or providing training; (iii) establishing standards and assessing trainees; and (iv) issuing certificates upon satisfactory completion of training courses.</p>
<i>Procurement Code (Act)</i> 1988	<p>The Procurement Code stipulates the arrangements and processes governing procurement by the Government. Its intention is to support competitive and transparent procurement practices.</p>

## APPENDIXES

Title	Description
<i>Financial Management Act 1990</i>	<p>The <i>Financial Management Act 1990</i> governs public sector financial management. Among other things, it stipulates that:</p> <ul style="list-style-type: none"><li>• RMI policy is to provide full disclosure of financial operations and adequate financial information needed in the management of operations, and shall ensure effective control over revenues, multilateral and bilateral grants-in-aid including US federal grants, income, expenditures, monies and other assets, and shall be in accordance with the standards promulgated by the US GASB (Sec. 104).</li><li>• The governing principles of the financial management system, including fiscal policy objectives (Sec. 121).</li><li>• The Secretary of Finance is responsible for maintaining adequate systems of internal control (Sec. 128).</li></ul>

## Appendix 5. Key Governing Laws and Regulations: Private Sector

Title	Description
<i>Foreign Investment Business License Act 1990</i>	This Act sets out the arrangements for granting foreign investment business licenses.
<i>Banking Act 1987</i>	Among other things, the <i>Banking Act 1987</i> has the following requirements: <ul style="list-style-type: none"> <li>• Every licensed bank must, subject to the Banking Commissioner's approval, appoint an independent financial auditor (Sec. 134)</li> <li>• Financial statement audits must be completed within three months of financial year-end in conformity with generally accepted auditing standards (Sec. 134).</li> <li>• Licensed banks must publish balance sheets and profit and loss accounts in the local media, within four months of financial year-end (for their RMI operations) (Sec. 132).</li> </ul>
<i>Securities and Investment Act 1966</i>	This Act governs the issuance and registration of securities.
<i>Cooperatives Act 1993</i>	This Act governs the operations and arrangements of cooperatives. With regards to accounting and auditing provisions, the following provisions are relevant: <ul style="list-style-type: none"> <li>• The books of associations shall be audited at financial year-end by an experienced bookkeeper or accountant ... and which shall be subject to audit by the OAG (Sec. 773).</li> </ul>
<i>Non-Profit Corporations Act 1991</i>	This Act allows non-profit corporations to be formed in accordance with the rules and regulations under the <i>Corporations, Partnerships and Associations Act</i> (Sec. 9).
<i>Title 19: Regulation of Professions and Occupations</i>	Title 19: Regulation of Professions and Occupations applies to: <ul style="list-style-type: none"> <li>• Health care providers (<i>Health Services Act 1983</i>)</li> <li>• Nursing practices (<i>Nursing Practices Act 1995</i>)</li> <li>• Land surveyors (<i>Land Surveyors Registration Act 1970</i>)</li> <li>• Notaries public (<i>Notaries Public Act 1966</i>), and</li> <li>• The legal profession (<i>Legal Profession Act 1991</i>).</li> </ul> No laws explicitly apply to the qualifications or practices of accountants or auditors.
<i>Income Tax Act 1989</i>	The simplified taxation regime for business income, set out in Section 109 of the <i>Income Tax Act 1989</i> focuses on taxing gross revenues. As such, the Act makes little or no reference to accounting rules.
<i>Trust Act 1994</i>	This Act governs trust arrangements.

## APPENDIXES

Title	Description
<i>Trust Companies Act 1994</i>	<p>Among other things, this Act stipulates that:</p> <ul style="list-style-type: none"> <li>• All licensed trust companies, incorporated in RMI, must prepare annual profit and loss accounts and balance sheets (Sec. 220).</li> <li>• These companies must annually appoint independent financial auditors (Sec. 221).</li> <li>• Audits of financial statements must be completed within three months of year-end (Sec. 221).</li> <li>• These audited financial statements must be forwarded to the Commissioner within four months of year-end (Sec. 222).</li> </ul>
<i>Corporate Administration Act</i>	This Act covers the administration of corporations.
<i>Corporate Formation Act</i>	This Act covers the formation of corporations.
<i>Corporate Operations Act</i>	<p>Among other things, this Act stipulates that:</p> <ul style="list-style-type: none"> <li>• All domestic corporations must keep correct and complete books of account and records (Sec. 371).</li> <li>• A corporation must provide (certain allowed) shareholders with an annual report including profit and loss accounts and balance sheets (upon written request) (Sec. 376).</li> </ul>
<i>Partnership Act</i>	This Act governs the formation and operations of partnerships.
<i>Limited Partnership Act</i>	This Act governs the formation and operations of limited partnerships.
<i>Unincorporated Association Act</i>	This Act governs the formation and operations of unincorporated associations.
<i>Limited Liability Companies Act 1995</i>	This Act governs the formation and operations of limited liability companies. The Act does not specify accounting or reporting requirements.

## **Appendix 6. The Guam Chapter of AICPA**

### **1. Introduction**

There are no professionally qualified Marshallese accountants in RMI; nor is there a professional accountancy body. However, Guam's professional accountancy body is relevant to RMI as Guam also operates under US accounting arrangements. This appendix briefly describes this body and its membership requirements.

### **2. Guam Board of Accountancy (GBA)**

The Guam *Public Accountancy Act 1990* promotes the reliability of financial information through the regulation of the accountancy profession. To this end, the *Public Accountancy Act 1990* established the Guam Board of Accountancy (GBA).

The GBA is a Guam government agency and a member of the US National Association of State Boards of Accountancy (NASBA). It administers and enforces the provisions of the *Public Accountancy Act 1990* regarding accountancy practices in Guam including: (i) examining candidates; (ii) issuing certificates and permits to practice public accountancy; (iii) investigating violations and infractions of the Act; and (iv) revoking or suspending certificates or refusing to renew permits to practice. The GBA comprises five members appointed by the Governor, all of whom are Guam residents and CPAs. Each member serves a four-year term.

### **3. The Guam Certified Public Accountant (CPA) License**

The GBA recognizes the following membership types:

#### **Regular Members**

Eligibility to become an AICPA Regular Member is granted to a person who: (i) possesses a valid and unrevoked CPA certificate; (ii) has passed an examination in accounting and other related subjects satisfactory to the AICPA Board of Directors (the Uniform CPA Examination); (iii) has completed the prescribed period of service in accounting (practical experience); and (iv) agrees to, and can comply with the AICPA Bylaws and the Code of Professional Conduct.

#### **Associate Members**

AICPA Associates are individuals who have passed the Uniform CPA Examination but have not yet met their state's additional requirements (e.g., practical experience) for certification/licensure. Individuals may be

Associates only so long as they are moving towards attaining the CPA certificate/license (but in no event for more than five years).

### **Section Associates**

Any non-CPA professional employed and sponsored by a CPA firm in an Institute-approved practice-monitoring program may enroll in any of the AICPA's four voluntary sections (consulting services, personal financial planning, information technology, and tax) as an associate.

### **Certified Public Accountant (CPA)**

The Board shall grant a CPA to any person who meets the good character, education and examination requirements and pays the prescribed fees. Table 15 sets out the membership requirements of the GBA—international and selected regional requirements are presented for comparison. IFAC recommends that the appraisal process be founded upon the key components of a professional qualification, falling into: (i) education – entry standards / body of knowledge; (ii) examinations – tests of professional competence; and (iii) experience – relevant to the practice function.<sup>87</sup> Furthermore, IFAC requires that CPE be a requirement for practising accountants.

### **Educational Requirement**

The education requirement for a certificate, which must be met before an applicant is eligible to apply for the CPA exam shall either be: (i) a graduate degree with a concentration in accounting from an accounting program or department that is accredited (level three accreditation) by an accrediting agency recognized by the Board; or (ii) a graduate degree from a business school or college of business that is accredited (level two accreditation) by an accrediting agency recognized by the Board and completed at least 24 semester hours in accounting at the upper division or graduate level, or a combination thereof, including courses covering the subjects of financial accounting, auditing, taxation, and management accounting.

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<sup>87</sup> IFAC. 1995 June. Statement of Policy of Council: Recognition of Professional Accountancy Qualifications. New York: IFAC.

DIAGNOSTIC STUDY OF ACCOUNTING AND AUDITING PRACTICES  
IN THE MARSHALL ISLANDS

**Table 15: Professional Accountant Qualifications**<sup>88</sup>

Requirement	International	Guam (US)	California (US)	Sri Lanka (ICASL)
Education	Recognized education program (IFAC: IEG 9, Para 26)	✔ Graduate degree with concentration in accounting	✔ Core course comprising 45 semester units of accounting, auditing or business-related subjects (a variety of other qualifications are accepted)	✔ A range of entry qualifications are accepted—a university degree is not necessarily required
Examination	A significant portion of responses must be written (IFAC: IEG 9, Para 44)	✔	✔	✔
Experience	Minimum of three years practical experience in an appropriate, supervised environment (IFAC: IEG 9, Para 49)	✘ Minimum of two years prescribed practical experience. One year can be waived in recognition of additional studies	✔ / ✘ Two, three, or four years prescribed experience; depending on education level	✔ At least three years for university degree holders and four years for others
Continuing professional education (CPE)	Annual minimum of 30 hours, or 90 hours over each three-year period, of structured learning activities (IFAC, ISAR)	✔ 40 hours for each annual license renewal period	✔ 80 hours for each two-year license renewal period (following first license renewal)	✘ Recommended but not mandatory. Follows the practice of ICAEW

## Board Exam

The examination required to be passed, as a condition for the granting of a certificate shall include but not limited to the AICPA Uniform CPA examination (or other uniformly adopted examination of every accountancy licensing jurisdiction of the US). The examination is in writing, held twice a year, and shall test the applicant's knowledge of the subjects of accounting and auditing and such other related subjects as the Board may specify by rule.

<sup>88</sup> Table adapted from: Favere-Marchesi, Michael. 2000. Audit Quality in ASEAN. *The International Journal of Accounting*. Vol 35(1). pp. 121-149.

### **Practical Experience Requirement**

Under Guam's Board of Accountancy regulation no person shall be issued a permit unless that person has obtained two years of experience doing public accounting work as an employee and under the direct supervision of a licensed CPA who is actively engaged in the practice of public accounting. The required two years of experience shall be obtained by performing public accounting services, which involve the use of accounting or auditing skills, or one or more types of management advisory or consulting services, or the preparation of tax returns or the furnishing of advice on tax matters.

Furthermore, the services should be performed for the clients of the CPA or the CPA firm and must regularly involve the exercise of independent judgment and the application of appropriate technical and behavioral standards such as the standards contained in the Code of Professional Conduct, GAAS, the Statement of Responsibilities in Tax Practice and the Statement of Standards for Management Advisory Services (all as promulgated by AICPA).

One of the two years of public accounting experience requirement will be waived, if the applicant has at least 30 semester hours of additional study in business or related subjects.

### **Continuing Professional Education (CPE)**

Applicants seeking renewal of a permit are required to show evidence that they have completed no less than 40 hours of continuing professional education complying with during the one-year period preceding renewal. The Board may in particular cases make exceptions to the requirements of CPE for reasons of individual hardship including health, military service, foreign residence, retirement, or other good cause. Programs qualifying for CPE credit may be in the form of: (i) a formal learning program; (ii) group programs; (iii) correspondence and formal individual study programs; (iv) serving as instructors, discussion leaders, and speakers at programs; and (v) publishing articles and books.

## **4. Guam Chapter of AICPA**

There were about 51 AICPA members in Guam in 2000. All AICPA members, by virtue of their membership, receive the following:

- *Journal of Accountancy* (monthly)
- *The CPA Letter* (10 times a year)
- *The Practicing CPA* (monthly; sent automatically to each practice unit with less than 50 AICPA members represented in the membership and to those members who specifically request it)

Members may also request to be placed on the distribution lists for exposure drafts of *Statements on Auditing Standards* and/or *IASs*. In addition, copies of the individual EDs may be acquired from the Accounting Standards, Auditing Standards, Consulting Services, and Professional Ethics divisions of the AICPA, as well as the State Legislation Department and the International Practice section of the Technical Information Division.

## Appendix 7. Guidelines on Professional Arrangements

### 1. Overview

The IFAC Board created a Compliance Committee in May 2000. The Committee is one of several initiatives designed to strengthen IFAC and the international profession. Its primary responsibilities are: (i) monitoring the relevance, sufficiency, and efficacy of IFAC membership obligations; (ii) monitoring member body compliance with these obligations; (iii) recommending actions to the IFAC Board and Council in respect of membership obligations; (iv) reviewing the investigative and disciplinary processes of member bodies, and reporting and making recommendations on these to the IFAC Board and Council; (v) considering how member bodies might best be encouraged, or if necessary, required to comply more closely with such obligations; (vi) devising schemes to assist member bodies to comply more closely and to considering whether additional powers are required to enforce compliance with membership obligations; and (vii) implementing agreed policy in this area. The Compliance Committee will also work closely with the Transnational Audit Committee in its monitoring of the members of the IFAC Forum of Firms (FOF) once these entities are fully established.

Table 16 sets out relevant international guidelines with respect to the accountancy profession. IFAC has also established a *Money Laundering Task Force*. The task force has obtained information from around the world on what other professional bodies are doing and is currently analyzing these activities. This is a first step in determining its scope of activities. Included in the work of the task force will be consideration of whether standards will be developed to help member bodies and their members to address money laundering and related issues.

**Table 16: International Guidelines for the Accountancy Profession**

Confederation of Asian and Pacific Accountants (CAPA)	CAPA's Guide on the Essential Components of a Professional Accountancy Body <sup>89</sup> covers: (i) Admission / Advancement Standards; (ii) Full Membership Requirements; (iii) CPE; (iv) Technical Standards; (v) Quality Assurance / Peer Review Program; (vi) Registration as Accountant/Auditor; (vii) Disciplinary Rules; (viii) Management and Administrative Structures; (ix) Governance; and (x) External Affiliations / Memberships. <sup>90</sup>
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<sup>89</sup> Confederation of Asian and Pacific Accountants (CAPA). 1998. *Guide on the Essential Components of a Professional Accountancy Body*. Kuala Lumpur: CAPA.

<sup>90</sup> Further details are provided in: Narayan, Francis B., Ted Godden, Barry Reid, and Maria Rosa Ortega. 2000. *Financial Management and Governance Issues in Selected Developing Member Countries: A Study of Cambodia, People's Republic of China, Mongolia, Pakistan, Papua New Guinea, Uzbekistan, and Viet Nam*. Manila: ADB. p. 27.

**Table 16: International Guidelines for the Accountancy Profession** *(continued)*

International Federation of Accountants (IFAC)	<p>IFAC pronouncements cover several areas:</p> <ul style="list-style-type: none"> <li>• Education Guidelines and Standards. IFAC's Education Committee issues IESs and IEGs. The IESs are intended to establish the essential elements on which education and training programs, both pre-qualification and post-qualification, for all accountants should be founded. The IEGs promote good practice and or provide good advice. They are based on careful study of the best practices and most effective methods for dealing with the issues being addressed.</li> <li>• Code of Ethics for Professional Accountants. This is intended to serve as a model on which to base national ethical guidance. It sets standards of conduct for professional accountants and states the fundamental principles that should be observed by professional accountants in order to achieve common objectives.</li> <li>• Statement of Policy of Council: Implementation and Enforcement of Ethical Requirements.<sup>91</sup> This statement sets expectations and provides guidance on disciplinary action, including punishment and publicity.</li> <li>• Assuring the Quality of Professional Services. This statement sets expectations on quality control policies and procedures for member bodies and professional firms.<sup>92</sup></li> </ul>
Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) of the UNCTAD	<p>In February 1999, UNCTAD issued a report on accounting education and qualifications.<sup>93</sup> The report provides a useful set of benchmarks in respect of these issues, in particular:</p> <ul style="list-style-type: none"> <li>• Guideline for a Global Accounting Curriculum and Other Qualification Requirements including (i) requirements for the qualifications of professional accountants; and (ii) a guideline for national systems for the qualifications of professional qualifications.</li> <li>• Global Curriculum for the Professional Education of Professional Accountants including: (i) organizational and business knowledge; (ii) information technology; and (iii) accounting and accounting-related knowledge.</li> </ul>
World Trade Organization (WTO): General Agreement on Trade in Services (GATS)	<p>The criteria for recognizing professional qualifications may not exceed what is necessary to ensure the quality of service. Each country is expected to have a methodology for comparing professional qualifications and this must be applied in a fair and consistent manner to all applicants.</p>

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<sup>91</sup> IFAC. 1998 January. *Statement of Policy of Council: Implementation and Enforcement of Ethical Requirements*. New York: IFAC.

<sup>92</sup> IFAC. 1999 August. *Assuring the Quality of Professional Services*. New York: IFAC.

<sup>93</sup> UNCTAD. 1999. *International Accounting and Reporting Issues: 1999 Review*. United Nations.

Furthermore, ISAR has initiated a project to assess the competence of accountants. The objective of the project is to rate professional accounting qualifications from around the world, thus creating impetus for improvements, and supporting international skill transferability.<sup>94</sup>

## **2. Membership Requirements**

### **Education**

IFAC and ISAR have published guidelines on education requirements. The IFAC guidelines, such as IEG 9, provide an overview as to what is expected. The ISAR guidelines are more useful in a practical sense as they suggest a detailed curriculum structure and contents.<sup>95</sup>

### **Experience**

With regards to practical experience, international guidelines state that:

An appropriate period of relevant experience in performing the work of professional accountants must be a component of a pre-qualification program. The period of experience may vary due to differences in the environment in which professional accountants offer their services. However, this period should be long enough to permit prospective accountants to demonstrate they have gained the knowledge, skills, and professional values sufficient for performing with professional competence and for continuing to grow throughout their careers. This objective cannot normally be met in a period of less than three years.

Paragraph 49 – IEG 9.

Moreover, IFAC recommends that practical experience requirements must be considered when professional bodies seek mutual recognition of qualifications.<sup>96</sup> The US CPA experience requirement differs between states and depends on academic qualifications.<sup>97</sup> For instance, the *Californian Accountancy Act* requires 24-48 months' experience.

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<sup>94</sup> Narayan, Francis B., Ted Godden, Barry Reid, and Maria Rosa Ortega. 2000. *Financial Management and Governance Issues in Selected Developing Member Countries: A Study of Cambodia, People's Republic of China, Mongolia, Pakistan, Papua New Guinea, Uzbekistan, and Viet Nam*. Manila: ADB. p. 29.

<sup>95</sup> UNCTAD. 1999. *International Accounting and Reporting Issues: 1999 Review*. United Nations.

<sup>96</sup> IFAC. 1995 June. *Statement of Policy of Council: Recognition of Professional Accountancy Qualifications*. New York: IFAC. Paragraph 22-25.

<sup>97</sup> Source: [www.aicpa.org/states/uaa/digest.htm](http://www.aicpa.org/states/uaa/digest.htm)

## Continuing Professional Education

IFAC and ISAR recommend a minimum of 30 hours CPE per year, or a minimum of 90 hours in every three-year period, of structured learning activity.<sup>98</sup>

## 3. Quality Control and Assurance

“In the case of professional accountants in public practice, the implementation of appropriate quality control policies and procedures is the responsibility of each firm of practicing accountants. The task of encouraging and assisting firms of practicing accountants to maintain and improve the quality of professional services is primarily that of the member bodies in each country. IFAC believes that the member bodies have the responsibility to take appropriate steps to achieve that objective in the legal, social, business, and regulatory environment prevailing within their countries.”

– IFAC (August 1999)<sup>99</sup>

In relation to quality control and assurance, IFAC suggests that:<sup>100</sup>

- Member bodies should adopt or develop quality control standards and relevant guidance that require firms of practicing accountants to establish the quality control policies and procedures necessary to provide reasonable assurance of conforming with professional standards in performing services. The nature and extent of a firm’s quality control policies and procedures depend on a number of factors, such as the size and nature of its practice, its geographic dispersion, its organization and appropriate cost/benefit considerations. Accordingly, the policies and procedures adopted by individual firms will vary, as will the manner in which the policies and procedures themselves and compliance with them are documented.
- Member bodies should develop quality review programs designed to evaluate whether firms of practicing accountants have established appropriate quality control policies and procedures and are complying with those policies.
- Member bodies should establish quality review programs designed to evaluate whether firms of practicing accountants have complied with relevant professional standards for assurance engagements.

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<sup>98</sup> IFAC. 1998 May. *International Education Guideline (IEG) 2: Continuing Profession Education*. New York: IFAC.

<sup>99</sup> IFAC. 1999 August. *Assuring the Quality of Professional Services*. New York: IFAC.

<sup>100</sup> *Ibid.*

- Member bodies should require firms of practicing accountants to make appropriate improvements in their quality control policies and procedures, or in their compliance with those policies and procedures, when the need for such improvement is identified. Where firms fail to comply with relevant professional standards, the member body should take appropriate corrective action. Member bodies should also take such educational or disciplinary measures as indicated by the circumstances.

As a basic condition, IFAC emphasizes that implementation of an adequate self-regulatory program cannot be effected until firms of practicing accountants in a country are bound by an appropriate code of ethics and also by adequate standards governing accounting principles and engagements to provide professional services. The IFAC *Code of Ethics for Professional Accountants*, ISAs and IASs all provide guidance for such standards.

## **Appendix 8. US Accounting Standard-Setting Bodies**

### **1. Financial Accounting Standards Board (FASB)**

The present FASB was established in 1973 as the body responsible for establishing and improving US financial accounting and reporting standards. FASB is autonomous, is run by full-time staff members, has over 50 professional accountants, and has weekly board meetings that are open to the public. FASB members are assumed to represent all facets of accounting. Each member is appointed for a five-year period. All FASB statements form part of US GAAP.

### **2. Government Accounting Standards Board (GASB)**

GASB was established in 1984 by the Financial Accounting Foundation (FAF) to set standards of financial accounting and reporting for state and local governmental entities. These standards guide the preparation of external financial reports of those entities. GASB is the successor to the National Council on Governmental Accounting, whose standards remain in effect until amended or superceded by the GASB. GASB has authoritative status for its standards under Rule 203 of the AICPA's' Rules of Conduct and legislation in various states.

### **3. Financial Accounting Foundation (FAF)**

In addition to its oversight responsibility for the GASB and its Advisory Council, the Foundation is also responsible for selecting members, providing funds, and exercising general oversight of FASB.

### **4. Governmental Accounting Standards Advisory Council (GASAC)**

The Governmental Accounting Standards Council (GASAC) is responsible for consulting with GASB on technical issues, project priorities, matters likely to require the attention of GASB, selection and organization of task forces, and other matters as requested by GASB or its chairperson. The GASAC is also responsible for helping to develop GASB's annual budget and assisting the FAF to raise funds for the Board. The Council has more than 25 members who broadly represent financial information preparers, attestors and users.

## Appendix 9. US GAAP for Nongovernment Entities

The following are sources of US GAAP for nongovernment (private sector) entities:

### 1. Accounting Research Bulletins (ARB)

ARB No.	Title and Key Topics	Issued
43	Restatement and Revision of Accounting Research Bulletins (ARB No. 43 replaced ARBs issued between September 1939 and January 1953)	June 1953
45	Long-Term Construction-Type Contracts (Percentage-of-Completion Method, Completed-Contract Method)	October 1955
51	Consolidated Financial Statements (Consolidated Financial Statements, Combined Financial Statements, Minority Interests)	August 1959

### 2. Accounting Principles Board (APB) Opinions

Opinion	Title and Key Topics	Issued
2	Accounting for the Investment Credit	December 1962
4	Accounting for the Investment Credit (Amendment of APB Opinion No. 2)	March 1964
6	Status of Accounting Research Bulletins (Amendment of ARB No. 43)	October 1965
7	Reporting the Results of Operations (I. Net Income and the Treatment of Extraordinary Items and Prior Period Adjustments II. Computation and Reporting of Earnings per Shares.)	November 1966
10	Omnibus Opinion (Consolidated Financial Statements, Poolings of Interest, Convertible Debt and Debt Issued with Stock Warrants Installment Method of Accounting)	December 1966
11	Accounting for Income Taxes (Superseded by Statement of Financial Accounting Standards No. 96 issued in December 1987.)	December 1967
14	Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants	March 1969
15	Earnings per Share (Superseded by Statement of Financial Accounting Standard No. 128 issued in February 1997.)	May 1969
16	Business Combinations	August 1970
17	Intangible Assets	August 1970
18	The Equity Method of Accounting for Investments in Common Stock	March 1971
19	Reporting Changes in Financial Position (Superseded by Statement of Financial Accounting Standards No. 95 issued in November 1987.)	March 1971

DIAGNOSTIC STUDY OF ACCOUNTING AND AUDITING PRACTICES  
IN THE MARSHALL ISLANDS

Opinion	Title and Key Topics	Issued
20	Accounting Changes	July 1971
21	Interest on Receivables and Payables	August 1971
22	Disclosure of Accounting Policies	April 1972
23	Accounting for Income Taxes - Special Areas	April 1972
25	Accounting for Stock Issued to Employees	October 1972
26	Early Extinguishment of Debt	October 1972
28	Interim Financial Reporting	May 1973
29	Accounting for Nonmonetary Transactions	May 1973
30	Reporting the Results of Operations; Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions	June 1973
31	Disclosure of Lease Commitments by Lessees (Superseded by Statement of Financial Accounting Standards No. 13 issued in November 1976)	June 1973

### 3. Statements of Financial Accounting Concepts (SFAC)

No.	Title	Issue Date
1	Objectives of Financial Reporting by Business Enterprises	November 1978
2	Qualitative Characteristics of Accounting Information	May 1980
3	(Was superseded by SFAC No. 6)	
4	Objectives of Financial Reporting by Nonbusiness Organizations	December 1980
5	Recognition and Measurement in Financial Statements of Business Enterprises	December 1984
6	Elements of Financial Statements	December 1985

### 4. Statements of Financial Accounting Standards (SFAS)

No.	Title and Key Topics	Issued
2	Accounting for Research and Development Costs	October 1974
5	Accounting for Contingencies	March 1975
13	Accounting for Leases	November 1976
15	Accounting by Debtors and Creditors for Troubled Debt Restructurings	June 1977
16	Prior Period Adjustments	June 1977
34	Capitalization of Interest Cost	October 1979
52	Foreign Currency Translation	December 1981
57	Related Party Disclosures	March 1982
80	Accounting for Futures Contracts	August 1984
86	Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed	August 1985
87	Employers' Accounting for Pensions	December 1985
95	Statement of Cash Flows	November 1987
96	Accounting for Income Taxes	December 1987

## APPENDIXES

No.	Title and Key Topics	Issued
105	Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk and Financial Instruments with Concentrations of Credit Risk	March 1990
106	Employers' Accounting for Postretirement Benefits Other Than Pensions	December 1990
107	Disclosures about Fair Value of Financial Instruments	December 1991
109	Accounting for Income Taxes	February 1992
115	Accounting for Certain Investments in Debt and Equity Securities	May 1993
121	Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of	March 1995
123	Accounting for Stock-Based Compensation	October 1995
128	Earnings per Share	February 1997
131	Disclosures about Segments of an Enterprise and Related Information	June 1997
133	Accounting for Derivative Instruments and Hedging Activities	June 1998
135	Rescission of FASB Statement No. 75 and Technical Corrections	February 1999

## Appendix 10. International Accounting Standards

The following IASs were in effect at 28 February 2002.<sup>101, 102</sup>

IAS 1	Presentation of Financial Statements	IAS 27	Consolidated Financial Statements and Accounting for Investments in Subsidiaries
IAS 2	Inventories	IAS 28	Accounting for Investments in Associates
IAS 7	Cash Flow Statements	IAS 29	Financial Reporting in Hyperinflationary Economies
IAS 8	Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies	IAS 30	Disclosures in the Financial Statements of Banks and Similar Financial Institutions
IAS 10	Events After the Balance Sheet Date	IAS 31	Financial Reporting of Interests in Joint Ventures
IAS 11	Construction Contracts	IAS 32	Financial Instruments: Disclosures and Presentation
IAS 12	Income Taxes	IAS 33	Earnings Per Share
IAS 14	Segment Reporting	IAS 34	Interim Financial Reporting
IAS 15	Information Reflecting the Effects of Changing Prices	IAS 35	Discontinuing Operations
IAS 16	Property, Plant and Equipment	IAS 36	Impairment of Assets
IAS 17	Leases	IAS 37	Provisions, Contingent Liabilities and Contingent Assets
IAS 18	Revenue	IAS 38	Intangible Assets
IAS 19	Employee Benefits	IAS 39	Financial Instruments: Recognition and Measurement
IAS 20	Accounting for Government Grants and Disclosure of Government Assistance	IAS 40	Investment Property
IAS 21	The Effects of Changes in Foreign Exchange Rates	IAS 41	Agriculture
IAS 22	Business Combinations		
IAS 23	Borrowing Costs		
IAS 24	Related Party Disclosures		
IAS 26	Accounting and Reporting by Retirement Benefit Plans		

<sup>101</sup> Source: IASC Website: [www.iasc.org.uk](http://www.iasc.org.uk)

<sup>102</sup> The following IASs have been withdrawn:

- IAS 3 was replaced by IAS 27 and IAS 28.
- IAS 4 was replaced by IASs 16, 22, and 38.
- IAS 5 was replaced by IAS 1.
- IAS 6 was replaced by IAS 15.
- IAS 9 was superseded by IAS 38.
- IAS 13 was replaced by IAS 1.
- IAS 25 was replaced by IAS 39 and IAS 40.

## Appendix 11. US GAAP for Government Entities

The following are sources of US GAAP for government entities. These statements are issued by GASB and are sometimes referred to as GASB Statements (GASBS).

No.	Title	Issued	Effective Date
1	Authoritative Status of NCGA Pronouncements and AICPA Industry Audit Guide	Jul 1984	Jul 1984
2	Financial Reporting of Deferred Compensation Plans Adopted under the Provisions of Internal Revenue Code Section 457	Jan 1986	15 Dec 1986
3	Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements	Apr 1986	15 Dec 1986
4	Applicability of FASB Statement No. 87, "Employers' Accounting for Pensions," to State and Local Governmental Employers	Sep 1986	Sep 1986
5	Disclosure of Pension Information by Public Employee Retirement Systems and State and Local Governmental Employers	Nov 1986	15 Dec 1986
6	Accounting and Financial Reporting for Special Assessments	Jan 1987	15 Jun 1987
7	Advance Refundings Resulting in Defeasance of Debt	Mar 1987	15 Dec 1986
8	Applicability of FASB Statement No. 93, "Recognition of Depreciation by Not-for-Profit Organizations," to Certain State and Local Governmental Entities	Jan 1988	Jan 1988
9	Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting	Sep 1989	15 Dec 1989
10	Accounting and Financial Reporting for Risk Financing and Related Insurance Issues	Nov 1989	Various
11	Measurement Focus and Basis of Accounting - Governmental Fund Operating Statements	May 1990	Deferred

DIAGNOSTIC STUDY OF ACCOUNTING AND AUDITING PRACTICES  
IN THE MARSHALL ISLANDS

No.	Title	Issued	Effective Date
12	Disclosure of Information on Post-employment Benefits Other Than Pension Benefits by State and Local Governmental Employers	May 1990	15 Jun 1990
13	Accounting for Operating Leases with Scheduled Rent Increases	May 1990	Various
14	The Financial Reporting Entity	Jun 1991	15 Dec 1992
15	Governmental College and University Accounting and Financial Reporting Models	Oct 1991	15 Jun 1992
16	Accounting for Compensated Absences	Nov 1992	15 Jun 1993
17	Measurement Focus and Basis of Accounting - Governmental Fund Operating Statements: Amendment of the Effective Dates of GASB Statement No. 11 and Related Statements - an amendment of GASB Statements No. 10, 11, and 13	Jun 1993	Jun 1993
18	Accounting for Municipal Solid Waste Landfill Closure and Post-closure Care Costs	Aug 1993	15 Jun 1993
19	Governmental College and University Omnibus Statement - an amendment of GASB Statements No. 10 and 15	Sep 1993	Various
20	Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting	Sep 1993	15 Dec 1993
21	Accounting for Escheat Property	Oct 1993	15 Jun 1994
22	Accounting for Taxpayer-Assessed Tax Revenues in Governmental Funds	Dec 1993	15 Jun 1994
23	Accounting and Financial Reporting for Refundings of Debt Reported by Proprietary Activities	Dec 1993	15 Jun 1994
24	Accounting and Financial Reporting for Certain Grants and Other Financial Assistance	Jun 1994	15 Jun 1995
25	Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans	Nov 1994	15 Jun 1996
26	Financial Reporting for Post-employment Healthcare Plans Administered by Defined Benefit Pension Plans	Nov 1994	15 Jun 1996
27	Accounting for Pensions by State and Local Governmental Employers	Nov 1994	15 Jun 1997

## APPENDIXES

No.	Title	Issued	Effective Date
28	Accounting and Financial Reporting for Securities Lending Transactions	May 1995	15 Dec 1997
29	The Use of Not-for-Profit Accounting and Financial Reporting Principles by Governmental Entities	Aug 1995	15 Dec 1993
30	Risk Financing Omnibus—an amendment of GASB Statement No. 10	Feb 1996	15 Jun 1996
31	Accounting and Financial Reporting for Certain Investments and for External Investment Pools	Mar 1997	15 Jun 1997
32	Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans - a rescission of GASB Statement No. 2 and an amendment of GASB Statement No. 31	Oct 1997	31 Dec 1998
33	Accounting and Financial Reporting for Non-exchange Transactions	Dec 1998	15 Jun 2000
34	Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments	Jun 1999	

### Effective Dates:

Phase 1—Financial statements for periods beginning after June 15, 2001, for governments with total annual revenues of \$100 million or more in the first fiscal year ending after June 15, 1999. Different provisions apply for reporting general infrastructure assets at transition.

Phase 2—Financial statements for periods beginning after June 15, 2002, for governments with total annual revenues of \$10 million or more but less than \$100 million in the first fiscal year ending after June 15, 1999. Different provisions apply for reporting general infrastructure assets at transition.

Phase 3—Financial statements for periods beginning after June 15, 2003, for governments with total annual revenues of less than \$10 million in the first fiscal year ending after June 15, 1999. Different provisions apply for reporting general infrastructure assets at transition.

DIAGNOSTIC STUDY OF ACCOUNTING AND AUDITING PRACTICES  
IN THE MARSHALL ISLANDS

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No.	Title	Issued	Effective Date
35	Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities—an amendment of GASB Statement No. 34	Nov 1999	In three phases based on a public institution's total annual revenues, beginning with periods beginning after June 15, 2001 and continuing through periods beginning after June 15, 2003. Public institutions that are component units of a primary government should implement this standard at the same time as that primary government.
36	Recipient Reporting for Certain Shared Non-exchange Revenues—an amendment of GASB Statement No. 33	Apr 2000	15 Jun 2000 (or with Statement 33)
37	Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Omnibus—an amendment of GASB Statements No. 21 and No. 34	Jun 2001	
38	Certain Financial Statement Note Disclosures	Jun 2001	

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## Appendix 12. International Standards on Auditing

The following International Standards on Auditing (ISAs) and International Auditing Practice Statements (IAPSS) were in effect at 30 September 2001.

### 1. International Standards on Auditing (ISAs)

100	Assurance Engagements	540	Audit of Accounting Estimates
120	Framework of ISAs	550	Related Parties
200	Objective and General Principles Governing an Audit of Financial Statements	560	Subsequent Events
210	Terms of Audit Engagements	570	Going Concerns
220	Quality Control for Audit Work	580	Management Representations
230	Documentation	600	Using the Work of Another Auditor
240	Fraud and Error	610	Considering the Work of Internal Auditing
250	Consideration of Laws and Regulations in an Audit of Financial Statements	620	Using the Work of an Expert
300	Planning	700	The Auditor's Report on Financial Statements
310	Knowledge of the Business	710	Comparatives
320	Audit Materiality	720	Other information in documents containing Audited Financial statements
400	Risk Assessments and Internal Control	800	The Auditor's Report on Special Purpose Audit Engagement
401	Auditing in a Computer Information Systems Environment	810	The Examination of Prospective Financial Information
402	Audit Considerations Relating to Entities Using Service Organizations	910	Engagements to Review Financial Statements
500	Audit Evidence	920	Engagements to Perform Agreed-Upon Procedures Regarding Financial Information
501	Audit Evidence-Additional Considerations for Specific Items	930	Engagements to Compile Financial Information
505	External Confirmations		Glossary of Terms
510	Initial Engagements - Opening Balances		Preface to ISAs and RSs
520	Analytical Procedures		
530	Audit Sampling and other Selective Testing Procedures		

## 2. International Auditing Practice Statements (IAPs)

1000	Inter-Bank Confirmation Procedures	1006	The Audit of International Commercial Banks
1001	CIS Environments-Stand-Alone Microcomputer Systems	1007	Communications with Management
1002	CIS Environments-On-Line Computer Systems	1009	Computer - Assisted Audit Techniques
1003	CIS Environments-Database Systems	1010	The Consideration of Environmental Matters in the Audit of Financial Statements
1004	The Relationship Between Bank Supervisors and External Auditors	1011	Implications For Management And Auditors Of The Year 2000 Issue
1005	The Special Consideration in the Audit of Small Entities		

## **Appendix 13. Generally Accepted Government Auditing Standards (GAGAS)**

### Chapter 1: Introduction

- Purpose
- Applicability
- Accountability
- Basic Premises
- Auditors' Responsibilities
- Procurement of Audit Services

### Chapter 2: Types of Government Audits

- Purpose
- Financial Audits
- Performance Audits
- Other Activities of An Audit Organization

### Chapter 3: General Standards

- Purpose
- Qualifications
  - Continuing Education Requirements
  - Staff Qualifications
- Independence
  - Personal Impairments
  - External Impairments
  - Organizational Independence
  - Internal Auditors
  - External Auditors
- Due Professional Care
- Quality Control

### Chapter 4: Field Work Standards for Financial Audits

- Purpose
- Relation to AICPA Standards
- Planning
  - Auditor Communication
  - Audit Follow-up
- Fraud, Illegal Acts, and Other Noncompliance
  - Auditors' Understanding of Possible Fraud and of Laws and Regulations
  - Due Care Concerning Possible Fraud and Illegal Acts
  - Noncompliance Other Than Illegal Acts

- Internal Control
  - Safeguarding of Assets
  - Control Over Compliance With Laws and Regulations
- Working Papers
- Financial Related Audits

#### Chapter 5: Reporting Standards for Financial Audits

- Purpose
- Relation to AICPA Standards
- Reporting Compliance with Generally Accepted Government Standards
- Reporting on Compliance with Laws and Regulations and on Internal Control Over Financial Reporting
  - Scope of Compliance and Internal Control Work
  - Fraud, Illegal Acts, and Other Noncompliance
  - Direct Reporting of Fraud and Illegal Acts
  - Deficiencies in Internal Control
- Privileged and Confidential Information
- Report Distribution
- Financial Related Audits

#### Chapter 6: Field Work Standards for Performance Audits

- Purpose
- Planning
  - Significance and User Needs
  - Understanding the Program
  - Criteria
  - Audit Follow-Up
  - Considering Others' Work
  - Staff and Other Resources
  - Written Audit Plan
- Supervision
- Compliance with Laws and Regulations
  - Illegal Acts and Other Noncompliance
  - Abuse
  - Obtaining Information About Laws, Regulations, and Other Compliance Requirements
  - Limitations of An Audit
- Management Controls
- Evidence
  - Audit Findings
  - Tests of Evidence
  - Working Papers

## Chapter 7: Reporting Standards for Performance Audits

- Purpose
- Form
- Timeliness
- Report Contents
  - Objectives, Scope, and Methodology
  - Audit Results
  - Recommendations
  - Statement on Auditing Standards
  - Compliance With Laws and Regulations
  - Management Controls
  - Views of Responsible Officials
  - Noteworthy Accomplishments
  - Issues Needing Further Study
  - Privileged and Confidential Information
- Report Presentation
  - Complete
  - Accurate
  - Objective
  - Convincing
  - Clear
  - Concise
- Report Distribution

## Appendix 14. College of the Marshall Islands (CMI): Courses

CMI offers the following courses in business, accounting and computing.<sup>103</sup>

Course	Title	Description
BU 101	Introduction to Business (3 credits)	Examines the role of business in a modern economy; its growth, structure, organization, and relationship to the changing environment. Surveys types of business, production, marketing, management, accounting, financing, computerization, human resources, and government requirements.
BU 105	Business Mathematics (3 credits)	Practical mathematical applications with emphasis on solving business problems. Reviews fundamental processes including percentages, fractions, decimals, percents, discounts, payroll, inventory, depreciation, cash and trade discounts, markup and markdowns, simple and compound interest, present value, annuities, stocks and bonds.
BU/SS 110	Business Economics (3 credits)	Introduces the basic theories and concepts in the modern field of economics and the application of theory to business.
BU 121	Business Communications I (3 credits)	Explores the principles and forms of effective written, oral, and nonverbal communications as applied to business, with emphasis on the ability to convey ideas and to understand others.
BU 122	Business Communications II (3 credits)	Introduces theory and practice of interpersonal communications. Emphasis on practical application of theory to improve communication skills and interpersonal relationships and reduce communication breakdowns.
BU 131	Accounting I (3 credits)	Introduction to basic bookkeeping and recording transactions in books of entry.
BU 132	Accounting II (3 credits)	Application of BU 131, interpretation of balance sheet, cost control features, and steps for establishing an accounting system.
BU 181	Business Law (3 credits)	Gives an overview of criminal law, contract law, property law, and consumer law, as each applies to business.
BU 231	Accounting III (3 credits)	Introduces receivables and temporary investments, inventories, plant and intangible assets, payroll, notes payable, and other current liabilities.
BU 232	Accounting IV (3 credits)	Introduces the various transactions relating to partnership and incorporation.

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<sup>103</sup> Source: [www.cmiedu.net](http://www.cmiedu.net)

## APPENDIXES

Course	Title	Description
BU 235	Governmental Accounting (3 credits)	Introduces governmental accounting principles and practical applications. Includes introduction to Fund Balance accounting.
BU 241	Principles of Marketing (3 credits)	Covers the business activities concerned with planning, pricing, promoting, and distributing goods and services. Provides an understanding of the role of marketing in our economy and the processes used to make business decisions.
BU 251	Small Business Management I (3 credits)	Surveys the small business environment. Examines the special opportunities and problems of small business. Provides the opportunity for students to understand and apply concepts and to develop skills necessary for the success of a business.
BU 252	Small Business Management II (3 credits)	Examines the key concepts and issues underlying the modern practice of managing the small business. Focuses on developing a business plan outlining goals, market analysis, and financial planning for a small business.
BU 261	Principles of Management I (3 credits)	Covers management theory and concepts that provide practical tools for planning, organizing, controlling, coordinating, and decision making within organizations.
BU 262	Principles of Management II (3 credits)	Analysis of management functions, including effective methods of managing organizations responsive to business realities in Micronesia.
BU 296	Business Internship (3 or 6 credits)	Provides the student with on-the-job field experience while earning college credit. With the assistance of the instructor-coordinator, the student is assigned to work under a supervisor in a governmental department or a private business, to learn through actual work experience. Work experience is appropriately related to the educational and career objective of the student.
BU 299	Special Topics	These courses are offered as occasion demands and/or an instructor is available.
CS 101	Introduction to Computers (3 credits)	Introduces the basic principles and techniques of data processing through hands-on experience with microcomputer software. Examines the impact of computer technology on individuals, government, business, and industry. Provides a basic understanding of computer terminology, operating systems, word processing, and spreadsheets.

DIAGNOSTIC STUDY OF ACCOUNTING AND AUDITING PRACTICES  
IN THE MARSHALL ISLANDS

Course	Title	Description
CS 102	Computer Applications (3 credits)	Development of data processing through hands-on experience with microcomputer software. Develops concepts related to database applications through systems analysis, data entry, and reporting. Introduces the concept of properties, handling, embedding, and linking of various objects created in different software applications. Examines the use of computer skills in careers in government, business, and industry. Provides the student with expanded understanding of operating systems, word processing, and spreadsheets.
CS 103	Word Processing (3 credits)	Provides basic understanding of word processing software to create, format, edit, save, and print on the IBM-compatible PC. Introduces desktop publishing.
CS 104	Spreadsheets (3 credits)	Introduces LOTUS 1-2-3 and Microsoft Excel and examines the uses of these spreadsheets that are commonly applied in today's business world. Provides a project-driven approach to creating spreadsheets to meet today's diverse business demands.
CS 105	Computer Service Technology (3 credits)	Includes computer history and career highlights. Covers microcomputer overview; safety, assembly and start-up procedures; operating systems, tools, equipment; troubleshooting; parts, supplies, peripherals; publications, resources, customer relations, and record keeping.
CS 120	Computer Science I (3 credits)	Fundamentals of algorithmic problem solving and structured programming. Topics include problem analysis and decomposition, stepwise refinement, pseudopodia and charting techniques, basic control structure and data types, modularization and parameter passing, files, arrays, testing, program tracing, and debugging. Introduction and application of principles of software engineering and object-oriented programming.
CS 141	Computer Science II (3 credits)	An intermediate course in problem-solving using Microsoft Visual C++. Focuses on more advanced concepts including arrays, classes, trees, and object-oriented methodology and implementation.
CS 213	Systems Analysis and Design (3 credits)	Provides a total approach to information system development. Teaches students how to develop and implement information systems in an engineered and disciplined manner.

## APPENDIXES

Course	Title	Description
CS 220	Advanced Computer Studies (3 credits)	Concepts and theory of database management systems with emphasis on implementation. In-depth focus on macro and template design, customization, and application. Other topics include file organization, information handling, management, and control.
CS 230	Database Management (3 credits)	Concepts and theory of database management systems, with emphasis on database implementation using the relational model. Other topics include file organization, information handling, management, and control, using a database management system.
CS 299	Special Topics	These courses are offered as occasion demands and/or an instructor is available.

## Appendix 15. USP: Undergraduate Accountancy Courses

USP offers the following undergraduate courses in accounting and financial management.<sup>104</sup>

Course	Title	Description
...	Preliminary 1	
...	Preliminary 2	
AFF01	Foundation 1	
AFF02	Foundation 2	
AF100	Introduction to Accounting and Financial Management for the Non Specialist	This course covers the principles of compilation of standard financial reports and their use in assessing an organization's financial strengths and weaknesses. It considers the contribution that accounting can make to the good management of an organization as a tool for planning, control and decision making. It also considers the nature of, and the markets for, organization finance.
AF101	Introduction to Accounting and Financial Management Part 1	The accounting system as a formal information system. Accounting conventions. An introduction to the analysis of the concepts of accounting, especially revenue, expenses, income, assets, depreciation, valuation, liabilities, and proprietorship. Introduction to accounting for partnerships and companies. A study of the accounting process from data collection to report preparation, presentation and analysis and interpretation (Prescribed text: Coutman, B., Introduction to the Accounting and Financial Management: Volumes 1 and 2. USP Publications)
AF102	Introduction to Accounting and Financial Management Part 2	An introduction to processing Accounting data for reporting to management. Budgets, cost concepts, classifications and accumulation, and accounting information systems will be introduced in the context of the management planning and control functions in the private sector and government, government agencies, and non-profit making organizations (Prescribed text: Martin, C., Introduction to Accounting, 4th ed. McGraw-Hill Book Company, 1994).

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<sup>104</sup> Source: [www.usp.ac.fj](http://www.usp.ac.fj)

## APPENDIXES

Course	Title	Description
AF201	Managerial Accounting	This course utilizes the cost accounting data studied in AF102. An analysis of the management accounting function with special emphasis on variable cost classification and its application to business decisions; techniques to facilitate the decision making process including capital investment decisions. An introduction to systems design and computer programming (Prescribed text: Langfield-Smith and Thorne, Managerial Accounting, McGraw-Hill, 1995).
AF203	Corporate Accounting	The purpose of this course is to provide students with an understanding of the functions of financial accounting for companies, and the ability to design, produce, and interpret accounting reports required by law and relevant to users of accounts (Prescribed text: Leo, K.J. and Hoggett, J.R., Company Accounting in Australia, 4th ed, John Wiley, 1997).
AF205	Law of Associations	This course introduces the basic principles of the law of partnership and the law of business corporations. Brief reference is made to the use of the trust in business contexts (Statutory material for the course is taken from Fiji. Occasional reference for comparative purposes is made to the statute law of other South Pacific island nations. Case law is drawn from variety of common law jurisdictions).
AF207	The Design of Accounting and Financial Management Models	This course comprises three parts: (i) Introduction: The design of accounting and financial models with an emphasis on optimization in AFM; (ii) Management control: analytical, quantitative modeling for budgetary control and financial planning; and (iii) Analysis for Decision Support Systems.
AF208	Financial Management	Development of a framework for investment and financing decisions both short and long term for private enterprises and government bodies; factors influencing the allocation of funds to competing alternatives; risk analysis models for financial decision making; the financial system; the theory of capital structure; financial strategies for growth (Prescribed text: Weston et al., Fundamentals of Financial Management, 11th edn, HBR).
AF300	Research Project in Accounting	Detailed proposals of a research project will be considered from students of proven ability. The course requires some research skills such as those provided by SE100.

DIAGNOSTIC STUDY OF ACCOUNTING AND AUDITING PRACTICES  
IN THE MARSHALL ISLANDS

Course	Title	Description
AF301	Accounting Theory and Applications	Aspects of advanced financial accounting, with particular reference to developments in accounting theory and in professional standards. Aspects of advanced management accounting theory and applications (Prescribed texts: Godfrey, J., Hodgson, A., and Holmes, K., Accounting Theory, 4th ed, John Wiley, 1997).
AF302	Information Systems	Information systems incorporating accounting systems; systems analysis including the design, evaluation, and implementation of business systems in general and accounting systems in particular; internal control and control systems; computer-based information systems; uses and potential of information systems (Prescribed text: O'Brien J.A. 'Managing Information Systems: Managing Information Technology in the Networked Empire, 3rd edition, Irwin, 1996).
AF304	Auditing	The audit function and the role of the auditor. The audit process as related to the audit of resources, commitments, revenue, and expenses. The internal audit, the audit report, and the changing status of the audit function (Prescribed text: Gul, F.A., Teoh, H.Y., and Andrew, B.H., Theory and Practice of Australian Auditing, 3rd ed, Thomas Nelson, Australia, 1994).
AF307	Public Sector Accounting	The course covers the broad spectrum of public sector accounting. Aspects of financial and management accounting as they affect governmental units and other non-profit organizations will be considered. An approach that balances the development and appreciation of a conceptual framework with applied problem solving will be pursued (Prescribed text: Jones and Pendlebury, Public Sector Accounting, Pitman, UK, 1988).
AF308	Taxation Law	This course is concerned almost exclusively with income tax. Each of the major issues that must be dealt with by any system of income tax are considered. The Fiji Income Tax Act is examined in detail as an example of a particular income tax.
AF309	Insolvency Law and Practice	This course introduces the legal principles and procedures governing the bankruptcy of individuals and the winding up of insolvent corporations, the law governing receivers, alternatives to bankruptcy and liquidation and related matters. Fiji statutory materials are used and case law is primarily from Fiji.

## Appendix 16. USP: Postgraduate Accountancy Courses

USP offers the following postgraduate courses in accounting and financial management.<sup>105</sup>

Course	Title	Description
AF 411	Advanced Corporate Accounting	This course covers advanced aspects of financial accounting, financial accounting regulatory framework, and specialized accounts not covered in undergraduate programs. The topics covered in this course include accounting for branches, mergers and acquisitions, the preparation of advanced consolidated financial statements, segmental financial statements, value added reporting, cashflow accounting and reporting, accounting for trusts, insurance and pension fund accounting, farm accounting, and the regulatory framework of financial accounting. There is no single textbook that covers the body of knowledge required for this course. In addition to lecture material, students will be required to read specified books and journal articles.
AF 412	Management Accounting and Finance in the South Pacific	The primary focus of this course is to study how management accounting information systems should be designed so as to provide adequate information for planning, decision making, and control of organizational activities with specific reference to the South Pacific economic scene. The accounting information systems will be discussed in conjunction with how people in organizations are likely to use and react to the information. The course will also address current developments in management accounting practice and research. The topics covered include design of management accounting control systems, management accounting models and behavioral implications, cost theory, transfer pricing and transfer pricing manipulations, performance measurement and evaluation.

<sup>105</sup> Source: [www.usp.ac.fj](http://www.usp.ac.fj)

DIAGNOSTIC STUDY OF ACCOUNTING AND AUDITING PRACTICES  
IN THE MARSHALL ISLANDS

Course	Title	Description
AF413	Advanced Accounting Theory	The course is structured to examine theoretical aspects of accounting and the adequacy of conceptual accounting doctrines in providing relevant, reliable, and objective accounting information. The theoretical issues covered will be of special relevance to the South Pacific Island Economies. The topics covered include developments in accounting theory, cultural and socioeconomic aspects of accounting, contribution of accounting to socioeconomic development in the South Pacific including entity theory, accounting information needs in a developing country, valuation assumptions which underlie accounting information and the validity of such assumptions including historic cost, present value, current value accounting, and the concept of profit.
AF414	Decision Support Systems	Accounting as an information system interfaces with information theory in general and computer technology in particular. In their role as accounting information specialists, accountants must have an understanding of how information technology can support managerial decision making. The aim of this course is to provide students with a basis in computer Decision Support Systems. The course content will enable students to be able to construct decision support systems, understand the nature of subsystems, the strategies for successfully designing and implementing decision support systems in an organization, and the current status of, and development perspectives in, decision support systems technology. There will be hands-on exposure to decision support system software packages.
AF 415	Reading Course in Accounting	This course provides flexibility to students who wish to have an understanding of the literature in specific topics in accounting and financial management. The special topics available in any semester will depend on staff research and teaching interests. At present staff in the department have expertise and interest to supervise students who would like to pursue special topics in the following fields: International Finance, International Accounting, Financial Institutions and Markets, Accounting Models and Behavior, Managerial Accounting and Managerial Finance, Banking, Auditing, Leasing and Social and Environmental Accounting.

## **Appendix 17. USDA PITA: Sample Training Curriculum**

### **Financial Management**

- Performance-Based Management
- Asset and Risk Management
- Financial Forecasting
- Management Accountability and Control
- Analysis and Planning for Information Systems
- Budget Formulation and Execution
- Budget Analysis
- Investment Analysis
- Performance Based Budgeting

### **Accounting**

- Government Accounting
- Fixed Asset Accounting
- Enterprise Accounting
- Revenue Accounting
- Activity Based Costing

### **Auditing**

- Performance Auditing
- Compliance Auditing and Questioned Costs
- Federal Grants and Contracts
- Financial Auditing
- Audit Management and Follow-up
- Formulating Audit Objectives

### **Leadership and Management**

- Leadership: Change, Challenge and Empowerment
- Managing for Results
- Strategic Planning for Customer Oriented Government
- Management Analysis
- Performance Measurement
- Techniques for Improving Organizational Performance
- Project Management
- Management Accountability and Control
- Program Evaluation

### **Human Resource Management**

- Performance Management
- Human Resource Management
- Classification and Compensation Systems
- Train-the-Trainer

### Federal Grants Management

- Obtaining and Successfully Implementing Federal Grants and Cooperative Agreements
- A Performance-based Approach to Managing Federal Grants
- Administrative Requirements and Cost Principles
- Procurement and Contracting Under Federal Grants

## Appendix 18. Relevant Extracts from the RMI Constitution

The Constitution came into effect on 1 May 1979. It is the supreme law of RMI and sets out rights and governance structures and arrangements (legislative, executive, judicial, public service, and local government). Relevant extracts are reproduced in this appendix.

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### Preamble

### Article I – Supremacy of the Constitution

### Article II – Bill of Rights

### Article III – The Council of Iroij

### Article IV – The Legislature

### Article V – The Executive

### Article VI – The Judiciary

### Article VII – The Public Service

#### *Section 4. The Secretary of Finance.*

(1) There shall be an officer of the Public Service to be called the Secretary of Finance who shall be the head of the Finance Department.

(2) In addition to the other functions and powers conferred on him by law, the Secretary of Finance shall be responsible for the preparation of the accounts relating to all public revenues and expenditure for each financial year, and for advising the Minister of Finance on all matters pertaining to the budget.

#### *Section 5. The Public Service Commission.*

(1) There shall be a Public Service Commission of the Marshall Islands consisting of a Chairman and 2 other members.

(2) The Chairman and other members of the Public Service Commission shall be appointed by the Cabinet, acting with the approval of the Nitijela, signified by resolution.

(3) At any one time, at least 2 members of the Public Service Commission shall be citizens of the Marshall Islands; and no member of the Commission shall remain a member if he ceases to be such a citizen.

(4) No person shall be appointed to be or shall remain a member of the Public Service Commission if he is or becomes a member of the Nitijela.

(5) No member of the Public Service Commission shall hold concurrently any office in the Public Service.

(6) A member of the Public Service Commission shall be appointed to hold office for a term of not more than 3 years, but shall be eligible for reappointment.

(7) In making appointments under Section 5 of this Article, and in fixing the terms of office of appointees, account shall be taken of the need to ensure that there is reasonable continuity in the membership of the Public Service Commission and that the terms of individual members will not expire at the same time.

### Article VIII – Finance

#### *Section 1. Legislative Control of Public Revenue and Expenditure.*

(1) No taxes shall be imposed or other revenue raised and no public money shall be expended unless authorized by law.

(2) All revenues received by the Government of the Marshall Islands shall be paid into an appropriate public fund or account established by this Constitution or by Act.

#### *Section 2. The Cabinet to Take Responsibility for Budgetary Matters.*

(1) It shall be the responsibility of the Cabinet to make proposals to the Nitijela on all matters pertaining to the budget.

(2) Except with the recommendation or consent of a member of the Cabinet, the Nitijela shall not proceed further than the

first reading of any Bill or amendment thereto introduced by a member of the Nitijela other than a member of the Cabinet, if that Bill would, in the opinion of the Speaker, dispose of or charge any of the public revenues of the Marshall Islands, or revoke or alter (otherwise than by way of reduction) any disposition thereof or charge thereon, or impose or alter or abolish any tax, rate, due, fee or fine.

### ***Section 3. The General Fund.***

(1) There shall be a Marshall Islands General Fund.

(2) All taxes and other revenues and moneys raised or received by the Government of the Marshall Islands shall be paid into the General Fund, unless permitted by Act to be paid into some other fund or account established for a specific purpose.

### ***Section 4. Withdrawals from the General Fund or other Public Account.***

(1) No moneys shall be withdrawn from the General Fund unless the issue of those moneys:

- (a) has been authorized by the Appropriation Act or a Supplementary Appropriation Act; or
- (b) has been authorized as anticipated or reprogrammed expenditure pursuant to Section 7 of this Article, or as an advance against a Contingencies Fund, pursuant to Section 9 of this Article; or
- (c) is to meet expenditure specifically charged on the General Fund by this Constitution or by Act.

(2) No moneys shall be withdrawn from the General Fund except with the authority of the Secretary of Finance, who shall satisfy himself that the expenditure of those moneys has been approved pursuant to Section 5 of this Article and that the withdrawal is made in accordance with such other procedures as may be prescribed by law.

(3) No moneys shall be withdrawn from any other public fund or account unless the issue of those moneys has been authorized by or pursuant to Act.

### ***Section 5. The Cabinet to Supervise Expenditure and to Account to the Nitijela.***

(1) No public money shall be expended without the approval of the Cabinet or of a person or body to which such approval authority has been delegated by or pursuant to Act.

(2) Any such delegation, whether or not to one or more members of the Cabinet, shall not derogate from the Cabinet's collective responsibility to account to the Nitijela for all public expenditure and to relate such expenditure either to the appropriations made by the Nitijela or to the authority conferred by this Constitution or by Act.

(3) The Secretary of Finance may make a report to the Cabinet on the immediate and long-term financial implications of any proposal for the expenditure of public money, and he shall make such a report pursuant to a direction of the Cabinet or of the Minister of Finance given either generally or in the particular case.

(4) The Minister of Finance shall, as soon as practicable after the end of the financial year, lay before the Nitijela at its regular session the accounts relating to all public revenues and expenditure for that financial year.

### ***Section 6. The Annual Appropriation Bill.***

(1) The Minister of Finance shall, in relation to each financial year, lay before the Nitijela, as soon as practicable after the commencement of its regular session, budget estimates of the revenues and expenditure of the Marshall Islands for that financial year.

(2) The budget estimates shall cover all expected sources of revenue payable into the General Fund, including loans raised or

to be raised, and all proposed expenditure from the General Fund including expenditure charged on the General Fund by this Constitution or by any Act, or payable under a continuing appropriation.

(3) Budget estimates relating to the raising of loans shall be accompanied by an analysis showing the future cost of servicing and repaying the loan.

(4) Budget estimates of capital expenditure shall be accompanied by an analysis showing the estimated future cost of maintaining the asset created or acquired.

(5) The program areas categorized in the budget estimates for that financial year (other than items charged on the General Fund by this Constitution or by Act or payable under a continuing appropriation) shall be included in a single Bill, to be known as the Appropriation Bill, which shall be introduced into the Nitijela to provide for the issue from the General Fund of the sums necessary to meet the expenditure incurred in those program areas and the appropriation of those sums for the purposes specified in the Bill.

### ***Section 7. Anticipated and Reprogrammed Expenditure.***

(1) Subject to such restrictions as may be prescribed by Act, the Cabinet may approve the expenditure of such sums as it considers necessary:

(a) in anticipation of provision to be made in the Appropriation Act for any financial year: Provided that the total amount issued and paid under this sub-paragraph in relation to any program area in any financial year shall not exceed the unexpended balance of the amount appropriated for that program area for the preceding financial year, together with an amount equal to 25 percent of the amount so appropriated; and all money so spent shall be included in the budget estimated for that financial year; or  
(b) where, during the period between the passing of the Appropriation Act for any

financial year and the end of that financial year, it is desirable that money appropriated in one program area should be spent in another program area:

Provided that the total amount of all sums issued and paid under this sub-paragraph in any financial year shall not result in an increase or decrease of more than 10 percent in the funds appropriated for any program area.

(2) A statement of the reprogrammed expenditure for any financial year shall be included in the accounts for that year laid before the Nitijela.

### ***Section 8. Supplementary Appropriation Bills.***

(1) If, after the passing of the Appropriation Act in respect of any financial year, the Cabinet finds it necessary or desirable to propose any expenditure over and above that authorized by that Appropriation Act, the Minister of Finance may lay before the Nitijela one or more supplementary estimates of the proposed expenditure and of the unappropriated revenues which are, or will be, available to meet that expenditure; and all requirements relating to budget estimates shall in each case apply.

(2) The program areas categorized in any such supplementary estimates shall be included in a Supplementary Appropriation Bill, which shall be introduced into the Nitijela to provide for the issue from the General Fund of the sums necessary to meet the supplementary expenditure incurred in those program areas and the appropriation of those sums for the purposes specified in that Supplementary Appropriation Bill.

### ***Section 9. Contingencies Fund.***

(1) If so empowered by Act, the Cabinet, on being satisfied that there has arisen an urgent and unforeseen need for expenditure for which no other provision exists, may authorize advances from the General Fund, to be charged against the amount

prescribed as a Contingencies Fund, to meet that need.

(2) A statement of all advances charged against the Contingencies Fund for any financial year shall be included in the accounts for that year laid before the Nitijela.

(3) If the amount so advanced has not already been appropriated by a Supplementary Appropriation Act, the budget estimates for the next succeeding financial year shall include provision for such an appropriation.

#### ***Section 10. Lapse of Appropriations.***

The appropriations made by the Appropriation Act or any Supplementary Appropriation Act shall lapse at the end of the financial year to which that Act relates, or at the end of such longer period as that Act may have prescribed in relation to a particular program area.

#### ***Section 11. Compensation of Certain Officers Charged on the General Fund.***

(1) The compensation payable to the holders of the offices of judge of the Supreme Court or of the High Court, of a member of the Public Service Commission and of Auditor-General shall be a charge on the General Fund.

(2) During the term of office of a holder of any such office, his compensation may be increased but not reduced, unless as part of a general reduction of compensation applied proportionately to all persons whose compensation is required to be specifically prescribed by Act

#### ***Section 12. Public Debt Charged on the General Fund.***

All debt charges for which the Marshall Islands are liable shall be a charge on the General Fund.

#### ***Section 13. The Auditor-General.***

(1) The Speaker shall nominate and, with the approval of the Nitijela, signified by

resolution, the President shall appoint an Auditor-General of the Marshall Islands.

(2) The Auditor-General shall hold office during good behavior until he reaches the age of 72 years.

(3) The Auditor-General may at any time resign his office by writing signed by him, addressed to the Speaker; but he shall not be removed or suspended from office except on the like grounds and in the like manner as a judge of the High Court or of the Supreme Court.

(4) If the office of Auditor-General is vacant, or it appears that the Auditor-General is for any reason unable to perform the functions of his office, the Speaker shall nominate and the President shall appoint an Acting Auditor-General; and the Acting Auditor-General shall continue to perform those functions until a new Auditor-General is appointed and assumes office, or, as the case may be, until the Auditor-General is again able to perform the functions of his office.

(5) A person who has held office as Auditor-General shall not be eligible for appointment to any other office in the service of the Marshall Islands within a period of 3 years after ceasing to hold the office of Auditor-General.

#### ***Section 14. Compensation of Auditor-General.***

The compensation of the Auditor-General shall be specifically prescribed by Act.

#### ***Section 15. Audit of Accounts.***

(1) The Auditor-General shall audit the public funds and accounts of the Marshall Islands including those of all Department or offices of the legislative, executive and judicial branches of government and of any other public corporation or other statutory authority constituted under the law of the Marshall Islands unless, in relation to any such public corporation or other statutory authority, provision is made by Act for audit by any other person.

(2) The Auditor-General may exercise his responsibilities under paragraph (1) of this Section either in person or through officers of the Public Service who are subordinate to him, acting in accordance with his general or special instructions.

(3) For the purpose of carrying out his functions under this Article, the Auditor-General or any person authorized by him shall have full access to all public records, books, vouchers, documents, cash, stamps, securities, stores or other government property in the possession of any officer.

(4) The Auditor-General shall report at least once annually to the Nitijela, at its regular session, on the performance of his functions under this Article, and shall, in his report, draw attention to any irregularities in the accounts audited by him.

(5) In the exercise of his functions, the Auditor-General shall not receive any direction from the Cabinet or from any other authority or person, but shall act independently.

(6) Nothing in this Section shall prevent the Auditor-General from offering technical advice and assistance to any person or authority having a responsibility in relation to the public revenues and expenditure of the Marshall Islands.

**Article IX – Local Government**

**Article X – Traditional Rights**

**Article XI – Citizenship**

**Article XII – Amendment of the Constitution**

**Article XIII – Transitional**

**Article XIV – General**

## Appendix 19. Extracts from the Compact of Free Association

P.L. 99-239 of January 14, 1986.

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### *Preamble*

The Government of the United States of America and the Governments of the Marshall Islands and the Federated States of Micronesia, ... affirming the interest of the Government of the United States in promoting the economic advancement and self-sufficiency of the peoples of the Trust Territory of the Pacific Islands.

### **Title One: Governmental Relations**

#### *Article I – Government*

##### Section 111

The peoples of the Marshall Islands and the Federated States of Micronesia, acting through the Governments established under their respective Constitutions, are self-governing.

#### *Article II – Foreign Affairs*

#### *Article III – Communications*

#### *Article IV – Immigration*

#### *Article V – Representation*

#### *Article VI – Environmental Protection*

#### *Article VII – General Legal Provisions*

##### Section 177

(a) The Government of the United States accepts the responsibility for compensation owing to citizens of the Marshall Islands or the Federated States of Micronesia for loss or damage to property and person of the citizens of the Marshall Islands, the Federated States of Micronesia or resulting from the nuclear testing program which the Government of the United States conducted in the Northern Marshall Islands between June 30, 1946, and August 18, 1958.

(b) The Government of the United States and the Government of the Marshall Islands

shall set forth in a separate agreement provisions for the just and adequate settlement of all such claims which have arisen in regard to the Marshall Islands and its citizens and which have not as yet been compensated or which in the future may arise, for the continued administration by the Government of the United States of direct radiation related medical surveillance and treatment programs and radiological monitoring activities and for such additional programs and activities as may be mutually agreed, and for the assumption by the Government of the Marshall Islands of responsibility for enforcement of limitations on the utilization of affected areas developed in cooperation with the Government of the United States and for the assistance by the Government of the United States in the exercise of such responsibility as may be mutually agreed. This separate agreement shall come into effect simultaneously with this Compact and shall remain in effect in accordance with its own terms.

(c) The Government of the United States shall provide to the Government of the Marshall Islands, on a grant basis, the amount of \$150 million to be paid or distributed in accordance with the separate agreement referred to in this Section, and shall provide the services and programs set forth in this separate agreement, the language of which is incorporated into this Compact.

### **Title Two: Economic Relations**

#### *Article I – Grant Assistance*

##### Section 211

(a) In order to assist the Governments of the Marshall Islands and the Federated States of Micronesia in their efforts to

advance the economic self-sufficiency of their peoples and in recognition of the special relationship that exists between them and the United States, the Government of the United States shall provide on a grant basis the following amounts:

(1) To the Government of the Marshall Islands, \$26.1 million annually for five years commencing on the effective date of this Compact, \$22.1 million annually for five years commencing on the fifth anniversary of the effective date of this Compact, and \$19.1 million annually for five years commencing on the tenth anniversary of this Compact. Over this fifteen year period, the Government of the Marshall Islands shall dedicate an average of no less than 40 percent of these amounts to the capital account subject to provision for revision of this percentage incorporated into the plan referred to in Section 211(b); and

(2) To the Government of the Federated States of Micronesia, \$60 million annually for five years commencing on the effective date of this Compact, \$51 million annually for five years commencing on the fifth anniversary of the effective date of this Compact, and \$40 million annually for five years commencing on the tenth anniversary of the effective date of this Compact. Over this fifteen year period, the Government of the Federated States of Micronesia shall dedicate an average of no less than 40 percent of these amounts annually to the capital account subject to provision for revision of this percentage incorporated into the plan referred to in Section 211(b). To take into account the special nature of the assistance, to be provided under this paragraph and Sections 212(b), 213(c), 214(c), 215(a)(3), 215(b)(3), 216(a), 216(b), 221(a), and 221(b), the division of these amounts among the national and state governments of the Federated States of Micronesia shall be certified to the Government of the United States by the Government of the Federated States of Micronesia.

(b) The annual expenditure of the grant amounts specified for the capital account in Section 211(a) by the Governments of the Marshall Islands and the Federated States of Micronesia shall be in accordance with official overall economic development plans provided by those Governments and concurred in by the Government of the United States prior to the effective date of this Compact. These plans may be amended from time to time by the Government of the Marshall Islands or the Federated States of Micronesia.

(c) The Government of the United States and the Governments of the Marshall Islands and the Federated States of Micronesia recognize that the achievement of the goals of the plans referred to in Section 211(b) depends upon the availability of adequate internal revenue as well as economic assistance from sources outside of the Marshall Islands and the Federated States of Micronesia, including the Government of the United States, and may, in addition, be affected by the impact of exceptional, economically adverse circumstances. Each of the Governments of the Marshall Islands and the Federated States of Micronesia shall therefore report annually to the President of the United States and to the Congress of the United States on the implementation of the plans and on their use of the funds specified in this Article. These reports shall outline the achievements of the plans to date and the need, if any, for an additional authorization and appropriation of economic assistance for that year to account for any exceptional, economically adverse circumstances. It is understood that the Government of the United States cannot be committed by this Section to seek or support such additional economic assistance.

#### Section 213

(a) The Government of the United States shall provide on a grant basis \$1.9 million

DIAGNOSTIC STUDY OF ACCOUNTING AND AUDITING PRACTICES  
IN THE MARSHALL ISLANDS

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annually to the Government of the Marshall Islands in conjunction with Section 321(a). The Government of the Marshall Islands, in its use of such funds, shall take into account the impact of the activities of the Government of the United States in the Kwajalein Atoll area of the Marshall Islands.

Section 214

As a contribution to efforts aimed at achieving increased self-sufficiency in energy production, the Government of the United States shall provide on a current account grant basis for fourteen years commencing on the first anniversary of the effective date of this Compact the following amounts:

(a) To the Government of the Marshall Islands, \$2 million annually.

Section 215

(a) As a contribution to the current account operations and maintenance of communications systems, the Government of the United States shall provide on a grant basis for fifteen years commencing on the effective date of this Compact the following amounts: (1) To the Government of the Marshall Islands, \$300,000 annually; and

(2) To the Government of the Federated States of Micronesia, \$600,000 annually.

(b) For the purpose of acquiring such communications hardware as may be located within the Marshall Islands and the Federated States of Micronesia or for such other current or capital account activity as may be selected, the Government of the United States shall provide, concurrently with the grant assistance provided pursuant to this Article during the first year after the effective date of this Compact, the sum of \$9 million to be allocated as follows:

(1) To the Government of the Marshall Islands, \$3 million; and

(2) To the Government of the Federated States of Micronesia, \$6 million.

Section 216

(a) The Government of the United States shall provide on a current account basis an annual grant of \$5.369 million for fifteen years commencing on the effective date of this Compact for the purposes set forth below:

(1) \$890,000 annually for the surveillance and enforcement by the Governments of the Marshall Islands and the Federated States of Micronesia of their respective maritime zones;

(2) \$1.791 million annually for health and medical programs, including referrals to hospital and treatment centers; and

(3) \$2.687 million annually for a scholarship fund or funds to support the post-secondary education of citizens of the Marshall Islands and the Federated States of Micronesia attending United States accredited, post-secondary institutions in the United States, its territories and possessions, the Marshall Islands or the Federated States of Micronesia. The curricular criteria for the award of scholarships shall be designed to advance the purposes of the plans referred to in Section 211(b).

(b) The Government of the United States shall provide the sum of \$1.333 million as a contribution to the commencement of activities pursuant to Section 216(a)(1).

(c) The annual grants referred to in Section 216(a) and the sum referred to in Section 216(b) shall be made available by the Government of the United States promptly after it receives instruction for their distribution agreed upon by the Governments of the Marshall Islands and the Federated States of Micronesia.

Section 217

Except as otherwise provided, the amounts stated in Sections 211, 212, 214, 215 and 231

shall be adjusted for each Fiscal Year by the percent which equals two-thirds of the percentage change in the United States Gross National Product Implicit Price Deflator, or seven percent, whichever is less in any one year, using the beginning of Fiscal Year 1981 as the base.

#### Section 218

If in any year the funds made available by the Government of the United States for that year pursuant to this Article or Section 231 are not completely obligated by the recipient Government, the unobligated balances shall remain available in addition to the funds to be provided in subsequent years.

#### Section 219

All funds previously appropriated to the Trust Territory of the Pacific Islands which are unobligated by the Government of the Trust Territory of the Pacific Islands as of the effective date of this Compact shall accrue to the Governments of the Marshall Islands and the Federated States of Micronesia for the purposes for which such funds were originally appropriated as determined by the Government of the United States.

### *Article II – Program Assistance*

#### Section 221

(a) The Government of the United States shall make available to the Marshall Islands and the Federated States of Micronesia, in accordance with and to the extent provided in the separate agreements referred to in Section 232, without compensation and at the levels equivalent to those available to the Trust Territory of the Pacific Islands during the year prior to the effective date of this Compact, the services and related programs:

- (1) of the United States Weather Service;
- (2) of the United States Federal Emergency Management Agency;

(3) provided pursuant to the Postal Reorganization Act, 39 U.S.C. 101 et seq.;

(4) of the United States Federal Aviation Administration; and

(5) of the United States Civil Aeronautics Board or its successor agencies which has the authority to implement the provisions of paragraph 5 of Article IX of such separate agreements, the language of which is incorporated into this Compact.

(b) The Government of the United States, recognizing the special needs of the Marshall Islands and the Federated States of Micronesia particularly in the fields of education and health care, shall make available, as provided by the laws of the United States, the annual amount of \$10 million which shall be allocated in accordance with the provisions of the separate agreement referred to in Section 232.

(c) The Government of the United States shall make available to the Marshall Islands and the Federated States of Micronesia such alternate energy development projects, studies and conservation measures as are applicable to the Trust Territory of the Pacific Islands on the day preceding the effective date of this Compact, for the purposes and duration provided in the laws of the United States.

(d) The Government of the United States shall have and exercise such authority as is necessary for the purposes of this Article and as is set forth in the separate agreements referred to in Section 232, which shall also set forth the extent to which services and programs shall be provided to the Marshall Islands and the Federated States of Micronesia.

#### Section 222

The Government of the United States and the Government of the Marshall Islands or the Federated States of Micronesia shall consult regularly or upon request regarding:

(a) the economic development of the Marshall Islands or the Federated States of Micronesia; or

(b) the services and programs referred to in this Article. These services and programs shall continue to be provided by the Government of the United States unless their modification is provided by mutual agreement or their termination in whole or in part is requested by any recipient Government.

#### Section 224

The Government of the United States and the Government of the Marshall Islands or the Federated States of Micronesia may agree from time to time to the extension of additional United States grant assistance, services and programs as provided by the laws of the United States, to the Marshall Islands or the Federated States of Micronesia, respectively.

#### Section 225

The Governments of the Marshall Islands and the Federated States of Micronesia shall make available to the Government of the United States at no cost such land as may be necessary for the operations of the services and programs provided pursuant to this Article, and such facilities as are provided by the Government of the Marshall Islands or the Federated States of Micronesia at no cost to the Government of the United States as of the effective date of this Compact or as may be mutually agreed thereafter.

#### Section 226

The Governments of the Marshall Islands and the Federated States of Micronesia may request, from time to time, technical assistance from the federal agencies and institutions of the Government of the United States, which are authorized to grant such technical assistance in accordance with its laws and which shall

grant such technical assistance in a manner which gives priority consideration to the Marshall Islands and the Federated States of Micronesia over other recipients not a part of the United States, its territories or possessions. The Government of the United States shall coordinate the provision of such technical assistance in consultation with the respective recipient Government.

#### Section 227

In recognition of the special development needs of the Federated States of Micronesia, the Government of the United States shall make available United States military Civic Action Teams for use in the Federated States of Micronesia under terms and conditions specified in a separate agreement which shall come into effect simultaneously with this Compact.

### *Article III – Administrative Provisions*

#### Section 231

Upon the thirteenth anniversary of the effective date of this Compact, the Government of the United States and the Governments of the Marshall Islands and the Federated States of Micronesia shall commence negotiations regarding those provisions of this Compact which expire on the fifteenth anniversary of its effective date. If these negotiations are not concluded by the fifteenth anniversary of the effective date of this Compact, the period of negotiations shall extend for not more than two additional years, during which time the provisions of this Compact including Title Three shall remain in full force and effect. During this additional period of negotiations, the Government of the United States shall continue its assistance to the Governments with which it is negotiating pursuant to this Section at a level which is the average of the annual amounts granted pursuant to Sections 211, 212, 213, 214, 215 and 216 during the first fifteen years of this Compact. The average annual

amount paid pursuant to Sections 211, 212, 214 and 215 shall be adjusted pursuant to Section 217.

Section 233

The Government of the United States, in consultation with the Governments of the Marshall Islands and the Federated States of Micronesia, shall determine and implement procedures for the periodic audit of all grants and other assistance made under Article I of this Title and of all funds expended for the services and programs provided under Article II of this Title. Such audits shall be conducted on an annual basis during the first five years following the effective date of this Compact and shall be at no cost to the Government of the Marshall Islands or the Federated States of Micronesia.

*Article IV – Trade*

*Article V – Finance and Taxation*

Section 251

The currency of the United States is the official circulating legal tender of the Marshall Islands and the Federated States of Micronesia. Should the Government of the Marshall Islands or the Federated States of Micronesia act to institute another currency, the terms of an appropriate currency transitional period shall be as agreed with the Government of the United States.

Title Three: Security and Defense Relations

*Article I – Authority and Responsibility*

*Article II – Defense Facilities and Operating Rights*

Section 321

(b) If, in the exercise of its authority and responsibility under this Title, the Government of the United States requires the use of areas within the Marshall Islands or the Federated States of Micronesia in addition to those for which specific arrangements are concluded pursuant to Section 321(a), it may request the Government concerned to satisfy those requirements through leases or other arrangements. The Government of the Marshall Islands or the Federated States of Micronesia shall sympathetically consider any such request and shall establish suitable procedures to discuss it with and provide a prompt response to the Government of the United States.

*Article III – Defense Treaties and International Security Agreements*

*Article IV – Service in Armed Forces of the United States*

*Article V – General Provisions*

Title Four: General Provisions

*Article I – Approval and Effective Date*

*Article II – Conference and Dispute Resolution*

*Article III – Amendment*

*Article IV – Termination*

*Article V – Survivability*

*Article VI – Definition of Terms*

*Article VII – Concluding Provisions*