

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

INDEPENDENT AUDITORS' REPORTS ON
INTERNAL CONTROL AND ON COMPLIANCE

YEAR ENDED SEPTEMBER 30, 2003

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

Board of Directors
Kwajalein Atoll Joint Utilities Resources, Inc.:

We have audited the financial statements of the Kwajalein Atoll Joint Utilities Resources, Inc. (KAJUR) as of and for the year ended September 30, 2003, and have issued our report thereon dated April 6, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

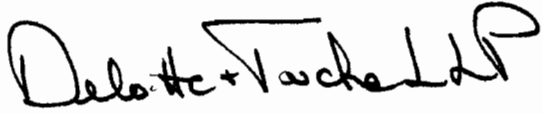
In planning and performing our audit, we considered KAJUR's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect KAJUR's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying Schedule of Findings as items 2003-1 through 2003-6.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe the reportable conditions described above are material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether KAJUR's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance that are required to be reported under *Government Auditing Standards*, which are described in the accompanying Schedule of Findings and Questioned Costs (pages 6 through 12) as items 2003-1 through 2003-6.

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

A handwritten signature in black ink, appearing to read "Deloitte + Touche LLP". The signature is stylized and cursive, with the company name written in a fluid, connected script.

April 6, 2005

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

Board of Directors
Kwajalein Atoll Joint Utilities Resources, Inc.:

Compliance

We have audited the compliance of the Kwajalein Atoll Joint Utilities Resources, Inc. (KAJUR) with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to its one major federal program for the year ended September 30, 2003. KAJUR's major federal program is identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs (pages 6 through 12). Compliance with the requirements of laws, regulations, contracts, and grants applicable to its one major federal program is the responsibility of KAJUR's management. Our responsibility is to express an opinion on KAJUR's compliance based on our audit.

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

In our opinion, KAJUR complied, in all material respects, with the requirements referred to above that are applicable to its one major federal program for the year ended September 30, 2003.

Internal Control Over Compliance

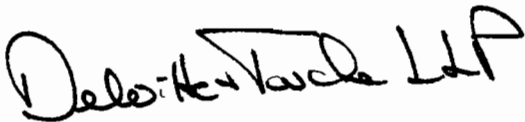
The management of KAJUR is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered KAJUR's internal control over compliance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

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

Schedule of Expenditures of Federal Awards

We have audited the basic financial statements of KAJUR as of and for the year ended September 30, 2003, and have issued our report thereon dated April 6, 2005. Our audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying Schedule of Expenditures of Federal Awards (page 5) is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. This schedule is the responsibility of the management of KAJUR. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

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

A handwritten signature in black ink, appearing to read "Deloitte Touche LLP". The signature is stylized and cursive.

April 6, 2005

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Expenditures of Federal Awards
Year Ended September 30, 2003

| Program Title | Grant Number | Program or Award Amount | Expenditures FY03 |
|--|------------------------|-------------------------------|----------------------|
| <u>U.S. Department of the Interior</u> | | | |
| <u>Capital Improvement Programs CFDA #15.875</u> | | | |
| Funds passed through the American Samoa Power Authority (ASPA) | | | |
| Apprentice Program | OMIP-ASPA/KAJUR 2001-1 | \$ 56,000 | \$ 17,337 |
| TWI Training | OMIP-ASPA/KAJUR 2001-1 | 21,000 | 4,885 |
| Sewer Treatment Plant Relocation | OMIP-ASPA/KAJUR 2001-3 | 1,100,000 | 1,810,276 |
| New Landfill | OMIP-ASPA/KAJUR 2001-3 | 800,000 | 422,604 |
| Repair Water Desalination Plant | OMIP-ASPA/KAJUR 2001-3 | 500,000 | 297,867 |
| Fuel Storage Tanks | OMIP-ASPA/KAJUR 2001-3 | 750,000 | 225,629 |
| Refurbish School Building | OMIP-ASPA/KAJUR 2001-3 | 600,000 | 51,007 |
| New Generator Study | OMIP-ASPA/KAJUR 2001-4 | 400,000 | 75,305 |
| | | <u>\$ 4,227,000</u> | <u>\$ 2,904,910</u> |

The Schedule of Expenditures of Federal Awards is presented on the accrual basis of accounting.

The above expenditures reconcile to the underlying financial statements as follows:

| | |
|---|---------------------|
| Capitalized in construction in progress | \$ 2,756,376 |
| Expenses | <u>148,534</u> |
| | <u>\$ 2,904,910</u> |

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs
Year Ended September 30, 2003

Section I - Summary of Auditor's Results

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

| <u>Name of Federal Program</u> | <u>CFDA Number</u> |
|---|--------------------|
| Capital Improvement Projects and Technical Assistance Grants | 15.875 |

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

Section II - Financial Statement Findings

| <u>Reference Number</u> | <u>Findings</u> | <u>Refer Page #</u> |
|-----------------------------|----------------------------------|-------------------------|
| 2003-1 | Contractual Services | 7 |
| 2003-2 | Local Noncompliance | 8 |
| 2003-3 | Noncompliance | 9 |
| 2003-4 | Purchases/Disbursements | 10 |
| 2003-5 | Payables and Accrued Liabilities | 11 |
| 2003-6 | Construction Work-in-Progress | 12 |

Section III - Federal Award Findings and Questioned Costs

No matters are reportable.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2003

Contractual Services

Finding No. 2003-1

Criteria: Contractual services should be supported by valid contracts.

Condition: On April 30, 2003, the ASPA management contract expired and three ASPA employees were retained by KAJUR on a contractual basis. Our review of these contracts indicated that a KADA or RepMar representative did not sign the contracts. In addition, we noted that the ASPA contracted employees are receiving certain benefits over and above those normally accorded other employees; namely, tax-exempt living allowances, tuition subsidy for children, and 25% of base salary as a hardship allowance.

Cause: The cause of the above condition is that there is no current Board of Directors or any other government entity overseeing the operations of KAJUR.

Effect: The effect of the above condition is that KAJUR may have paid invalid contract expenditures.

Recommendation: We recommend that RepMar or KADA appoint a Board of Directors to oversee the operations of KAJUR in order to ensure that contractual services are properly authorized and paid.

Auditee Response and Corrective Action Plan: The three key management team members remaining to operate KAJUR was an understanding as per request from the RMI. Contracts were reviewed by the RMI and agreed verbally without any signed agreement made because there were outstanding issues between the KADA and the RMI on establishing KAJUR as a separate new legal organization. The cost of the management contract was understood because of comparison to the cost that ASPA used to pay for the management team. The 25% is incorrect as the correct amount charged is 20% RMI standard hardship allowance. 25% was the ASPA hardship allowance for their employees during the management contract but was reduced during the individual contract because of the RMI standard hardship allowance on oversea contractors. Educational allowance and living allowance are part that was agreed by the RMI to match benefits ASPA used to provide. This will secure the management team position to remain without jeopardizing personal obligations.

In provision of the management team and other employees, it is unfair to classify comparison directly to normal KAJUR employees because of the contractual basis and competitive package to meet competitive requirements especially local hires are career employees of KAJUR.

Auditor must understand the cost that RMI had absorbed alone regarding the 50% agreement share between KADA and the RMI for the management contract cost of improvement. However, RepMar absorbed all of the cost and are entitled to all of the new assets of KAJUR.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2003

Local Noncompliance

Finding No. 2003-2

Criteria: Section 131 of the RepMar Social Security Act of 1990 (SSA) and Section 215 of the Social Security Health Fund Act of 1991 (HFA) state that no later than the tenth day after the end of each quarter, every employer shall submit to the Social Security Administrator a report of the wages and salaries paid by the employer, and the contributions due from the employer, under Sections 129 and 130 of the SSA and 213 and 214 of the HFA and pay into the Fund the contributions due.

Condition: KAJUR was delinquent in remitting social security employer and employee contributions during the year ended September 30, 2003.

Cause: The cause of the above condition is that the required reports were not timely submitted.

Effect: The effect of the above condition is noncompliance with the SSA and the HFA.

Prior Year Status: Noncompliance with the SSA and the HFA was reported as a finding in the audits of KAJUR for the years ended September 30, 1998 through 2002.

Recommendation: We recommend that management comply with the SSA and the HFA.

Auditee Response and Corrective Action Plan: KAJUR expected and recommended the auditor to consider the cash flow report expenditure versus revenue and recommended, in part, to assist the Social Security problem. Delinquency in remitting social security employer and employee share is not a substandard performance or lack of control on the responsibility of the employer. KAJUR intend to meet the requirements; however, the impact of high fuel costs and legal status to channel proper government role and tariff rate adjustment had a say on the delinquency part. Utility operation viability is based on factors of customer affordability and weight of the economics with respect to any adjustment that can be made based on variable driven component. Any tolerance level base on affordability that needs to be adjusted has to be absorbed by the responsible party under public utility operation.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2003

Noncompliance

Finding No. 2003-3

Criteria: Section 14.3 and appendix N of the management contract states that the management contractor is required to maintain liability insurance against liability and other risks specified in the management contract.

Condition: KAJUR is not currently maintaining insurance against liability and other risks as required in the management contract.

Cause: The cause of the above condition is that the required insurance has not been obtained.

Effect: The effect of the above condition is noncompliance with the terms of the management contract.

Prior Year Status: Noncompliance with the management contract regarding liability insurance was reported as a finding in the audit of KAJUR for the years ended September 30, 2000 through 2002.

Recommendation: We recommend that management comply with provisions of the management contract.

Auditee Response and Corrective Action Plan: Specify finding shared the same implication with the social security problem. There were insurance and liability measures taken place but KAJUR cannot commit on additional costs because of its current cash flow problem. KAJUR will look into this if there is improvement on its cash flow.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2003

Purchases/Disbursements

Finding No. 2003-4

Criteria: Taxes payable should be remitted on a timely basis.

Condition: KAJUR is currently delinquent with regard to income tax withholding and social security taxes.

Cause: The cause of the above condition is that untimely payments of these liabilities has occurred.

Effect: The effect of the above condition is potential interest and penalty charges.

Prior Year Status: The delinquency regarding withholding taxes and social security taxes was reported as a finding in the audits of KAJUR for the years ended September 30, 1993 through 2002.

Recommendation: We recommend that KAJUR implement policies and procedures to ensure the timely payment of taxes.

Auditee Response and Corrective Action Plan: The reason for the delay was that the financial controller was off-island on vacation at the time and by the time he got back, the deadline had already passed.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2003

Payables and Accrued Liabilities

Finding No. 2003-5

Criteria: Employee allotments payable should be remitted on a timely basis.

Condition: KAJUR is currently delinquent with respect to employee allotments withheld related to employee life insurance, medical insurance, loans, and miscellaneous payments.

Cause: The cause of the above condition is that payments of allotments have not been made in a timely manner.

Effect: The effect of the above condition is the potential exposure and risk of loss related to unpaid employees' insurance and loans.

Prior Year Status: The delinquency regarding employee allotments was reported as a finding in the audits of KAJUR for the years ended September 30, 2000 through 2002.

Recommendation: We recommend that KAJUR implement policies and procedures to ensure the timely payment of employee allotments withheld.

Auditee Response and Corrective Action Plan: Finding No 2003-5 shared the same reason with social security problem failing to remit on a timely basis due to high cost of operation (fuel price). KAJUR has policies and procedures to ensure the timely payment of taxes, but with the cash flow problem that we are facing everyday, KAJUR hardly settled its taxes on time. If KAJUR choose to settle its taxes before buying fuel to run the generators, Ebeye will be facing frequent power outages every week.

• KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2003

Construction Work-in-Progress

Finding No. 2003-6

Criteria: Items recorded as Construction Work-in-Progress (CWIP) should represent valid assets.

Condition: Per work order #EW21-01, items with a cost of \$123,469 were paid by ASPA on behalf of KAJUR. These items were capitalized in fiscal year 2002 but were expensed when the job was completed in the current year.

Cause: The cause of the above condition is that the amount was originally incorrectly capitalized.

Effect: The effect of the above condition is that Construction Work-in-Progress was erroneously recorded in the prior year.

Recommendation: We recommend that KAJUR ensure that items recorded to CWIP represent valid assets.

Auditee Response and Corrective Action Plan: Finding No 2005-6 is an impact of high cost on operation (high fuel price in Ebeye) and tariff rate is not based on a full recovery basis.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Unresolved Prior Year Findings
Year Ended September 30, 2003

The status of unresolved prior year findings is disclosed within the Schedule of Findings and Questioned Costs section of this report (pages 6 through 12).