

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.  
(A COMPONENT UNIT OF THE  
REPUBLIC OF THE MARSHALL ISLANDS)

INDEPENDENT AUDITORS' REPORTS ON  
INTERNAL CONTROL AND ON COMPLIANCE

YEAR ENDED SEPTEMBER 30, 2011

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

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, 2011, and have issued our report thereon dated August 8, 2012. 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

Management of KAJUR is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered KAJUR's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of KAJUR's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of KAJUR's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying Schedule of Findings and Questioned Costs (pages 6 through 9), we identified a certain deficiency in internal control over financial reporting that we consider to be a material weakness and another deficiency that we consider to be a significant deficiency.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described in the accompanying Schedule of Findings and Questioned Costs as item 2011-2 to be a material weakness.

A *significant deficiency* is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiency described in the accompanying Schedule of Findings and Questioned Costs as item 2011-1 to be a significant deficiency.

#### 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 grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of KAJUR in a separate letter dated August 8, 2012.

KAJUR's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. We did not audit KAJUR's responses and, accordingly, we express no opinion on them.

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

*Deloitte & Touche LLC*

August 8, 2012

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS  
THAT COULD HAVE A DIRECT AND MATERIAL EFFECT ON EACH MAJOR PROGRAM  
AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB  
CIRCULAR A-133 AND ON THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

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

Compliance

We have audited the Kwajalein Atoll Joint Utilities Resources, Inc.'s (KAJUR) compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on KAJUR's one major federal program for the year ended September 30, 2011. 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 9). 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. 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 compliance requirements referred to above that could have a direct and material effect on its one major federal program for the year ended September 30, 2011.

### Internal Control Over Compliance

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 the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of KAJUR's internal control over compliance.

*A deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

### Schedule of Expenditures of Federal Awards

We have audited the basic financial statements of KAJUR as of and for the year ended September 30, 2011, and have issued our report thereon dated August 8, 2012. 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 the Board of Directors, management, federal awarding agencies, the cognizant audit and other federal agencies, and others within the entity and is not intended to be and should not be used by anyone other than these specified parties.

*Deloitte & Touche LLC*

August 8, 2012

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Expenditures of Federal Awards  
Year Ended September 30, 2011

<u>Program Title</u>	<u>Expenditures</u>
<u>U.S. Department of the Interior</u>	
<u>Compact of Free Association, as Amended:</u>	
<u>Section 211(b)(2) Kwajalein Atoll Landowners Special Needs</u>	
<u>CFDA #15.875</u>	
Kwajalein Impact Fund	<u>\$ 1,600,000</u>

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

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

Expenses (included within total operating expenses of \$6,029,802)	\$ 1,100,000
Capital assets	<u>500,000</u>
	<u>\$ 1,600,000</u>

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs  
Year Ended September 30, 2011

**A. SUMMARY OF AUDITORS' RESULTS**

*Financial Statements*

- |    |   |             |
|----|---|-------------|
| 1. | Type of auditors' report issued:                          | Unqualified |
|    | Internal control over financial reporting:                |             |
| 2. | Material weakness(es) identified?                         | Yes         |
| 3. | Significant deficiency(ies) identified?                   | Yes         |
| 4. | Noncompliance material to the financial statements noted? | No          |

*Federal Awards*

- |                                       |   |               |
|---------------------------------------|---|---------------|
| Internal control over major programs: |   |               |
| 5.                                    | Material weakness(es) identified?   | No            |
| 6.                                    | Significant deficiency(ies) identified?   | None reported |
| 7.                                    | Type of auditors' report issued on compliance for major programs:   | Unqualified   |
| 8.                                    | Any audit findings disclosed that are required to be reported in accordance with Section 510(a) of OMB Circular A-133?  | No            |
| 9.                                    | Identification of major programs:   |               |
|                                       | CFDA<br><u>Number</u> <u>Federal Program</u>  |               |
|                                       | 15.875    Compact of Free Association, as Amended:<br>Kwajalein Atoll Landowners Special Needs<br>Kwajalein Impact Fund |               |
| 10.                                   | Dollar threshold used to distinguish between Type A and Type B Programs:  | \$300,000     |
| 11.                                   | Auditee qualified as a low-risk auditee?  | No            |

**B. FINANCIAL STATEMENT FINDINGS**

<u>Reference Number</u>	<u>Findings</u>	<u>Questioned Costs</u>	<u>Refer Page #</u>
2011-1	Revenues	\$ -	8 - 9
2011-2	Receivables	\$ -	10

**C. FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

No findings reported.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2011

**B. FINANCIAL STATEMENT FINDINGS**

Finding No. 2011-1

Revenues

Criteria: Management is responsible for establishing adequate internal control requiring that revenues are accurately identified, recorded and collected.

Condition: Our tests of revenues, prepaid and postpaid, noted the following:

- Of seventy-five token receipts tested, we noted the following:
  - a. Sixteen token receipts used the old residential and commercial rates of 34.6 cents and 40.6 cents instead of the approved rates of 35.8 cents and 41.8 cents, respectively, effective February 1, 2011.

Customer Account No.	Date	Cost	Rate (In USD)	Kwh Units	Rate (In USD)	Kwh Units	Variance (In Kwh)	Variance (In USD)
144320	02/04/11	\$ 300	\$ 0.346	867	\$ 0.358	838	29	\$ 10
109711	02/05/11	\$ 150	\$ 0.406	370	\$ 0.418	359	11	\$ 4
121030	02/08/11	\$ 100	\$ 0.346	289	\$ 0.358	279	10	\$ 3
176800	02/09/11	\$ 50	\$ 0.406	123	\$ 0.418	120	3	\$ 1
121030	02/12/11	\$ 150	\$ 0.346	434	\$ 0.358	419	15	\$ 5
166200	02/17/11	\$ 150	\$ 0.346	434	\$ 0.358	419	15	\$ 5
105028	02/18/11	\$ 1,000	\$ 0.346	2,890	\$ 0.358	2,793	97	\$ 35
105505	02/19/11	\$ 100	\$ 0.346	289	\$ 0.358	279	10	\$ 3
151400	02/21/11	\$ 200	\$ 0.406	493	\$ 0.418	478	15	\$ 6
124520	02/23/11	\$ 100	\$ 0.346	289	\$ 0.358	279	10	\$ 3
109410	02/24/11	\$ 200	\$ 0.346	578	\$ 0.358	559	19	\$ 7
144320	02/25/11	\$ 400	\$ 0.346	1,156	\$ 0.358	1,117	39	\$ 14
151400	02/26/11	\$ 200	\$ 0.406	493	\$ 0.418	478	15	\$ 6
160610	03/01/11	\$ 100	\$ 0.346	289	\$ 0.358	279	10	\$ 3
151400	03/05/11	\$ 200	\$ 0.406	493	\$ 0.418	478	15	\$ 6
125010	03/21/11	\$ 500	\$ 0.406	1,232	\$ 0.418	1,196	36	\$ 15

- b. Variances were noted between total token receipts issued and daily deposits.

Date	Total Amount of Token Receipts Issued	Amount Deposited	Variance
12/06/10	\$ 4,190	\$ 4,240	\$ (50)
01/18/11	\$ 5,125	\$ 5,065	\$ 60
04/13/11	\$ 4,967	\$ 4,962	\$ 5
05/06/11	\$ 6,366	\$ 6,426	\$ (60)
06/21/11	\$ 5,089	\$ 5,139	\$ (50)
07/05/11	\$ 5,500	\$ 5,467	\$ 33
07/18/11	\$ 5,823	\$ 5,818	\$ 5
07/26/11	\$ 5,215	\$ 5,225	\$ (10)
08/23/11	\$ 6,007	\$ 6,002	\$ 5

For 12/06/10 and 07/26/11, part of the cash payment was applied to salary allotments. For 01/18/11 and 04/13/11, tokens were issued without payment as the original issuance did not work. For 07/05/11, \$33 was not deposited.



KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2011

Finding No. 2011-1, Continued

Condition, Continued:

- Of sixty-three billing statements tested, meters for account nos. 107110, 171210 and 141930 do not have readings for October 2010, January 2011 and February 2011, respectively, because the meter reader could not access the meters.

Cause: The cause of the above condition is the lack of review of utility revenues.

Effect: The effect of the above condition is the potential misstatement of utility revenues.

Recommendation: We recommend that KAJUR timely update the electric rates, investigate the variances of token receipts issued to collection reports and consider relocating meters to timely bill postpaid customers.

Prior Year Status: Errors in billings was reported as a finding in the Single Audits of KAJUR for fiscal years 2004 through 2010.

Auditee Response and Corrective Action Plan:

**Name of Contact Person:** Romeo Alfred, General Manager

**Corrective Action:** KAJUR agrees that management has yet to establish adequate internal control to ensure that revenues are adequately identified, recorded and collected.

Relative to timely update of electric rates, KAJUR management wishes to clarify that rate changes are done at MEC's main office in Majuro. When instructions are not received at KAJUR's end to make rate changes, changes are not made in a timely manner. Additionally, KAJUR is not able to make rate changes on its own without support from the FoxPro program designer who is also based in Majuro.

KAJUR will push for better communication/coordination between KAJUR and MEC to ensure that rate changes are done in a timely manner when required. Furthermore, a new billing system for KAJUR has been purchased and employees are currently being trained in this new system. The target date set for KAJUR to start using this system was tentatively set for August 2012. With this new system in place, KAJUR will have the ability to make timely rate changes on its own as authorized.

With regard to variances between token receipts and collection reports, KAJUR wishes to point out that the cash power system uses four different codes of transaction. These are Cash (for cash purchases), Credit Card (for allotments), Check (for check purchases) and Free Issue (for Mid-Corridor). The problem arises when the proper code is not applied to its corresponding transaction. The correct amount of revenue was collected but discrepancy exists in the type of transaction made. To address this specific problem, KAJUR will establish control measures to ensure these types of oversight are addressed in a timely manner and that affected employees are appropriately disciplined.

**Proposed Completion Date:** August 2012

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2011

Finding No. 2011-2

Receivables

Criteria: The allowance for doubtful accounts should be stated at an amount which management believes is adequate to absorb possible losses on accounts receivable that may become uncollectible based on evaluations and prior collection experience.

Condition: Our analysis of the adequacy of the allowance for doubtful accounts resulted in a proposed audit adjustment to increase the allowance by \$161,122.

Cause: The cause of the above condition is the lack of policies and procedures requiring doubtful receivables be adequately provided for.

Effect: The effect of the above condition is a possible misstatement of receivables and the related allowance for doubtful accounts.

Recommendation: We recommend that KAJUR establish policies and procedures requiring doubtful receivables be adequately provided for.

Prior Year Status: The lack of an analysis to support the allowance for doubtful accounts was reported as a finding in the Single Audits of KAJUR for fiscal years 2005 through 2010.

Auditee Response and Corrective Action Plan:

**Name of Contact Person:** Romeo Alfred, General Manager

**Corrective Action:** KAJUR agrees that it lacks adequate internal policies and procedures to ensure that doubtful receivables are adequately provided for. KAJUR also recognizes the fact that this deficiency was also noted in a finding in the Single Audits of KAJUR for fiscal years 2005 through 2010.

In addition to the lack of internal policies and procedures, KAJUR also recognize that this deficiency is also systematic in nature specifically in reference to the billing system KAJUR currently uses (FoxPro). The FoxPro system does not separate freshwater billings (\$15/mo) from saltwater billings (\$10/mo) but instead treats this as one rate (\$25/mo). This is problematic since not all residences receive both saltwater and freshwater and are therefore not being billed for both. With the new billing system currently being installed at KAJUR, management see this as an adequate step in addressing the problem noted above.

**Proposed Completion Date:** August 2012

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Unresolved Prior Year Comments  
Year Ended September 30, 2011

Questioned Costs

The prior year Single Audit report on compliance with laws and regulations noted the following questioned costs and comments that were unresolved at September 30, 2011:

Questioned costs of KAJUR as previously reported:

Fiscal year 2004 Single Audit	\$ 488,494
Fiscal year 2005 Single Audit	434,069
Fiscal year 2006 Single Audit	<u>452,893</u>

1,375,456

Questioned costs of fiscal year 2011 Single Audit

-

Unresolved questioned costs at September 30, 2011

\$ 1,375,456

Unresolved Findings

The status of unresolved findings is discussed in the Schedule of Findings and Questioned Costs section of this report (pages 6 through 9).