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June 10, 2014

Mr. Romeo Alfred
General Manager
Kwajalein Atoll Joint Utilities Resources, Inc.

Dear Mr. Alfred:

In planning and performing our audit of the financial statements of the Kwajalein Atoll Joint Utilities Resources, Inc. (KAJUR), a component unit of the Republic of the Marshall Islands, as of and for the year ended September 30, 2013, on which we have issued our report dated June 10, 2014, 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, we considered KAJUR's internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, 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. However, in connection with our audit, we identified, and included in the attached Appendix I, deficiencies related to KAJUR's internal control over financial reporting and other matters as of September 30, 2013 that we wish to bring to your attention.

We have also issued a separate report to the Board of Directors, also dated June 10, 2014, on our consideration of KAJUR's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters.

The definition of a deficiency is also set forth in the attached Appendix I.

A description of the responsibility of management for establishing and maintaining internal control over financial reporting and of the objectives of and inherent limitations of internal control over financial reporting, is set forth in the attached Appendix II and should be read in conjunction with this report.

This report is intended solely for the information and use of KAJUR, management, others within the organization, and the Office of the Auditor-General and is not intended to be and should not be used by anyone other than these specified parties.

We will be pleased to discuss the attached comments with you and, if desired, to assist you in implementing any of the suggestions.

We wish to thank the staff and management of KAJUR for their cooperation and assistance during the course of this engagement.

Very truly yours,

Deloitte & Touche LLP

## SECTION I - CONTROL DEFICIENCIES

We identified, and have included below, control deficiencies involving KAJUR's internal control over financial reporting as of September 30, 2013 that we wish to bring to your attention:

(1) General Journal Entries

Several journal entries lack an approver's signature evidencing independent review. We recommend that KAJUR establish and implement procedures requiring journal entry review. This matter was discussed in our previous letters to management for fiscal years 2011 and 2012.

(2) Inventory

A $462,448 decrease in fuel inventory was posted based on reconciliation of actual inventory on hand during the September 30, 2013 count.

Per examination of the Daily Inventory Report and the Daily Meter Reading Report, we noted discrepancies in four months tested. Actual gallons consumed from the main tank exceed recorded daily meter readings. Daily variances are summarized into monthly averages as presented below.

| **Month** | **Average Monthly Variance of Actual Consumption over Fuel Expense Recorded** |
|---|---|
| October | 18% |
| December | 21% |
| April | 14% |
| July | 15% |
| **Average** | 17% |

We also noted days where a sounding was not performed due to weather or staff unavailability. The reports do not provide information why the sounding was not performed. As a result, no information for that day's inventory consumption was recorded.

In several instances, KAJUR ran out of fuel which required them to purchase at nearly double the normal cost. A daily report is provided to the Marshalls Energy Company, Inc. (MEC) to monitor remaining fuel inventories and the expected day that KAJUR will run out of fuel. It takes an average of 2 to 3 days for bunker fuel to be delivered.

We recommend that KAJUR review attendant controls over the accounting processes power plant operations fuel expenses. Furthermore, we recommend periodic reconciliation with month end sounding reports to reduce significant adjustments recorded at year-end. KAJUR may also consider rotation of duties if personnel are unavailable to perform fuel soundings. It is also recommended that KAJUR communicate with MEC to minimize the opportunity to run out of fuel. This matter was discussed in our previous letter to management for fiscal year 2012.

## SECTION I - CONTROL DEFICIENCIES, CONTINUED

(3) Materials and Supplies

Inventory issuance tickets do not contain issuer and receiver signatures evidencing receipt and authorization.

The October 2012 monthly summary of issued supplies contained a variance of 14 units of membrane inventory issuance tickets. Given a unit cost of $852.65, an $11,837 overstatement of expense occurred.

A $70,435 year-end adjustment to supplies expense occurred to reconcile the actual count with the inventory subsidiary report. Our inquiry of inventory personnel revealed that the variance was due to a failure to prepare inventory issuance tickets.

We recommend that KAJUR implement appropriate internal control policies and procedures requiring proper documentation of inventory issuance tickets and periodic reconciliation of inventory reports.

(4) Payroll

Tests of payroll expenses noted that two of fourteen personnel action forms (PAF) were not updated for the latest pay rate. Furthermore, an overpayment of $15.45 occurred due to incorrect overtime computation. We recommend that KAJUR implement personnel policies and procedures requiring current personnel action forms and relevant personnel documents. In addition, we recommend improved review processes over payroll processing prior to payment. This matter was discussed in our previous letters to management for fiscal years 2011 and 2012.

(5) Mid Corridor

The Mid-corridor $45,282 beginning balance had no subsidiary ledger to identify customer unclaimed tokens. In addition, a $430 overstatement occurred of the outstanding balance as of September 30, 2013.

We recommend that KAJUR maintain a mid-corridor subsidiary ledger on a per customer basis.

(6) Disbursements

Tests revealed one $6,554 travel expense did not contain supporting invoices validating the amount. Furthermore, car rental expense of $413 was unsupported by an invoice.

Diesel fuel purchases from a local vendor of 5,000 gallons lacked a signed Bunker Delivery Receipt (BDR) to validate the receipt of purchased fuel.

We recommend that KAJUR adopt internal control policies and procedures requiring complete documentation of expenses recorded.

(7) Bank Reconciliation

The September 2013 bank reconciliation included $1,681 of stale checks reported as a reconciling item. It appears that the reconciliation process is not timely monitored to clear outstanding stale checks. We recommend management review long and outstanding reconciling items to present updated and relevant bank reconciliation.

## SECTION I - CONTROL DEFICIENCIES, CONTINUED

(8) Fixed Assets

Depreciation expense was overstated by $470,456 which was corrected through a proposed audit adjustment. Thus fixed assets reflected a negative net book value of $99,304 due to errors in depreciation recording.

Tests of fixed asset verifications noted several assets that have been damaged, dismantled, or disposed of. Details are as follows:

| Account # | Project Description | Acquisition Date | Life | Acquisition $ Cost | $ of Book Value |
|---|---|---|---|---|---|
| 1133 | Generator Accessories | 9/1/2000 | 25 | $159,538 | $69,665 |
| 1133 | Cummin Generator | 6/1/2004 | 25 | $192,600 | $112,992 |
| 1135 | Yamaha Boat Engine | 4/6/2009 | 10 | $14,880 | $8,184 |

In addition, we noted a lack of sufficient information, such as tags showing asset serial numbers and item codes that serve as a reference in verifying the assets.

We recommend KAJUR establish internal control policies and procedures over adequate documentation and monitoring of fixed assets. We also recommend accounting procedures be implemented over the physical asset counts. This inventory would provide KAJUR information on the operational efficiency of its fixed assets. In addition, we also recommend that KAJUR implement accounting procedures over asset retirements and disposals. This matter was discussed in our previous letter to management for fiscal year 2012.

(9) Expenses

Certain water, cashpower, and fuel issuances for reciprocal services obtained were not recorded. Such transactions resulted in a $24,300 understatement of corresponding revenue and expenses. No signed agreement evidenced the reciprocal service entered into by KAJUR.

We recommend KAJUR complete documentation to support its business transactions.

(10) Revenues

Tests of diesel inventory sales noted several transactions charged below published prices. Sales discounts were recorded to match the sales price. We recommend the KAJUR adopt internal control policies and procedures over fully recording sales below published prices.

(11) Allowance for Doubtful Accounts

An audit adjustment of $76,410 was proposed to bring bad debt expense recorded during the year to $273,279. The rate of the allowance over gross receivables was 90% for FY13 as compared with 88% for FY12. It appears that KAJUR has weak collection policies that resulted in increasing doubtful receivables. We recommend the KAJUR adopt internal control policies and procedures on timely collection and implement programs to mitigate risk of inadequate collections. This matter was discussed in our previous letters to management for fiscal years 2005 through 2012.

## SECTION II - OTHER MATTERS

Our observations concerning other matters related to operations, compliance with laws and regulations, and best practices involving internal control over financial reporting that we wish to bring to your attention at this time are as follows:

(1) Procurement

KAJUR does not have written policies and procedures governing its procurement process. We recommend that KAJUR adopt formal policies and procedures that are consistent with RepMar's Procurement Code. This matter was discussed in our previous letters to management for fiscal years 2011 and 2012.

(2) Revenues

KAJUR does not maintain records of power generated, transmitted and billed throughout the year. Such information would be helpful in monitoring line losses. We recommend management consider maintaining records of power generated, transmitted and billed. This matter was discussed in our previous letters to management for fiscal years 2011 and 2012.

## SECTION III - DEFINITIONS

The definition of a deficiency that is established in AU 325, *Communicating Internal Control Related Matters Identified in an Audit*, is as follows:

A *deficiency* 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 deficiency in design exists when (a) a control necessary to meet the control objective is missing or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective would not be met. A deficiency in operation exists when (a) a properly designed control does not operate as designed, or (b) the person performing the control does not possess the necessary authority or competence to perform the control effectively.

## MANAGEMENT'S RESPONSIBILITY FOR, AND THE OBJECTIVES AND LIMITATIONS OF, INTERNAL CONTROL OVER FINANCIAL REPORTING

The following comments concerning management's responsibility for internal control over financial reporting and the objectives and inherent limitations of internal control over financial reporting are adapted from auditing standards generally accepted in the United States of America.

### Management's Responsibility

KAJUR's management is responsible for the overall accuracy of the financial statements and their conformity with generally accepted accounting principles. In this regard, management is also responsible for establishing and maintaining effective internal control over financial reporting.

### Objectives of Internal Control over Financial Reporting

Internal control over financial reporting is a process affected by those charged with governance, management, and other personnel and designed to provide reasonable assurance about the achievement of the entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. Internal control over the safeguarding of assets against unauthorized acquisition, use, or disposition may include controls related to financial reporting and operations objectives. Generally, controls that are relevant to an audit of financial statements are those that pertain to the entity's objective of reliable financial reporting (i.e., the preparation of reliable financial statements that are fairly presented in conformity with generally accepted accounting principles).

### Inherent Limitations of Internal Control over Financial Reporting

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.