

**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, 2012

**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, 2012, and have issued our report thereon dated May 10, 2013. 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 10), we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

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 deficiencies described in the accompanying Schedule of Findings and Questioned Costs as item 2012-02 to be material weaknesses.

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 deficiencies described in the accompanying Schedule of Findings and Questioned Costs as item 2012-01 to be significant deficiencies.

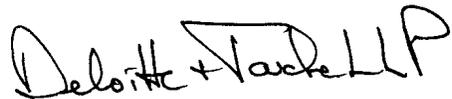
Compliance and Other Matters

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 May 10, 2013.

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.

A handwritten signature in black ink that reads "Deloitte + Tardell LLP". The signature is written in a cursive, stylized font.

May 10, 2013

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, 2012. 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 10). 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 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, 2012.

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.

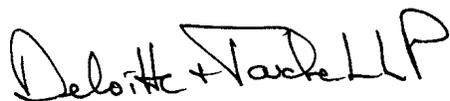
A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement 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 financial statements of KAJUR as of and for the year ended September 30, 2012, and have issued our report thereon dated May 10, 2013, which contained an unqualified opinion on those financial statements. Our audit was conducted for the purpose of forming an opinion on the financial statements 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 financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Schedule of Expenditure of Federal Awards is fairly stated in all material respects in relation to the financial statements 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.



May 10, 2013

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Expenditures of Federal Awards
Year Ended September 30, 2012

<u>Program Title</u>	<u>Expenditures FY12</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>	
Power Generation, Distribution, and Maintenance	\$ 1,925,000
Potable Water Support	<u>100,000</u>
	<u>\$ 2,025,000</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:

Power Generation, Distribution, and Maintenance (included within fuel and lubricants expense of \$4,333,873)	\$ 1,925,000
Potable Water Support (included within water purchases expense of \$160,074)	<u>100,000</u>
	<u>\$ 2,025,000</u>

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs
Year Ended September 30, 2012

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 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
<u>Number</u> <u>Federal Program</u> | |
| | 15.875 Compact of Free Association, as Amended:
Kwajalein Atoll Landowners Special Needs
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>Refer Page #</u>
2012-01	Revenues	7
2012-02	Receivables	8 - 9

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, 2012

Finding No. 2012-01

Revenues

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

Condition: Tests of prepaid and postpaid revenues noted the following:

- Of seventy prepaid token receipts tested:
 - a. Two token receipts used the old residential rates of 41.8 cents instead of the approved rates of 43.0 cents effective April 1, 2012, which is the only month in the year approved rates changed.

<u>Customer Account No.</u>	<u>Date</u>	<u>Cost</u>	<u>Rate Used (In USD)</u>	<u>Kwh Units</u>	<u>Effective Rate (In USD)</u>	<u>Kwh Units</u>	<u>Variance (In Kwh)</u>	<u>Variance (In USD)</u>
104630	04/05/12	\$ 100	\$ 0.418	239.23	\$ 0.43	232.56	6.68	\$ 2.87
104650	04/02/12	\$ 20	\$ 0.418	47.85	\$ 0.43	46.50	1.29	\$ 0.57

- b. One token receipt used a commercial rate instead of a residential rate.

<u>Customer Account No.</u>	<u>Date</u>	<u>Cost</u>	<u>Rate Used (In USD)</u>	<u>Kwh Units</u>	<u>Effective Rate (In USD)</u>	<u>Kwh Units</u>	<u>Variance (In Kwh)</u>	<u>Variance (In USD)</u>
105014	02/20/12	\$ 40	\$ 0.478	83.68	\$ 0.418	95.69	12.01	\$ 5.02

- Of sixty-eight postpaid receipts tested:
 - a. Two accounts used the old rates instead of the approved rates effective April 1, 2012, the only month throughout the year when approved rates changed.

<u>Customer Account No.</u>	<u>Date</u>	<u>Cost</u>	<u>Rate Used (In USD)</u>	<u>Kwh Units</u>	<u>Effective Rate (In USD)</u>	<u>Kwh Units</u>	<u>Variance (In Kwh)</u>	<u>Variance (In USD)</u>
163140	04/30/12	\$ 809	\$ 0.478	1,693.00	\$ 0.49	1,693.00	-	\$ 20.32
132300	04/30/12	\$ 1,456	\$ 0.488	2,983.00	\$ 0.50	2,983.00	-	\$ 35.80

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 electric rates and investigate variances between token receipts issued against collection reports.

Prior Year Status: Errors in billings was reported as a finding in the Single Audits of KAJUR for fiscal years 2004 through 2011.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2012

Finding No. 2012-01, Continued

Name of Contact Person: Romeo Alfred, General Manager

Corrective Action: KAJUR agrees that management has to enhance 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 in timely manner, changes are not implemented immediately causing delay in application of the effective rates.

KAJUR will push for better coordination between KAJUR and MEC to ensure that rate changes are communicated in a timely manner when required.

Proposed Completion Date: April 2013

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2012

Finding No. 2012-02

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 \$251,518.

Cause: The cause of the above condition is the lack of policies and procedures requiring that doubtful receivables are adequately provided for. The adjustment also resulted from disputed customer billings due to current problems in water and sewer operations. In addition, the adjustment was also influenced by the increasing and undercollected long outstanding electric accounts.

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 implement programs to require collections from postpaid customers to be timely received. We further recommend that accounting policies be established to periodically assess the adequacy of the allowance for doubtful accounts.

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 2011.

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 2011.

On the current difficulties with water and sewer operations, KAJUR is taking additional measures to improve water and sewer services. Furthermore, KAJUR has received prepaid purchased equipments starting August 2012 relative to reverse osmosis method for potable water purification maintenance. With these additional equipments, KAJUR will have the ability to improve its existing water and sewer services that would alleviate disputes on collections. In addition, KAJUR is working out for water operation upgrades that will be supported by KDF 2012 budget which has not been released for KAJUR as of September 30, 2012 cut off date.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2012

Finding No. 2012-02

Relative to long outstanding electric receivable, KAJUR is currently arranging collection programs for large electric consumers. KAJUR is also attempting to set up means to collect the receivables through the cash power system replacing the existing postpaid billing. KAJUR is planning to secure funding to purchase three-phase cash power meter which cost about \$10,000 each. While KAJUR is finalizing its scaled down spending plan for Office of Insular Affairs 2012 carried over funds that were initially approved for water and sewer support, KAJUR plans to request that the excess fund from the spending plan can be reallocated for the three-phase cash power meters.

Proposed Completion Date: March 2013

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Unresolved Prior Year Findings and Questioned Costs
Year Ended September 30, 2012

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, 2012:

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 2012 Single Audit	<u>-</u>
Unresolved questioned costs at September 30, 2012	\$ <u>1,375,456</u>

Unresolved Findings

The status of unresolved findings is discussed in the Schedule of Findings and Questioned Costs section of this report (pages 6 through 10).