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May 10, 2013

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, 2012, on which we have issued our report dated May 10, 2013, 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, 2012 that we wish to bring to your attention.

We have also issued a separate report to the Board of Directors, also dated May 10, 2013, 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, 2012 that we wish to bring to your attention:

(1) General Journal Entries

Tests of general journal entries noted the following:

- Gaps in the numerical sequence of general journal entries were as follows:

| Start | End | Number of Missing Journal Entries |
|---|---|---|
| 20 | 22 | 1 |
| 123 | 125 | 1 |
| 263 | 342 | 79 |

We recommend that KAJUR establish and implement procedures requiring numerical control and review of general journal entries. This matter was discussed in our previous letters dated May 18, 2011 and August 8, 2012.

(2) Inventory

- Fuel Expense

There was a $551,459 decrease in fuel inventory based on a reconciliation of actual inventory on hand during the September 30, 2012 count.

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

| Month | Average Monthly Variance of Actual Consumption over Fuel Expense Recorded |
|---|---|
| October | 12% |
| January | 16% |
| June | 17% |
| September | 20% |
| **Average** | 16% |

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

## SECTION I - CONTROL DEFICIENCIES, CONTINUED

(2) Inventory, Continued

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

There were missing inventory sheets for certain months tested.

During the site visit to the power plant, we observed that there were no locks attached to pipeline valves. Such physical control could possibly reduce risk of unauthorized fuel access.

We recommend that KAJUR review attendant controls over the accounting process on recording fuel expenses in consideration of power plant operations. KAJUR may also consider rotation of duties if personnel are unavailable to perform fuel sounding. In addition, KAJUR may also consider enhancing physical security to minimize unauthorized access of fuel inventory. It is also recommended that KAJUR communicate with MEC to minimize chances of running out of fuel.

(3) Materials and Supplies Costing

During tests of inventory costing, we noted discrepancies in unit costs for several items as presented below:

| Item Number | Item Name | Part # | Unit-Price | Unit Cost per Calculation | Variance |
|---|---|---|---|---|---|
| 1 | CYLINDER HEAD (RECON) | 3640321RX | $3,027.54 | $3,122.85 | ($95.31) |
| 2 | LOWER ENGINE GASKET SET | 3804300 | $1,213.54 | $1,234.57 | ($21.03) |
| 3 | CIU (Small) | Small | $53.53 | $29.83 | $23.70 |

The variance noted for items 1 and 2 pertain to the exclusion of freight charges. Item number 3 results from an old rate used for items purchased in a prior year.

We recommend that KAJUR include freight charges and consider updated prices in inventory valuation. This matter has been discussed in our previous letters dated May 18, 2011 and August 8, 2012.

(4) Payroll

Tests of payroll expenses noted that a personnel action form (PAF) for one employee was not signed by the general manager. Further, a memo related to salary adjustment for two employees was not signed by the general manager. We recommend that KAJUR implement personnel policies and procedures requiring the propriety of personnel action forms and relevant personnel documents. This matter has already been discussed in our letter dated August 8, 2012.

## SECTION I - CONTROL DEFICIENCIES, CONTINUED

(5) Mid Corridor

Mid-corridor beginning balance of $71,698 had no subsidiary ledger that would identify customer's unclaimed tokens. We recommend that KAJUR maintain a mid-corridor subsidiary ledger per customer.

(6) Fixed Assets

Accumulated depreciation for sewer is larger than compared to related costs. Details are presented in the table below:

| Account No. | Description | Balance |
|---|---|---|
| 11121-400-0 | Structures and Improvements-Sewer | $ 712,078 |
| 11511-400-0 | Accum. Depr- Sewer Production | (883,510) |
| 11512-400-0 | Accum. Depr - Sewer T&D | (32,136) |
| | *Net Book Value* | $ (203,568) |

This matter was corrected through a proposed audit adjustment.

We also noted that items which have a remaining net book value as of September 30, 2012 though the expected useful life ended on September 30, 2011. See table below for details:

| Account No. | Description | Useful Life | Date Put in Service | Useful Life End Date | Cost | Accum. Depr. as of Sept. 30, 2012 | Net Book Value as of Sept. 30, 2012 |
|---|---|---|---|---|---|---|---|
| 11121-200-0 | Power House Building & Associated Storey | 25 | 9/30/1986 | 9/30/2011 | $1,961,312 | $1,693,639 | $267,673 |
| 11321-200-0 | Office Space & Equipment | 25 | 9/30/1986 | 9/30/2011 | 653,771 | 538,397 | 115,374 |

Tests of fixed asset verifications noted several assets that have been damaged, dismantled, or disposed of.

See table for details:

| Account # | Project Description | Acquisition Date | Life | Acquisition $ Cost | $ of Book Value |
|---|---|---|---|---|---|
| 11238-300-0 | Transport Equip- T&D WU | 9/30/2009 | 5 | 5,600.00 | 1,120.00 |
| 11133-200-0 | Install & Commissioning & Switchgear | 5/1/2002 | 15 | 88,587.00 | 39,367.80 |
| 11221-200-0 | Gormann Rupp flammable Pump | 2/1/2008 | 5 | 261,157.00 | 17,601.40 |
| 11238-200-0 | Transportation Equipment | 9/30/2009 | 10 | 12,586.92 | 8,810.84 |

## SECTION I - CONTROL DEFICIENCIES, CONTINUED

(6) Fixed Assets, Continued

We recommend that KAJUR implement accounting procedures over the conduct of physical asset counts to review fixed asset balances. Such assessment would provide KAJUR information on the operational efficiency of company-owned fixed assets. In addition, we also recommend that KAJUR implement accounting procedures over asset retirements and disposals.

(7) Expenses

Tests of expenses noted that a copy of GJ242 with attendant supporting documentation was not available. We recommend that KAJUR require that supporting documents for expenses be maintained.

## 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 dated May 18, 2011 and August 8, 2012.

(2) Revenues

KAJUR does not maintain records on power generated, transmitted and billed throughout the year. Such information would be helpful in monitoring line losses. We recommend management consider maintaining records on power generated, transmitted and billed. This matter was discussed in our previous letters dated May 18, 2011 and August 8, 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.