

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, 2009

**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, 2009, and have issued our report thereon dated June 30, 2010. 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 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 would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A *control 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 misstatements on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies described in the accompanying Schedule of Findings and Questioned Costs (pages 6 through 21) as items 2009-1 through 2009-13 to be significant deficiencies in internal control over financial reporting.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that the significant deficiencies described above are material weaknesses.

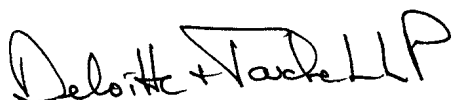
Compliance and Other Matters

As part of obtaining reasonable assurance about whether KAJUR's basic 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 June 30, 2010.

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.

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June 30, 2010

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS
APPLICABLE TO 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 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, 2009. 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 21). 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, 2009.

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 the 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, 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 *control deficiency* in an entity's internal control over compliance 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 noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control.

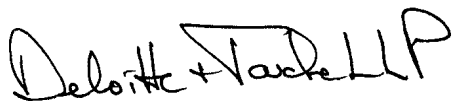
A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be 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, 2009, and have issued our report thereon dated June 30, 2010. 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.

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

June 30, 2010

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Expenditures of Federal Awards
Year Ended September 30, 2009

<u>Program Title</u>	<u>Expenditures FY09</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 Development Fund	\$ 2,995,780
<u>Section 211(d)(1) Infrastructure Development Projects</u>	
<u>CFDA #15.875</u>	
Ebeye Stabilization Project	<u>79,932</u>
	<u>\$ 3,075,712</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:

Prepaid expenses	786,726
Expenses (included within total operating expenses of \$6,268,292)	<u>2,288,986</u>
	<u>\$ 3,075,712</u>

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs
Year Ended September 30, 2009

Section I - Summary of Auditor's 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 that is not considered to be a material weakness? | None reported |
| 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 that is not considered to be a material weakness? | 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. KAJUR's major programs were as follows: | |
| <u>CFDA #</u> <u>Name of Federal Program</u> | |
| 15.875 Compact of Free Association, as Amended,
Kwajalein Atoll Landowners Special Needs
Infrastructure Development Projects | |
| 10. 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. | |
| 11. 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>Page #</u>	<u>Questioned Costs</u>
2009-1	External Financial Reporting	7	\$ -
2009-2-3	Revenues	8 - 10	\$ -
2009-4	Inventory Purchases	11	\$ -
2009-5 - 6	Purchases/Disbursements	12 - 13	\$ -
2009-7	Payroll	14	\$ -
2009-8 - 10	Receivables	15 - 17	\$ -
2009-11	Inventories	18	\$ -
2009-12	Fixed Assets	19 - 20	\$ -
2009-13	Deferred Grant Revenue	21	\$ -

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2009

Finding No. 2009-1

External Financial Reporting

Criteria: Adequate accounting controls necessitate that journal entries and adjustments be independently approved and recorded by different employees to facilitate accuracy and authorization.

Condition: Accounting journal entries and adjustments during the year ended September 30, 2009 were initiated and recorded by the same accounting personnel with the absence of independent review. Furthermore, the majority of journal vouchers were prepared subsequent to September 30, 2009.

Cause: The cause of the above condition is the lack of established policies and procedures that promote adequate segregation of duties pertaining to journal entries.

Effect: The effect of the above condition is a possible misstatement of the financial statements.

Recommendation: We recommend that KAJUR adopt policies and procedures to promote adequate segregation of duties pertaining to journal entries.

Prior Year Status: Lack of adequate segregation of duties pertaining to journal entries was reported as a finding in the audits of KAJUR for fiscal years 2005 through 2008.

Auditee Response and Corrective Action Plan: Throughout the Audit Findings and Auditee Response Report, it is a common theme and goal to initiate during the fiscal year (FY) 2010 for KAJUR's new management and MEC's combined utility management team to promote a controlled accounting environment. As a utility company under the management of MEC, KAJUR will adopt and implement policies and procedures established by MEC for consistency and standardization purposes. Per MEC management, the initiative to adopt various policies and procedures will be initiated during FY 2010 and should be completed within FY 2011.

KAJUR is in agreement with the audit finding number 2009-1 and recommendation.

KAJUR's new management has recently restructured the Accounting Department by clearly defining and assigning tasks and duties among its staff team members. Effective FY 2010, the accounting journal entries and adjustments are being prepared and recorded by the accounting personnel. The journal entry and all appropriate supporting documentation will be reviewed and approved by the Accounting Manager or Management designee prior to posting to the General Ledger. The journal entry preparer and approver will no longer be performed by the same accounting personnel.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2009

Finding No. 2009-2

Revenues

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

Condition: KAJUR maintains its utility billing system, including monthly meter reading and billing generation, in Microsoft Excel and does not utilize standard utility billing software, which may assist accuracy and recording. KAJUR's set up of excel spreadsheets is open to error, is without worksheet protection, lacks an automatic numbering system for invoices and data integrity checks are not available. We understand that KAJUR started using FOXPRO for its billing system during fiscal year 2010. FOXPRO automatically computes the monthly bill and the outstanding receivable at each month end. It also automatically computes receivable aging. However, as of this date, we noted that the information generated from the FOXPRO system is not yet reliable. Also, changes are still being made to the FOXPRO system for it to automatically compute receivable aging.

Additionally, the following were noted during our examination of sales - electric, water and sewer:

- Of forty (40) electric invoices tested, the following were noted:

For two (2) invoices, rates applicable for residential customers were used even though the customers were classified as commercial customers.

Two (2) invoices were billed incorrectly as an erroneous previous month's meter reading was used to compute current month consumption.

- KAJUR did not recognize revenues for metered water (except for RMI Hospital) and sewer services because management believes that the customers did not receive these services during fiscal year 2009. However, according to management, a survey was performed subsequent to year end and it was discovered that certain customers are actually receiving those services. This could mean that KAJUR provided water and sewer services at no cost during fiscal year 2009.

Cause: The cause of the above condition is the lack of established policies and procedures over utility revenues.

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

Recommendation: We recommend that policies and procedures be established pertaining to utility and other operating revenues, including utilization of appropriate software to assist in the validity and accuracy of the customer database and billing information.

Prior Year Status: Non-utilization of utility billing software to generate billings was reported as a finding in the audits of KAJUR for fiscal years 2004 through 2008.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2009

Finding No. 2009-2, Continued

Revenues, Continued

Auditee Response and Corrective Action Plan: KAJUR is in agreement with the audit finding number 2009-2 and recommendation.

During FY 2010, KAJUR acquired and implemented a new billing software system, FOXPRO. Unfortunately, the implementation of FOXPRO has not been a smooth and flawless conversion. As indicated above, KAJUR is not able to continue with FOXPRO due to the billing software system's lack of data integrity and reliability at this time. KAJUR Billing Manager will need to work closely with the new billing software provider and technical support in a testing environment to address all system issues prior to the next go live production date. Furthermore, detailed reconciliations of the customer accounts would need to be completed to ensure the data converted to FOXPRO is accurate and complete. Close monitoring (and reconciliations) will need to be continued post live as well.

During the interim (remaining FY 2010) period, KAJUR has reverted back to the use of Excel Spreadsheets until FOXPRO conversion can be completed and all system issues have been addressed. Although, we hope this can be accomplished within FY 2010, it is most likely that FOXPRO will be fully operational in the production environment by FY 2011. As such, KAJUR and MEC management both recognize that this issue will continue to be an audit finding. Until FOXPRO can be utilized, KAJUR management (i.e. Accounting or Billing Manager) will take extra measures to analyze the monthly billings charges for any anomalies and trends.

For a long-term solution, KAJUR management defers to MEC management for further guidance on implementing a fully integrated accounting software package to include a billing software package.

In regards to potential loss of revenue for metered water and sewer services, KAJUR management is currently in the process of exploring the opportunities available and in response to the survey findings. Funding and technical expertise will be sought after to resolve the system inefficiencies and is expected to begin during the FY 2010-2011 timeframe.

As a utility company under the management of MEC, KAJUR will adopt and implement policies and procedures established by MEC for consistency and standardization purposes.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2009

Finding No. 2009-3

Revenues

Criteria: Revenues from mid-corridor customers should be correctly identified and recorded.

Condition: We noted two (2) instances where mid-corridor revenue recognized was not actually for a mid-corridor resident.

Cause: The cause of the above condition is the lack of policies and procedures to ensure that mid-corridor customers are correctly identified before recording related revenue.

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

Recommendation: We recommend that management identify mid-corridor customers and recognize related revenues.

Auditee Response and Corrective Action Plan: KAJUR is in agreement with the audit finding number 2009-3 and recommendation.

KAJUR new management has taken the necessary steps and communicated to the Customer Service Staff not to issue or give out tokens to any unknown customers who are not in the Mid-Corridors list. For future process sustainability, an initiative to create desktop procedures will need to be explored further.

As a utility company under the management of MEC, KAJUR will adopt and implement policies and procedures established by MEC for consistency and standardization purposes.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2009

Finding No. 2009-4

Inventory Purchases

Criteria: Receiving reports document evidence of the receipt of materials and supplies into inventory.

Condition: Receiving reports were not consistently used throughout the year. Specifically, receiving reports were not provided for the following purchases of supplies and materials:

Item no.	Part#
Connector DCK disconnect	3377244
Hose hump	3634116
Fleet guard filter	Fs19765

Cause: The cause of the above condition is the lack of established policies and procedures requiring documentation to evidence receipt of materials and supplies into inventory.

Effect: The effect of the above condition is a possible payment for materials and supplies not received and for invalid expenses.

Recommendation: We recommend that receiving reports be completed for all purchases.

Prior Year Status: Lack of receiving reports for materials and supplies received into inventory was reported as a finding in the audits of KAJUR for fiscal years 2005 through 2008.

Auditee Response and Corrective Action Plan: KAJUR is in agreement with the audit finding number 2009-4 and recommendation.

Effective immediately, KAJUR new management will take the necessary steps to resolve the issue and ensure that receiving reports are completed for all applicable purchases of materials and supplies.

As an added control measure, it will be the role of the Accounts Payable (AP) staff member(s) to ensure that the receiving reports (as appropriate) are attached, completed, valid and reconciled to the Invoices prior to payment processing. Invoices submitted for payment will not be processed if receiving reports are missing or discrepant. The AP team will initiate the follow up communication process for receiving reports.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2009

Finding No. 2009-5

Purchases/Disbursements

Criteria: Purchases/disbursements should be supported by valid invoices, contracts, and/or other relevant documentation.

Condition: We noted that there was no support (such as plane tickets, boat trip, etc.) for certain travel expenses (check #'s 006540, 006559 and 000215):

Furthermore, invoices for the following disbursements were not on file:

Check #6633 & #6805

Check #6976

Check #6567

Check #6932

Check #6784

Cause: The cause of the above condition is the lack of policies and procedures to ensure that payments are made only for purchases that are adequately supported by a valid vendor invoice, contract, and/or other relevant documentation.

Effect: The effect of the above condition is a possible misstatement of expenses.

Recommendation: We recommend that management establish policies and procedures to assist in ensuring that payments are made only for adequately supported purchases of goods or services.

Prior Year Status: Lack of supporting documents for purchases/disbursements was reported as a finding in the audit of KAJUR for fiscal year 2008.

Auditee Response and Corrective Action Plan: KAJUR is in agreement with the audit finding number 2009-5 and recommendation.

Effective immediately (FY 2010), AP invoice processing will require a step to pre-audit the invoice(s) prior to payment processing. At a minimum, the pre-audit of invoices will include the following:

- PO related purchases: A three way match will be performed to ensure the Purchase Requisition, Purchase Order and Invoice (i.e. quantity, description, unit price) are complete and accurate.
- Other supporting documentation will be attached: As appropriate, documents such as receiving reports, email communication, authorization and other forms will be provided as supporting documentation to substantiate payment of the invoice for the goods or services received.
- Contractual Services: Any invoices submitted for payment associated with a Contract need to be reconciled to the contract terms. Copy of the contract may be included as supporting documentation, as appropriate.
- Any discrepant invoices will not be processed until further research is completed and supporting documentation is reconciled completely and accurately.
- Approving Manager or designee will review invoice and supporting documentation. Approving signature represents authorization that payment voucher is complete and accurate for processing.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2009

Finding No. 2009-6

Purchases/Disbursements

Criteria: Check payments should be made payable to vendors.

Condition: Various checks totaling more than \$250,000 were written out to an employee, who, in turn, cashed the checks to purchase items in Kwajalein.

Cause: The cause of the above condition is the non-acceptance of the bank's checks in Kwajalein.

Effect: The effect of the above condition is an increased potential for misappropriation of funds.

Recommendation: We recommend consideration of opening an account with a bank whose checks are accepted in Kwajalein or asking MEC management to facilitate the acquisitions.

Auditee Response and Corrective Action Plan: KAJUR is in agreement with the audit finding number 2009-6 and recommendation.

KAJUR new General Manager will meet with the MEC Board of Directors to resolve this issue. With the challenges of obtaining a credit card, most likely MEC management to facilitate the acquisitions will be the short term solution pending further guidance and approval from the MEC Board of Directors. KAJUR should have a resolution in place within FY 2010.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2009

Finding No. 2009-7

Payroll

Criteria: Payroll expenses should be authorized and supported by appropriate documentation.

Condition: The following payroll exceptions were noted:

- The personnel action form for employee # ANTF was not provided as the document was not available.
- The contract doesn't indicate a pay rate for employee # LENJ, but we understand that the rate derives from the personnel action form which was unsigned.
- Employee # JAIT was paid at a higher rate compared to the authorized personnel action form.
- The overtime hours of employee # KIJJ was approved for 40 hours by the then General Manager; however, the employee was only paid for 31 hours.

Furthermore, the accounting clerk who processes payroll transactions also has access to and has editing authority over payroll master files.

Cause: The cause of the above condition is the lack of established policies and procedures pertaining to payroll.

Effect: The effect of the above condition is a possible misstatement of payroll expenses.

Recommendation: We recommend that management ensure that employees' hours are supported by approved timesheets, that payroll is accurately paid and that hourly rates are supported by approved personnel action forms. We also recommend that management ensure that appropriate segregation of duties is in place over the payroll function.

Prior Year Status: Lack of payroll supporting documentation was reported as a finding in the audits of KAJUR for fiscal years 2005 through 2008.

Auditee Response and Corrective Action Plan: KAJUR is in agreement with the audit finding number 2009-7 and recommendation.

The Payroll accounting personnel will perform due diligence to review the timesheets (and supporting documentation such as personnel forms) for completeness, accuracy and appropriate supervisory/management approval. As an added control measure, Accounting/HR Manager or designee will review each payroll's supporting documentation to ensure it is complete and accurate. Any missing supporting documentation or discrepancies will be corrected no later than the following pay period.

Effective immediately, payroll accounting clerk will not have authorization to access/edit rights to payroll master files. Payroll edits will be subject to the approval of the Accounting/HR Manager. Understanding of the system access controls will need to be explored further to determine the security access and right levels. However, KAJUR should expect to have segregation of duties for payroll functions within FY 2010.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2009

Finding No. 2009-8

Receivables

Criteria: Reconciliation of the utility receivables general and subsidiary ledger should be performed monthly.

Condition: As of September 30, 2009, recorded electric receivables do not reconcile to the supporting subsidiary ledger by \$454,914. Furthermore, water and sewer receivables do not reconcile to the supporting subsidiary ledger by \$145,551. Such were corrected by management as of September 30, 2009 upon the auditors' request.

Cause: The cause of the above condition is the lack of internal control policies and procedures to ensure that receivables are supported by reconciled subsidiary ledgers on a monthly basis.

Effect: The effect of the above condition is a possible misstatement of receivables.

Recommendation: We recommend that KAJUR establish policies and procedures to require that receivables are supported by reconciled subsidiary ledgers on a monthly basis.

Prior Year Status: Lack of internal control policies and procedures to ensure that receivables are supported by reconciled subsidiary ledgers was reported as a finding in the audits of KAJUR for fiscal years 2007 and 2008.

Auditee Response and Corrective Action Plan: KAJUR is in agreement with the audit finding number 2009-8 and recommendation.

As a utility company under the management of MEC, KAJUR will adopt and implement policies and procedures established by MEC for consistency and standardization purposes. Currently, MEC management is working on establishing reconciliation policies and procedures effective FY 2010.

At a high level, the reconciliation policies and procedure will include the following:

- Perform monthly reconciliation
- All supporting documentation to include (but not limited to) subsidiary ledger reports, General Ledger reports and other forms (i.e. Excel Spreadsheet, Journal Entries, screenshots, invoices, etc.) must be attached to substantiate the reconciliation performed.
- All material variances will be researched and resolved by the following reconciliation month.
- Supervisory/Manager or designee (someone other than the reconciler) review and approval will be completed (evident by the existence of a physical signature on the face of the reconciliation worksheet).

Once the policy and procedure (along with the reconciliation template) is completed, KAJUR will need to perform all account reconciliations to date initially. Upon completion, adherence to a monthly reconciliation schedule will be enforced.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2009

Finding No. 2009-9

Receivables

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

Condition: Receivables are maintained in an excel file which is prone to errors, and therefore a reliable aging report cannot be provided. Analysis of the adequacy of the allowance for doubtful receivables resulted in a proposed audit adjustment to increase the allowance by \$108,096.

Cause: The cause of the above condition is the lack of internal control policies and procedures to ensure that the allowance for doubtful accounts is adequately supported.

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 to require that the allowance for doubtful accounts is adequately supported.

Prior Year Status: Lack of an analysis to support allowance for doubtful accounts was reported as a finding in the audits of KAJUR for fiscal years 2005 through 2008.

Auditee Response and Corrective Action Plan: KAJUR is in agreement with the audit finding number 2009-9 and recommendation.

As a utility company under the management of MEC, KAJUR will adopt and implement policies and procedures established by MEC for consistency and standardization purposes. At this time, MEC also does not have an allowance for doubtful account policy and hope to have one in place prior to the end of FY 2010, which KAJUR will be able to adopt as well.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2009

Finding No. 2009-10

Receivables

Criteria: Customer payments should be correctly applied against outstanding receivables.

Condition: Reconciliation of the monthly accounts receivables schedule to revenues posted in the general ledger reflected a double recording of \$476,303. Such were adjusted by management for the fiscal year ended September 30, 2009 upon the auditors' request.

Cause: The cause of the above condition is the lack of established policies and procedures to adequately monitor accounts receivable.

Effect: The effect of the above condition is a possible misstatement of receivables and utility revenues.

Recommendation: We recommend that a monthly review and monitoring of accounts receivable occur to assist in identifying whether customer payments are correctly applied.

Auditee Response and Corrective Action Plan: KAJUR is in agreement with the audit finding number 2009-10 and recommendation.

As a utility company under the management of MEC, KAJUR will adopt and implement policies and procedures established by MEC for consistency and standardization purposes. Currently, MEC management is working on establishing reconciliation policies and procedures effective FY 2010.

At a high level, the reconciliation policies and procedure will include the following:

- Perform monthly reconciliation
- All supporting documentation to include (but not limited to) subsidiary ledger reports, GL reports and other forms (i.e. Excel Spreadsheet, Journal Entries, screenshots, invoices, etc.) must be attached to substantiate the reconciliation performed.
- All material variances will be researched and resolved by the following reconciliation month.
- Supervisory/Manager or designee (someone other than the reconciler) review and approval will be completed (evident by the existence of a physical signature on the face of the reconciliation worksheet).

Once the policy and procedure (along with the reconciliation template) is completed, KAJUR will need to perform all account reconciliations to date initially. Upon completion, adherence to a monthly reconciliation schedule will be enforced.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2009

Finding No. 2009-11

Inventories

Criteria: Physical counts of inventories and reconciliation of subsidiary ledgers with the general ledger should be performed on a regular basis.

Condition: During fiscal year 2009, an inventory physical count was performed at September 30, 2009 but no reconciliation of such to the general ledger occurred until the audit process. As of September 30, 2009, the materials and supplies inventory valuation report reflected a variance of \$14,872 while the fuel inventory reflected an overstatement of \$196,958. Such were adjusted by management as of September 30, 2009 upon the auditors' request.

Cause: The cause of the above condition is the lack of internal control policies and procedures to ensure that subsidiary ledger inventory balances are updated and reconciled to the general ledger on a regular basis.

Effect: The effect of the above condition is a possible misstatement of inventories.

Recommendation: We recommend that KAJUR establish policies and procedures to require that subsidiary ledger inventory balances are updated and reconciled to the general ledger on a regular basis.

Prior Year Status: Lack of internal control policies and procedures over subsidiary ledger inventory balances was reported as a finding in the audits of KAJUR for fiscal years 2007 and 2008.

Auditee Response and Corrective Action Plan: KAJUR is in agreement with the audit finding number 2009-11 and recommendation.

As a utility company under the management of MEC, KAJUR will adopt and implement policies and procedures established by MEC for consistency and standardization purposes. Currently, MEC management is working on establishing reconciliation policies and procedures effective FY 2010.

At a high level, the reconciliation policies and procedure will include the following:

- Perform monthly reconciliation
- All supporting documentation to include (but not limited to) subsidiary ledger reports, GL reports and other forms (i.e. Excel Spreadsheet, Journal Entries, screenshots, invoices, etc.) must be attached to substantiate the reconciliation performed.
- All material variances will be researched and resolved by the following reconciliation month.
- Supervisory/Manager or designee (someone other than the reconciler) review and approval will be completed (evident by the existence of a physical signature on the face of the reconciliation worksheet).

Once the policy and procedure (along with the reconciliation template) is completed, KAJUR will need to perform all account reconciliations to date initially. Upon completion, adherence to a monthly reconciliation schedule will be enforced.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2009

Finding No. 2009-12

Fixed Assets

Criteria: Established fixed asset policies and procedures should govern property acquisition, capitalization, disposals, reconciliation, physical inventory and depreciation. Additionally, fixed assets should be inventoried on a regular basis and the fixed asset register should provide sufficient detail to locate and identify assets.

Condition: Per tests performed on fixed assets, the following were noted:

- No physical inventory of fixed assets occurred during fiscal year 2009.
- No reconciliation between the fixed asset register and the general ledger occurred during the year, specifically for accumulated depreciation.
- During sighting of fixed assets, we noted that a Colt SUV Plus (L. Green) was neither light green nor an SUV. An incorrect fixed asset description was detailed on the fixed asset register.
- KAJUR currently does not have a capitalization policy detailing the minimum level of expenditures to necessitate capitalization. Specifically, we noted that various assets were purchased from a liquidation auction. However, these assets were not capitalized in a timely manner, and at times, were incorrectly expensed. The total uncapitalized fixed assets aggregated \$142,160 and the total amount of fixed asset purchases incorrectly charged to expense was \$39,600. Also, we noted that \$42,183 of import taxes on various fixed assets was not capitalized. These matters were adjusted by management as of September 30, 2009 upon audit request.
- No formal policy currently exists relative to assigning useful lives. Specifically, we noted that useful lives assigned generators and fuel tanks were not in line with useful lives assigned similar assets. The difference in depreciation expense recognized versus depreciation expense calculated using the revised useful lives were adjusted by management as of September 30, 2009.
- KAJUR does not periodically assess recorded amounts of long-lived assets to determine whether a reserve is required.

Cause: The cause of the above condition is the lack of established policies and procedures over accounting for fixed assets.

Effect: The effect of the above condition is that fixed assets may be misstated throughout the year and the current practice of describing assets in the fixed asset register is not sufficient to identify the assets.

Recommendation: We recommend that management adopt fixed asset policies and procedures to govern property acquisition, capitalization, disposal, reconciliation, physical inventory and depreciation. Additionally, the policies and procedures should assist in ensuring that fixed assets are physically inventoried, identified and referenced in the fixed asset register.

Prior Year Status: Lack of internal control policies and procedures on the property acquisition, capitalization, reconciliation, physical inventory and depreciation was reported as a finding in the audits of KAJUR for fiscal years 2004 through 2008.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2009

Finding No. 2009-12, Continued

Fixed Assets, Continued

Auditee Response and Corrective Action Plan: KAJUR is in agreement with the audit finding number 2009-12 and recommendation.

As a utility company under the management of MEC, KAJUR will adopt and implement policies and procedures established by MEC for consistency and standardization purposes. Currently, MEC management is working on establishing reconciliation policies and procedures effective FY 2010.

At a high level, the reconciliation policies and procedure will include the following:

- Perform monthly reconciliation
- All supporting documentation to include (but not limited to) subsidiary ledger reports, GL reports and other forms (i.e. Excel Spreadsheet, Journal Entries, screenshots, invoices, etc.) must be attached to substantiate the reconciliation performed.
- All material variances will be researched and resolved by the following reconciliation month.
- Supervisory/Manager or designee (someone other than the reconciler) review and approval will be completed (evident by the existence of a physical signature on the face of the reconciliation worksheet).

Once the policy and procedure (along with the reconciliation template) is completed, KAJUR will need to perform all account reconciliations to date initially. Upon completion, adherence to a monthly reconciliation schedule will be enforced.

If deemed appropriate, management may make a decision to have Fixed Asset reconciliation performed on a quarterly basis. Initially, however, monthly reconciliation will be performed prior to any reconciliation schedule changes.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2009

Finding No. 2009-13

Deferred Grant Revenue

Criteria: Deferred revenue should reflect amounts received but not expended or earned.

Condition: At September 30, 2009, deferred revenue includes \$112,800 for federal grants drawn in fiscal year 2003.

Cause: The cause of the above condition is the lack of established policies and procedures to ensure that expended grants funds are accurately recorded.

Effect: The effect of the above condition is the possible misstatement of deferred revenue.

Recommendation: We recommend that KAJUR establish policies and procedures to require that expended grants funds are accurately recorded.

Prior Year Status: Misstatement of deferred revenue was reported as a finding in the audits of KAJUR for fiscal years 2005 through 2008.

Auditee Response and Corrective Action Plan: KAJUR is in agreement with the audit finding number 2009-13 and recommendation.

As a utility company under the management of MEC, KAJUR will adopt and implement policies and procedures established by MEC for consistency and standardization purposes.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Unresolved Prior Year Findings and Questioned Costs
Year Ended September 30, 2009

Questioned Costs

The prior year Single Audit report on compliance with laws and regulations noted the following questioned costs that were unresolved at September 30, 2009:

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 2009 Single Audit

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Unresolved questioned costs of KAJUR at September 30, 2009

\$ 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 21).