

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, 2010

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, 2010, and have issued our report thereon dated May 18, 2011. 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 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 12), we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and one other deficiency that we consider to be a significant deficiency.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying Schedule of Findings and Questioned Costs as items 2010-2 through 2010-4 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 deficiency described in the accompanying Schedule of Findings and Questioned Costs as item 2010-1 to be a significant deficiency.

#### Compliance and Other Matters

As part of obtaining reasonable assurance about whether KAJUR's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of KAJUR in a separate letter dated May 18, 2011.

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

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

*Deloitte & Touche LLC*

May 18, 2011

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, 2010. 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 12). Compliance with the requirements of laws, regulations, contracts, and grants applicable to its one major federal program is the responsibility of KAJUR's management. Our responsibility is to express an opinion on KAJUR's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about KAJUR's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of KAJUR's compliance with those requirements.

In our opinion, KAJUR complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on its one major federal program for the year ended September 30, 2010.

## Internal Control Over Compliance

Management of KAJUR is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered KAJUR's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of KAJUR's internal control over compliance.

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

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

## Schedule of Expenditures of Federal Awards

We have audited the basic financial statements of KAJUR as of and for the year ended September 30, 2010, and have issued our report thereon dated May 18, 2011. Our audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying Schedule of Expenditures of Federal Awards (page 5) is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. This schedule is the responsibility of the management of KAJUR. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

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

*Deloitte & Touche LLC*

May 18, 2011

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Expenditures of Federal Awards  
Year Ended September 30, 2010

<u>Program Title</u>	<u>Expenditures</u>
<u>U.S. Department of the Interior</u> <u>Compact of Free Association, as Amended:</u> <u>Section 211(b)(2) Kwajalein Atoll Landowners Special Needs</u> <u>CFDA #15.875</u>	
Kwajalein Development Fund	<u>\$ 1,548,782</u>

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

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

Expenses (included within total operating expenses of \$6,093,950)	<u>\$ 1,548,782</u>
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KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs  
Year Ended September 30, 2010

**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 that is not considered to be a material weakness? | No          |
| 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?  | No          |
| 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 program was as follows:   |             |
|     | CFDA<br><u>Number</u> <u>Federal Program</u>  |             |
|     | 15.875    Compact of Free Association, as Amended:<br>Kwajalein Atoll Landowners Special Needs<br>Infrastructure Development Projects |             |
| 10. | Dollar threshold used to distinguish between Type A and Type B Programs, as those terms are defined in OMB Circular A-133:            | \$300,000   |
| 11. | KAJUR qualified as a low-risk auditee, as that term is defined in OMB Circular A-133?   | No          |

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs  
Year Ended September 30, 2010

**B. FINDINGS RELATING TO THE FINANCIAL STATEMENTS, WHICH ARE REQUIRED TO BE REPORTED IN ACCORDANCE WITH GAGAS**

<u>Reference Number</u>	<u>Findings</u>	<u>Questioned Costs</u>	<u>Refer Page #</u>
2010-1	Revenues	\$ -	8 - 9
2010-2	Inventories	\$ -	10
2010-3	Receivables	\$ -	11
2010-4	Grants	\$ -	12

**C. FINDINGS AND QUESTIONED COSTS - MAJOR FEDERAL AWARD PROGRAMS AUDIT**

No findings reported.



KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2010

**B. FINDINGS RELATING TO THE FINANCIAL STATEMENTS, WHICH ARE REQUIRED TO BE REPORTED IN ACCORDANCE WITH GAGAS**

Finding No. 2010-1

Revenues

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

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

- Of thirty-two receipts tested, two token receipts in May 2010 (receipt nos. 221119 and 92009) used the old residential rate of 29.8 cents per kilowatt-hour (kwh) unit instead of the approved rate of 32.2 cents per kwh unit, effective May 1, 2010.
- Of sixty-three billing statements tested, we noted the following:
  - a. Three billing statements were in error as follows:

Customer Account No.	Month	Per Billing Statements (In Kwh)			Per Reading Reports (In Kwh)				Multiplier	Variance (In Kwh)	Rate (In USD)	Variance (In USD)
		Previous	Current	Usage	Previous	Current	Usage	Variance				
170910	04/10	1,210	1,210	-	1,210	1,788	578	(578)	1	(578)	\$ 0.358	\$ (207)
305003	03/10	54,552	56,506	1,954	55,462	56,506	1,044	910	1	910	\$ 0.298	\$ 271
152541	11/09	1,817	1,817	-	1,817	1,871	54	(54)	80	4,320	\$ 0.300	\$ (1,296)

- b. Five billing statements erroneously billed 32 cents per kwh instead of the approved rate of 31 cents per kwh as follows:

Customer Account No.	Month	Usage (In Kwh)	Rate (In USD)	Electricity Charge	Rate (In USD)	Electricity Charge	Variance (In USD)
162611	11/09	3,007	\$ 0.320	\$ 962	\$ 0.310	\$ 932	\$ 30
132300	12/09	1,877	\$ 0.320	\$ 601	\$ 0.310	\$ 582	\$ 19
163100	12/09	4,537	\$ 0.320	\$ 1,452	\$ 0.310	\$ 1,406	\$ 45
136871	11/09	17,600	\$ 0.320	\$ 5,632	\$ 0.310	\$ 5,456	\$ 176
163120	01/10	3,311	\$ 0.320	\$ 1,060	\$ 0.310	\$ 1,026	\$ 33

- KAJUR did not recognize revenue for metered water (except for RMI Hospital and mid-corridor) and sewer services. A survey performed during the year discovered that certain customers were receiving those services.
- Our tests of receivables noted that the amount due per the September 2010 water billing to one customer (the new hospital) was in excess of the balance in the subsidiary ledger by \$15,130.

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

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

Recommendation: We recommend that KAJUR review billing statements, recognize revenue for metered water and reconcile billings to subledgers.

Prior Year Status: Errors in billings was reported as a finding in the Single Audits of KAJUR for fiscal years 2004 through 2009.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2010

Finding No. 2010-1, Continued

Auditee Response and Corrective Action Plan:

**Name of Contact Person:** Ms. Saeko Shoniber, Board Fiscal Officer

**Corrective Action:** KAJUR is in agreement with this finding and its recommendation. The new General Manager has confirmed that in late 2010 KAJUR began the accounting procedures currently in use at the Marshalls Energy Company, Inc. (MEC). Unfortunately, these procedures were not properly implemented due to the sudden passing of the former General Manager. To properly address this finding, the following actions will be taken:

1. KAJUR will ensure the accounting policies and procedures acquired from MEC are properly implemented within the Accounting Department.
2. A periodic review and reconciliation process for subledgers is being established and will be properly implemented within KAJUR's Accounting Department.
3. Results from a recent utility survey of all living quarters on Ebeye will be analyzed to ensure proper water billings for island-wide customers.

**Proposed Completion Date:** Ongoing

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2010

Finding No. 2010-2

Inventories

Criteria: Reconciliation of subsidiary ledgers to the general ledger should be performed on a periodic basis.

Condition: At September 30, 2010, fuel inventory was overstated by \$349,490; which was adjusted by management upon our 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 misstatement of inventories.

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

Prior Year Status: Lack of internal control policies and procedures over subsidiary ledger inventory balances was reported as a finding in the Single Audits of KAJUR for fiscal years 2007 through 2009.

Auditee Response and Corrective Action Plan:

**Name of Contact Person:** Ms. Saeko Shoniber, Board Fiscal Officer

**Corrective Action:** KAJUR is in agreement with this finding and its recommendation. To properly address this finding, the following actions will be taken:

1. KAJUR will ensure the accounting policies and procedures acquired from MEC are properly implemented within the Accounting Department.
2. A periodic review and reconciliation process for subledgers will be developed and implemented within KAJUR's Accounting Department.
3. A Benchmarking Liaison Officer was appointed to help ensure critical data is captured and periodically analyzed so discrepancies are determined and corrected.
4. As of October 2010, the frequency of physical inventories has been increased from "sporadically over a 12-month period" to once every month.

**Proposed Completion Date:** Ongoing

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2010

Finding No. 2010-3

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 \$226,899.

Cause: The cause of the above condition is the lack of policies and procedures to ensure that doubtful receivables are adequately provided for.

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

Recommendation: We recommend that KAJUR establish policies and procedures to ensure that doubtful receivables are adequately provided for.

Prior Year Status: The lack of an analysis to support the allowance for doubtful accounts was reported as a finding in the Single Audits of KAJUR for fiscal years 2005 through 2009.

Auditee Response and Corrective Action Plan:

**Name of Contact Person:** Ms. Saeko Shoniber, Board Fiscal Officer

**Corrective Action:** KAJUR is in agreement with this finding and its recommendation. To properly address this finding, the following actions will be taken:

1. KAJUR will ensure the accounting policies and procedures acquired from MEC are properly implemented within the Accounting Department.
2. As of October 2010, KAJUR's Accounting Department converted to a new accounting system that will allow better accounting and evaluation of doubtful accounts.

**Proposed Completion Date:** Ongoing

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2010

Finding No. 2010-4

Grants

Criteria: Revenues should be recorded when earned.

Condition: Grant funds paid directly to the vendor in FY 2009 of \$355,900 were not recorded by KAJUR. This condition was corrected through a proposed audit adjustment.

Cause: The cause of the above condition is the lack of monitoring and recording of funds requested from the grantor.

Effect: The effect of the above condition was a restatement of prior year amounts.

Recommendation: We recommend that KAJUR establish procedures to ensure monitoring and recording of funds requested.

Auditee Response and Corrective Action Plan:

**Name of Contact Person:** Ms. Saeko Shoniber, Board Fiscal Officer

**Corrective Action:** KAJUR is in agreement with this finding and its recommendation. To properly address this finding, the following actions will be taken:

1. KAJUR will ensure the accounting policies and procedures acquired from MEC are properly implemented within the Accounting Department.
2. Improved coordination between MEC and KAJUR will be established to ensure proper monitoring and recording of grants awarded to KAJUR.

**Proposed Completion Date:** Ongoing

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Unresolved Prior Year Comments  
Year Ended September 30, 2010

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, 2010:

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 2010 Single Audit	<u>-</u>
Unresolved questioned costs at September 30, 2010	\$ <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 12).