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June 20, 2013

Mr. Joseph Batol
General Manager
Majuro Water and Sewer Company, Inc.

Dear Mr. Batol:

In planning and performing our audit of the financial statements of Majuro Water and Sewer Company, Inc. (MWSC) as of and for the year ended September 30, 2012 (on which we have issued our report dated June 20, 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 MWSC'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 MWSC's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of MWSC'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 MWSC'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 June 20, 2013, on our consideration of MWSC'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 the Board of Directors, 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 MWSC 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 MWSC's internal control over financial reporting as of September 30, 2012 that we wish to bring to your attention:

1) Journal Entries

Upon examination of payment transactions, we noted that check # 15047 debited accounts payable without establishing a prior accrual. This condition may result in reconciling items if not properly monitored. It appears that there is a lack of a review process in posting journal entries to the accounting system. We recommend management establish adequate internal controls over the review of journal entries prior to posting.

In addition, we noted incorrect designation of GL codes in recording several months of water and sewer revenues. It appears that there is a lack of review procedures that resulted in recording journal entries using incorrect GL codes. We recommend management establish adequate internal control policies over the review of journal entries.

Furthermore, we noted the recording of $12,000 of receivables without proper supporting documentation to support the claim. It appears that the entity lacks review procedure over journal entries which resulted in the recording of transactions without proper supporting documentation. We recommend management adopt appropriate control policies requiring sufficient documentation to support the validity of journal entries.

2) Fixed Assets

Various fixed asset purchases were directly charged as expenses. Check # 15188 in the amount of $2,136 for payment of two desktops was expensed. This transaction appears to be in noncompliance with MWSC's accounting policy for fixed asset capitalization for items $500 and above. We recommend management establish adequate internal control to comply with established policies.

3) Billing Reports

We noted various credit balances in the Monthly Billing Report. Per further investigation of the September 30, 2012 report, we noted that customer # 53175 has a credit balance due to incorrect application of customer payments.

We also noted that the amount written off for customer # 50260 exceeded the outstanding balance, which resulted in a credit balance as of September 30, 2012. It appears that there is lack of timely review of customer accounts. We recommend management establish adequate internal control policies over the timely review of customer accounts and investigate abnormal customer account balances.

4) Collections

We noted collections from customers without the issuance of receipts. Cash receipts for customer #s 51478 and 52364 indicated the lack of issuance of official receipts. Per discussion with the Accounting Manager, it is MWSC's policy to issue official receipts as evidence of customer account settlement. We recommend that management require adherence to MWSC policy.

5) Bank Reconciliation

Upon examination of the bank reconciliation for the BOG main account, we noted discrepancies between the cash adjusted balance and the general ledger balance. It appears that there is inadequate internal control over the reconciliation and review process resulting in $220 of unreconciled amounts. We recommend that management establish internal control policies over the timely reconciliation and review process. Furthermore, we recommend timely resolution of the discrepancies.

6) Inventory Issuances

Several work order forms did not contain approver signatures. We recommend that management adopt internal control policies over monitoring and validating inventory issuances.

7) Cash Disbursements

Several transactions were not supported by invoices. We recommend that management implement appropriate internal control policies over documentation of cash disbursements.

8) Grants

Inventories received during 2012 that were funded by grants were not included in the year-end inventory valuation report. It appears that there is inadequate internal control over monitoring inventories and documentation of grants received. We recommend that management implement internal control policies with respect to monitoring inventories and documentation of grants received.

9) Approval of Timecards

Timecards were not signed by employees or by the reviewing supervisor. Supervisors are required to report to the Manager only if an issue with timecards occurs. However, there is no evidence of the review being performed. We recommend that reviewers evidence their review on the timecards, for example through their initials. This finding was reported in our previous letter for fiscal year 2011.

10) Inadequate Documentation of Employee Termination

There exist situations when an employee resigned or was terminated and the employee's formal letter of termination was not included in file. Pay rates in file were not updated regularly, and the date of termination is not specified in personnel schedules. Recorded salaries and wages may be inaccurate if a formal record of termination if not maintained. Prior to an employee departing, MWSC should obtain employee signatures on the notice of termination form. This signature could potentially release MWSC of future liability. A termination checklist detailing all procedures and duties required for an employee being terminated, resigning, retiring, etc. should be formally implemented and completed prior to an employee leaving. This finding was reported in our previous letter for fiscal year 2011.

11) <u>Account Reconciliation</u>

The accounts payable subledger and the general ledger differ by $32,375. Furthermore, we noted several unposted payment transactions resulting in the reconciling items. It appears that there is inadequate monitoring and the lack of a review process that resulted in the unreconciled differences. We recommend management adopt adequate internal control policies relative to monitoring and review of account reconciliations to properly address exceptions and would provide appropriate resolution on a timely basis. This finding was reported in our previous letters for fiscal years 2009 through 2011.

12) <u>Fixed Assets</u>

During tests of fixed assets, we noted the following:

a) A Ford 1997 F-Series truck with plate # 1680 was not included in the fixed asset register.

b) Inquiry with the Accounting Manager, there is no formal accounting policy on the process of fixed asset retirements. During the year ended September 30, 2012 $111,497 of disposals occurred.

c) In addition, during the verification of fixed assets, a HP G62 Notebook (costing $899.99) purchased in June 2011 was not located.

We recommend management implement appropriate internal control policies that would enhance efficient monitoring, accountability, and retirement of fixed asset procedures.

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) <u>Collection of Receivables</u>

No significant movement occurred from FY11 to FY12 for water delivery receivables. It appears that there is an inadequate collection effort on the part on MWSC resulting in long outstanding receivables and an increase in the allowance for uncollectible accounts. We recommend management reassess collectibility of receivables and adopt appropriate internal control policies over timely collection of receivables.

As at September 30, 2012, receivable aging indicated that customer water accounts with balances greater than 90 days represent 95% of the total. We recommend that management continue to review the subsidiary ledger to determine uncollectible accounts to be written-off and to obtain requisite approval from the Board. We encourage MWSC to continue its efforts to improve the collection of receivables. This matter was discussed in our previous letters to management for the audits of fiscal years 2007 through 2011.

SECTION II – OTHER MATTERS, CONTINUED

2) Disconnection of Non-paying Customers

   MWSC policy is to disconnect nonpaying customers whose balances are sixty days overdue and are above $150. As of September 30, 2012, this policy has not been strictly enforced as certain customers continue to be connected despite noncompliance with this policy. We recommend that management establish procedures to ensure compliance with the policy. This matter was discussed in our previous letters to management for the audits of fiscal years 2007 through 2011.

3) Maintenance of Files

   Per compliance tests of procurement transactions, we noted a prepaid purchase of $150,000. Such transaction requires competitive bidding processes due to it exceeding $25,000. MWSC failed to provide documents that would serve as evidence of compliance with the bidding process. We recommend that management implement and adopt appropriate control policies over procurement documentation and adhere to RepMar compliance requirement required.

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 Company 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

MWSC'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.