

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

INDEPENDENT AUDITORS' REPORT ON  
INTERNAL CONTROL AND ON COMPLIANCE

YEAR ENDED SEPTEMBER 30, 2000



INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON  
INTERNAL CONTROL OVER FINANCIAL REPORTING BASED  
UPON THE ENGAGEMENT TO AUDIT IN ACCORDANCE  
WITH GOVERNMENT AUDITING STANDARDS

Board of Directors  
Kwajalein Atoll Joint Utilities Resources, Inc.:

We were engaged to audit the financial statements of the Kwajalein Atoll Joint Utilities Resources, Inc. (KAJUR) as of and for the year ended September 30, 2000. Our report dated May 8, 2001, stated that the scope of our work was not sufficient to enable us to express, and we did not express, an opinion on the financial statements due to our inability to determine that cash, receivables, inventories, plant and equipment, bank overdraft, accounts payable, accrued liabilities, contributed capital, revenues and expenses were fairly stated.

Compliance

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, require that an audit be planned and performed to obtain reasonable assurance about whether KAJUR's financial statements are free of material misstatement. We performed tests of KAJUR's compliance with certain provisions of laws, regulations, contracts and grants, 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 our objective and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance that are required to be reported under *Government Auditing Standards*, which are described in the accompanying Schedule of Findings (pages 3 through 16) as items 2000-11 through 2000-14.

Internal Control Over Financial Reporting

In planning the audit, we considered KAJUR's internal control over financial reporting in order to determine the auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect KAJUR's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying Schedule of Findings as items 2000-1 through 2000-10.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider items 2000-2, 2000-3, 2000-4, 2000-6, 2000-7, 2000-8, 2000-9 and 2000-10 to be material weaknesses.

This report is intended solely for the information and use of the Board of Directors and management and is not intended to be, and should not be, used by anyone other than these specified parties.

*Deloitte & Touche*

May 8, 2001

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings  
Year Ended September 30, 2000

Revenue/Receipts

Finding No. 2000-1

Criteria: Billings should be remitted to customers on a timely basis.

Condition: KAJUR does not mail out billings due to the cost of mailing. Additionally, KAJUR printed some of their billings on blank paper.

Cause: The cause of the above condition is the decision of management to stop mailing invoices and to announce the availability of billings for pick-up.

Effect: The effect of the above condition is the lack of assurance that all customers have been notified of amounts owed. Additionally, customer accounts can be misrecorded due to lack of sequential control.

Recommendation: We recommend that billings be mailed to customers on a timely basis. We further recommend that KAJUR generate billings on prenumbered invoices to ensure proper recording of accounts.

Prior Year Status: Untimely remittance of billings to customers was reported as a finding in the audits of KAJUR for the years ended September 30, 1998 and 1999.

Auditee Response and Corrective Action Plan: In November 1999, when the American Samoa Power Authority (ASPA) took over management of KAJUR, issuance of monthly electric billings was late by four months. KAJUR/ASPA immediately focused on bringing billings up to date, and became current with issuance of monthly billings in March 2000. Meters are now read on a timely basis on the twenty-fifth or twenty-seventh day of each month. Billings are prepared and distributed seven days after meters are read, except for September 2000, when we printed the bills in mid-October 2000. This was due to the verification of all residential customers with prepaid debit meters to be removed from the FoxPro billing system.

Billings were printed on blank paper due to the high cost of pre-numbered invoices. In addition, management is planning to phase out the FoxPro billing system due to the many problems with the system.

Monthly billings are hand-delivered to customers rather than mailed. This process is less expensive and the majority of these billings are for commercial customers as the majority of residential customers are on prepaid debit meters.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings, Continued  
Year Ended September 30, 2000

Purchases/Disbursements

Finding No. 2000-2

Criteria: Taxes payable should be remitted on a timely basis.

Condition: KAJUR is currently delinquent with regard to income tax withholding and social security taxes.

Cause: The cause of the above condition is unknown.

Effect: The effect of the above condition is potential interest and penalty charges.

Recommendation: We recommend that KAJUR implement policies and procedures to ensure the timely payment of taxes payable.

Prior Year Status: The delinquency regarding withholding taxes and social security taxes was reported as a finding in the audits of KAJUR for the years ended September 30, 1993 through 1999.

Auditee Response and Corrective Action Plan: KAJUR has installed the payroll module of the MAS90 accounting system. This will record more accurate accounts of what KAJUR owes for income tax withholding and social security taxes. The nonpayment of taxes in a timely manner is due to cash flow problems.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings, Continued  
Year Ended September 30, 2000

External Financial Reporting

Finding No. 2000-3

Criteria: Adequate accounting controls necessitate that all general ledger amounts be properly recorded and reconciled.

Condition: At September 30, 2000, subsidiary ledgers for cash, receivables, inventory and fixed assets were not reconciled to general ledger control totals. Additionally, KAJUR is not reconciling operating subsidies or contributed capital received with the respective granting entities.

Cause: The cause of the above condition is the lack of prescribed policies and procedures.

Effect: The effect of the above condition is the lack of controls over the general ledger system.

Recommendation: We recommend that KAJUR record all transactions and reconcile all general ledger accounts.

Prior Year Status: The lack of reconciliation to general ledger control totals was reported as a finding in the audits of KAJUR for the years ended September 30, 1993 through 1999.

Auditee Response and Corrective Action Plan: KAJUR has implemented in house accounting procedures to improve controls, recording and record keeping of all transactions, and in reconciling subledgers to general ledger accounts on a monthly basis.

Both the new and previous general operating cash accounts were reconciled to the general ledger, with the exception of the Capital Improvement and the Bank of Guam accounts. In fiscal year 2001, the previous cash accounts at Bank of Marshall Islands and Bank of Guam are inactive.

Receivables were not reconciled as the FoxPro and new Suprima systems do not have reports to balance to the general ledger. In fiscal year 2001, KAJUR is keeping track of customer receivables on a spreadsheet, which is very time consuming.

In September 2000, KAJUR started reconciling the inventory system using spreadsheets and kardex cards. Management is planning to account for inventory in the future through the MAS90 module which will integrate with the general ledger.

Also in September 2000, KAJUR started reconciling the fixed asset register, detailing all contributed capital from KADA and RMI.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings, Continued  
Year Ended September 30, 2000

Cash

Finding No. 2000-4

Criteria: All cash accounts should be recorded and bank reconciliations should be performed on a monthly basis and adjusting entries derived should be promptly posted to the general ledger.

Condition: KAJUR did not record a capital improvement fund cash account, nor did it record approximately \$540,000 of transactions from this account during the year ended September 30, 2000. This situation was corrected through proposed adjustments. Additionally, KAJUR did not perform reconciliations of its Bank of Guam checking account and did not record reconciliation adjusting entries. Based on the confirmed bank balance, an adjustment of \$10,202 was proposed to the general ledger balance.

Cause: The cause of the above condition is unknown.

Effect: The effect of the above condition is that cash in bank balances are misstated throughout the year.

Recommendation: We recommend that KAJUR record all cash accounts, perform monthly bank reconciliations and record any derived adjusting entries in a timely manner. The preparer and reviewer should sign and date the bank reconciliation.

Prior Year Status: The lack of timely preparation of bank reconciliations was reported as a finding in the audits of KAJUR for the years ended September 30, 1993 through 1999.

Auditee Response and Corrective Action Plan: KAJUR is implementing written procedures for handling cash, deposits, and monthly reconciliation of bank accounts.

Bank reconciliations are prepared monthly with adjustments derived promptly posted to the general ledger. The preparer and reviewer are now signing and dating the bank reconciliations.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings, Continued  
Year Ended September 30, 2000

Cash

Finding No. 2000-5

Criteria: Cash receipts should be supported by validated deposit slips and be deposited on a timely basis.

Condition: Of twenty-five cash receipts tested for the year ended September 30, 2000, we noted the following:

- For four items (Receipt #s 16540, 16324, 17091 and 18575), validated deposit slips indicated deposit dates of three to six business days after receipt;
- For four items (Receipt #s 15989, 16047, 16163 and 16251), cash receipts were not supported by validated deposit slips. We were able to agree the cash receipts to bank statement deposits;
- One item for \$5,947, listed as deposit in transit on the September 30, 2000 bank reconciliation, was not deposited until October 11, 2000.

Cause: The cause of cash receipts not being deposited on a timely basis is the lack of prescribed policies and procedures for ensuring timely deposits of receipts. The cause of the missing validated deposit slip is unknown.

Effect: The effect of the above condition is weak control over cash and the potential for misappropriation of cash.

Recommendation: We recommend that KAJUR develop and maintain procedures to ensure that all cash receipts are deposited properly and intact, and are supported by a cashier's report and validated deposit slip.

Prior Year Status: The lack of prescribed policies and procedures related to cash collection was reported as a finding in the audits of KAJUR for the years ended September 30, 1997 through 1999.

Auditee Response and Corrective Action Plan: KAJUR has implemented standard operating procedures for handling daily cash and deposits. Cash collections not immediately deposited are locked in a security safe in the customer service office. All bank deposits are made the following business day.

The one deposit in transit for \$5,947 was a Raytheon payroll allotment check. KAJUR received a faxed copy of the Raytheon employee allotment list in September 2000, which was used to issue tokens to customers. The actual funds were not direct deposited to KAJUR's account on time. Procedures to handle payroll allotments from customers have been implemented. Tokens will be issued to customers only if funds from their employer have been received by KAJUR.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings, Continued  
Year Ended September 30, 2000

Receivables

Finding No. 2000-6

Criteria: Receivable subledger balances should be reconciled to the general ledger on a monthly basis. Aged subledger balances should be evaluated periodically to determine an appropriate allowance for doubtful accounts or whether write-off is appropriate.

Condition: Our testing of KAJUR's receivables determined the following:

- KAJUR's utility receivable subledger balance did not agree with the general ledger by \$100,787 at September 30, 2000. This situation was corrected through a proposed adjustment.
- KAJUR's utility receivable subledger is not aged and KAJUR has not adjusted its allowance for doubtful accounts from the prior year balance. Subsequent receipts related to KAJUR's net utility receivable balance at September 30, 2000 of \$743,069 amounted to \$14,487, indicating receivables are overstated.
- KAJUR's receivables include \$109,336 of receivables from federal agencies which has not been collected for three years.

Cause: The cause of the above condition is the lack of policies and procedures requiring reconciliation of subledger balances to the general ledger, or the periodic review of receivable balances to determine an appropriate allowance for doubtful accounts.

Effect: The effect of the above condition is that receivables are materially overstated.

Recommendation: We recommend that KAJUR reconcile receivable subledger balances to the general ledger on a monthly basis and evaluate receivables periodically to determine an appropriate allowance for doubtful accounts.

Prior Year Status: The lack of reconciliation of receivable subledger balances to the general ledger and the lack of evaluation of receivables to determine an appropriate allowance for doubtful accounts was reported as a finding in the audit of KAJUR for the years ended September 30, 1993 through 1999.

Auditee Response and Corrective Action Plan: KAJUR is currently implementing policies and procedures to reconcile the subledger to the general ledger on a monthly basis. KAJUR is currently reconciling all individual customers account balances. At the present time, KAJUR is keeping track of customer balances using a spreadsheet.

In May 2001, KAJUR did a survey of all active meters and identified accounts which can not be collected due to deceased customers or customers who have moved out of Ebeye. Adjustments for uncollectible accounts will be reflected in the fiscal year 2001 financial statements.

Receivables from federal agencies will be written-off in fiscal year 2001. Due to poor filing of records of the previous management, we could not find documents related to the \$109,336 in receivables.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings, Continued  
Year Ended September 30, 2000

Inventory

Finding No. 2000-7

Criteria: Proper control over supplies inventory necessitates adequate procedures to accurately account for all supplies inventory. Final inventory summaries should reflect the number of items counted during inventory count procedures as of balance sheet date.

Condition: Supplies inventory were not organized and labeled to ensure an accurate count of the inventory items at September 30, 2000. Our verification of items on hand revealed three out of six items counted did not agree to the final inventory listing.

Cause: The cause of the above condition is a lack of prescribed policies and procedures to accurately count inventory and record inventory withdrawals.

Effect: The effect of the above condition is weak control over supplies inventory.

Recommendation: We recommend that KAJUR establish proper physical control over supplies inventory by designating a work area to store supplies. Additionally, inventory items should be organized and properly labeled to ensure an accurate physical count. Final inventory listings should reflect the quantity of items counted at balance sheet date.

Prior Year Status: The lack of physical controls over inventory was reported as a finding in the audits of KAJUR for the years ended September 30, 1993 through 1999.

Auditee Response and Corrective Action Plan: KAJUR has taken the necessary steps to count and cost present inventory items on hand for power generation, transmission and distribution in fiscal year 2001. KAJUR has ordered and received a Inventory Receivable Report and Issue Ticket Forms for use in the control of inventory. Kardex cards for each inventory item are in place. All inventory items at the Transmission and Distribution shop will be moved to the power plant so that the one person handling inventory will be receiving and issuing parts from one location.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings, Continued  
Year Ended September 30, 2000

Fixed Assets

Finding No. 2000-8

Criteria: Adequate presentation and control of fixed assets is essential in preparing fairly presented financial statements. Additionally, unless all fixed assets are recorded, depreciation, used in rate settings, will be understated.

Condition: KAJUR has not taken a physical inventory of fixed assets during the year ended September 30, 2000. Additionally, KAJUR was not able to reconcile fixed assets with contributed capital. This situation was corrected through a proposed adjustment.

Cause: The cause of the above condition is that no physical inventory of fixed assets has been required by management.

Effect: The effect of the above condition is that fixed assets and depreciation expense may be misstated. Additionally, a serious weakness in control exists over the safeguarding of fixed assets.

Recommendation: We recommend that KAJUR perform a physical inventory of all fixed assets on hand, agree the count with existing records and make necessary adjustments. Contributed fixed assets should be credited to contributions. Additionally, we recommend that KAJUR implement a system of tagging fixed assets and perform periodic counts to ensure existence.

Prior Year Status: The lack of physical control over fixed assets was reported as a finding in the audits of KAJUR for the years ended September 30, 1993 through 1999.

Auditee Response and Corrective Action Plan: Fixed asset registers are in place for all major contributed assets from KADA and RepMar. A count of all other miscellaneous assets has been performed, however, they were not included in the fixed asset register on September 30, 2000 because their original value were not available. KAJUR is still working at identifying and valuing the rest of the equipment.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings, Continued  
Year Ended September 30, 2000

Payables and Accrued Liabilities

Finding No. 2000-9

Criteria: Accounts payable subsidiary ledgers should be reviewed periodically to determine propriety.

Condition: Our testing of KAJUR's accounts payable subsidiary ledger noted the following:

- One account was recorded twice;
- Amounts were recorded for ASPA's management fee which is a liability of RepMar;
- One account was recorded in Singapore dollars;
- Amounts were included for ADB projects which had already been paid from an unrecorded cash account;
- Liabilities were recorded to RepMar for withholding tax, and to MISSA for social security tax. These liabilities were incurred prior to the management contract between RepMar and ASPA. The management contract transferred these liabilities to RepMar.

Cause: The cause of the above condition is unknown.

Effect: The effect of the above condition is the misstatement of accounts payable.

Recommendation: We recommend that KAJUR review its accounts payable subsidiary ledger periodically to determine propriety.

Auditee Response and Corrective Action Plan: Duplicate entries to the accounts payable system occurred because of poor maintenance of files. A misunderstanding of the liability for the management contract fees caused the error in accrued fees. These misstatements of accounts payable were corrected. All fees for the management contract for fiscal year 2001 have also been reversed. The Accountant is currently checking and reviewing accounts payable on a monthly basis.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings, Continued  
Year Ended September 30, 2000

Payables and Accrued Liabilities

Finding No. 2000-10

Criteria: Employee allotments payable should be remitted on a timely basis.

Condition: KAJUR is currently delinquent with regards to employee allotments withheld related to employees' life insurance, medical insurance, loans, and miscellaneous payments.

Cause: The cause of the above condition is unknown.

Effect: The effect of the above condition is the potential exposure and risk of loss related to unpaid employees' insurance and loans.

Recommendation: We recommend that KAJUR implement policies and procedures to ensure the timely payment of employee allotments withheld.

Auditee Response and Corrective Action Plan: Cash flow is the main reason for not paying employee allotments on a timely basis.

Because KAJUR was not paying employee allotments on a timely manner, some employees might have default policies. KAJUR has asked all insurance companies with whom KAJUR employees have policies to provide KAJUR the status of its policies. Management plans to withhold allotments for employees with inactive/cancelled policies and offset the amount with arrears owed to KAJUR. Allotments for employees who don't have outstanding balances owed to KAJUR will be paid when funds are available.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings, Continued  
Year Ended September 30, 2000

Local Noncompliance

Finding No. 2000-11

Criteria: Section 5 of the Republic of the Marshall Islands (RepMar) Income Tax Act of 1989, as amended, states that the employer shall, once every four weeks or thirteen times per year, pay taxes withheld under Section 4 of the Act.

Condition: KAJUR is currently delinquent with regards to income tax withholdings from employee wages to be remitted to RepMar during the year ended September 30, 2000.

Cause: The cause of the above condition is unknown.

Effect: The effect of the above condition is noncompliance with the Income Tax Act of 1989, as amended.

Recommendation: We recommend that management comply with the Income Tax Act of 1989, as amended.

Prior Year Status: Noncompliance with the Income Tax Act of 1989, as amended was reported as a finding in the audits of KAJUR for the years ended September 30, 1998 and 1999.

Auditee Response and Corrective Action Plan: Cash flow is the main reason for not paying taxes in a timely manner. KAJUR is trying to improve it's collections on customers in arrears to pay these liabilities.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings, Continued  
Year Ended September 30, 2000

Local Noncompliance

Finding No. 2000-12

Criteria: Sections 131 and 215 of the RepMar Social Security Act of 1990 and the Social Security Health Fund Act of 1991, respectively, state that no later than the tenth day after the end of each quarter, every employer shall submit to the Social Security Administrator a report of the wages and salaries paid by the employer, and the contributions due from the employer, under Sections 129 and 130, and 213 and 214, respectively, and pay into the Fund the contributions due.

Condition: KAJUR is currently delinquent with regards to remitting to the Marshall Islands Social Security Administration (MISSA) employer and employee contributions during the year ended September 30, 2000.

Cause: The cause of the above condition is unknown.

Effect: The effect of the above condition is noncompliance with the Social Security Act of 1990 and the Social Security Health Fund Act of 1991.

Recommendation: We recommend that management comply with the Social Security Act of 1990 and the Social Security Health Fund Act of 1991.

Prior Year Status: Noncompliance with the Social Security Act of 1990 and the Social Security Health Fund Act of 1991 was reported as a finding in the audits of KAJUR for the years ended September 30, 1998 and 1999.

Auditee Response and Corrective Action Plan: Cash flow is the main reason for not paying employees and employer contributions during the year ended September 30, 2000.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings, Continued  
Year Ended September 30, 2000

Local Noncompliance

Finding No. 2000-13

Criteria: Section 14.3 and appendix N of the management contract states that the management contractor is required to maintain liability insurance for general liability, workers compensation, property and casualty.

Condition: KAJUR is currently not maintaining insurance against liability and other risks as required in the management contract.

Cause: The cause of the above condition is unknown.

Effect: The effect of the above condition is noncompliance with the management contract.

Recommendation: We recommend that management comply with the provisions stated in the management contract.

Auditee Response and Corrective Action Plan: Management is working on obtaining an insurance policy for general liability, workers compensation, property and casualty.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings, Continued  
Year Ended September 30, 2000

Local Noncompliance

Finding No. 2000-14

Criteria: The management contract between RepMar, KADA and the American Samoa Power Authority (ASPA) requires the management contractor to have an operating cash flow budget for KAJUR's operations.

Condition: KAJUR did not have an operating cash flow budget in place for KAJUR's operations during the year ended September 30, 2000.

Cause: The cause of the above condition is unknown.

Effect: The effect of the above condition is noncompliance with the management contract.

Recommendation: We recommend that management comply with the provisions as set forth in the management contract.

Auditee Response and Corrective Action Plan: KAJUR has an operating cash flow budget for operations for fiscal year 2001.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings, Continued  
Year Ended September 30, 2000

Unresolved Prior Year Findings

The status of unresolved prior year findings is disclosed within the Schedule of Findings section of this report (pages 3 through 16).