

MAJURO WATER AND SEWER COMPANY, 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 AUDIT PERFORMED IN ACCORDANCE
WITH GOVERNMENT AUDITING STANDARDS

Board of Directors
Majuro Water and Sewer Company, Inc.:

We have audited the financial statements of Majuro Water and Sewer Company, Inc. (MWSC) as of and for the year ended September 30, 2000, and have issued our report thereon dated January 19, 2001. 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.

Compliance

As part of obtaining reasonable assurance about whether MWSC's financial statements are free of material misstatement, we performed tests of its 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 an objective of our audit 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 8) as items 2000-4 through 2000-6.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered MWSC's internal control over financial reporting in order to determine our 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 MWSC'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 2000-3.

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 item 2000-3 to be a material weakness. We also noted other matters involving the internal control over financial reporting which we have reported to management of MWSC in a separate letter dated January 19, 2001.

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

January 19, 2001

MAJURO WATER AND SEWER COMPANY, INC.

Schedule of Findings
Year Ended September 30, 2000

Purchases/Disbursements

Finding No. 2000-1

Criteria: Utilities should be insured by adequate general liability insurance in the event of accidents.

Condition: MWSC does not have an insurance policy with respect to general liability insurance.

Cause: The cause of the above condition is unknown.

Effect: The effect of the above condition is the possibility of substantial losses in the event of accidents.

Recommendation: We recommend that the management of MWSC consider obtaining general liability insurance.

Prior Year Status: The lack of general liability insurance was reported as a finding in the audits of MWSC for fiscal years 1994 through 1999.

Auditee Response and Corrective Action Plan: We agree with the finding. As MWSC is 100% wholly owned by the RMI government, we have opted to be self-insured.

MAJURO WATER AND SEWER COMPANY, INC.

Schedule of Findings, Continued
Year Ended September 30, 2000

Computer Processing

Finding No. 2000-2

Criteria: Provision of relevant and reliable information to management to aid in controlling business operations is directly dependent on the proper and timely recording of transactions in the general ledger.

Condition: During the year ended September 30, 2000, MWSC's computer system was upgraded to be Y2K compliant. In the process, historical general ledger information was lost and was subsequently re-input into the system. Transactions were posted several times and were not completely or properly corrected to appropriate income statement accounts.

Cause: The cause of the above condition is the lack of review by management of entries made to restore the general ledger after the loss of historical information.

Effect: The effect of the above condition is the misstatement of income statement accounts, which were corrected by proposed audit adjustments.

Recommendation: We recommend that management ensure that non-systematic transactions be closely reviewed for accuracy and propriety before posting to the general ledger.

Auditee Response and Corrective Action Plan: We agree with the finding. The problem was caused by upgrading of the accounting software. The responsibility for journal entries will be that of the Chief Financial Officer while training of the accounting staff takes place in the use of the upgraded accounting software.

MAJURO WATER AND SEWER COMPANY, INC.

Schedule of Findings, Continued
Year Ended September 30, 2000

Payables and Accrued Liabilities

Finding No. 2000-3

Criteria: The accrual basis of accounting requires that expenses be recorded when incurred.

Condition: At September 30, 2000, MWSC did not record interest payable in the general ledger or related interest expense. Audit adjustments were proposed to record \$569,974 for interest expense and interest payable. Additionally, accrued payroll of \$17,873 was not recorded in the current year and an audit adjustment of \$17,873 was proposed to adjust the underaccrual.

Cause: The cause of the above condition is the lack of reconciliation of accrued liability accounts to ensure that expenses are recorded in the correct fiscal year.

Effect: The effect of the above condition is the understatement of expenses and liabilities.

Recommendation: We recommend that management ensure that the accounting department review accrued liability accounts and record accruals at fiscal year end.

Prior Year Status: The lack of reconciliation of accrued liability accounts to ensure that expenses are recorded in the correct fiscal year was reported as a finding in the audits of MWSC for fiscal years 1996 through 1999.

Auditee Response and Corrective Action Plan: We agree with the finding. Authority for the day-to-day running of the accounting department has been given to the Chief Financial Controller until such time as the employees fully understand and comply with Company procedures.

MAJURO WATER AND SEWER COMPANY, INC.

Schedule of Findings, Continued
Year Ended September 30, 2000

Local Noncompliance

Finding No. 2000-4

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: At September 30, 2000, MWSC owed RepMar \$206,160 in income tax withholdings from employee wages. This amount is represented by income tax withheld from employee wages for the periods October 17, 1993 through July 15, 1994; January 1, 1995 through May 27, 1995; and March 30, 1997 through September 22, 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 and the incurrence of interest and penalties totaling \$8,383 for the year ended September 30, 2000.

Recommendation: We recommend that the management of MWSC 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 MWSC for fiscal years 1996 through 1999.

Auditee Response and Corrective Action Plan: We agree with the finding. Due to financial constraints, which was advised to the Board of Directors in prior years, MWSC is unable to meet its outstanding obligations.

MAJURO WATER AND SEWER COMPANY, INC.

Schedule of Findings, Continued
Year Ended September 30, 2000

Local Noncompliance

Finding No. 2000-5

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, and the contributions due, under Sections 129 and 130, and 213 and 214, respectively, and pay into the Fund the contributions due.

Condition: At September 30, 2000, MWSC owed the Marshall Islands Social Security Administration \$409,881 in employer and employee contributions, of which \$50,000 was paid on October 9, 2000. This amount includes the first and fourth quarters for fiscal year 2000 (\$37,515); four quarters for fiscal year 1999 (\$80,271); four quarters for fiscal year 1998 (\$114,454); the last three quarters for fiscal year 1997 (\$76,575); and the quarterly reports for March 1994, June 1994, September 1994, December 1994 and September 1996 (\$101,066). The \$50,000 payment made on October 9, 2000 was applied to MWSC's employer and employee contributions for the quarters ended March 1994, June 1994 and September 1994.

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 MWSC for fiscal years 1996 through 1999.

Auditee Response and Corrective Action Plan: We agree with the finding. Due to financial constraints, which was advised to the Board of Directors in prior years, MWSC is unable to meet its outstanding obligations.

MAJURO WATER AND SEWER COMPANY, INC.

Schedule of Findings, Continued
Year Ended September 30, 2000

Local Noncompliance

Finding No. 2000-6

Criteria: Section 4.1 of the subsidiary loan agreements between the Government of the Republic of the Marshall Islands (RepMar) and MWSC states that MWSC shall pay to RepMar interest at the rate of 6.64% and 6.9% on the principal sums withdrawn and outstanding on its two subsidiary loan agreements. Furthermore, this interest is payable on May 15 and November 15 in each year for Loan #1 and March 1 and September 1 in each year for Loan #2.

Condition: At September 30, 2000, MWSC has not made any payments to RepMar for interest on the principal sums withdrawn and outstanding.

Cause: The cause of the above condition is unknown.

Effect: The effect of the above condition is noncompliance with respect to Section 4 of the respective subsidiary loan agreements.

Recommendation: We recommend that the management of MWSC comply with the subsidiary loan agreements between RepMar and MWSC.

Prior Year Status: Noncompliance with respect to Section 4 of the subsidiary loan agreement was reported as a finding in the audits of MWSC for fiscal years 1996 through 1999.

Auditee Response and Corrective Action Plan: Under the terms of the loan and subsidiary loan agreements, payment is due upon receipt of an invoice from the Ministry of Finance. No invoice has been issued and received as yet by MWSC. In addition, the Cabinet of RepMar has initiated the write-off of the two subsidiary loan agreements with the Asian Development Bank.

MAJURO WATER AND SEWER COMPANY, INC.

Unresolved Prior Year Findings
Year Ended September 30, 2000

Unresolved Prior Year Comments

The status of unresolved prior year findings are disclosed within the Schedule of Findings section of this report (pages 3 through 8).