

MAJURO WATER AND SEWER COMPANY, INC.

INDEPENDENT AUDITORS' REPORT ON
INTERNAL CONTROL AND ON COMPLIANCE

YEAR ENDED SEPTEMBER 30, 2001

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, 2001, and have issued our report thereon dated January 11, 2002. 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 6) as items 2001-2 through 2001-4.

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 one matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. 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. The reportable condition is described in the accompanying Schedule of Findings as item 2001-1.

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, we consider the reportable condition described above to be a material weakness. We also noted other matters involving the internal control over financial reporting, which we have reported to the management of MWSC in a separate letter dated January 11, 2002.

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 11, 2002

MAJURO WATER AND SEWER COMPANY, INC.

Schedule of Findings
Year Ended September 30, 2001

Purchases/Disbursements

Finding No. 2001-1

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

Condition: As of September 30, 2001, 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 management consider obtaining general liability insurance.

Prior Year Status: The lack of adequate insurance coverage was reported as a finding in the audits of MWSC for fiscal years 1994 through 2000.

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, 2001

Local Noncompliance

Finding No. 2001-2

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, 2001, MWSC owed RepMar \$225,064 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; March 30, 1997 through December 17, 1999; June 3, 2000 through December 15, 2000; and July 15, 2001 through September 30, 2001.

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 MWSC for fiscal years 1996 through 2000.

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, 2001

Local Noncompliance

Finding No. 2001-3

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, 2001, MWSC owed the Marshall Islands Social Security Administration \$364,756 in employer and employee contributions. This amount includes \$337,540 pertaining to three quarterly returns for fiscal year 1999; four quarterly returns for fiscal year 1998; three quarterly returns for fiscal year 1997; one quarterly return for fiscal year 1996; one quarterly return for fiscal year 1995; and three quarterly returns for fiscal year 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 2000.

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. MWSC has entered into an informal agreement with the Marshall Islands Social Security Administration where monthly payments are being made to reduce the amounts owed.

MAJURO WATER AND SEWER COMPANY, INC.

Schedule of Findings, Continued
Year Ended September 30, 2001

Local Noncompliance

Finding No. 2001-4

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, 2001, 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 Section 4 of the respective subsidiary loan agreements.

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

Prior Year Status: Noncompliance with Section 4 of the subsidiary loan agreements was reported as a finding in the audits of MWSC for fiscal years 1996 through 2000.

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-offs 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, 2001

The status of unresolved prior year findings are disclosed within the Schedule of Findings section of this report (pages 3 through 6).