

October 14, 2021

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, 2020 (on which we have issued our report dated October 14, 2021) 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, certain deficiencies related to MWSC's internal control over financial reporting and other matters as of September 30, 2020 that we wish to bring to your attention.

We have also issued a separate report to the Board of Directors, also dated October 14, 2021, 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.

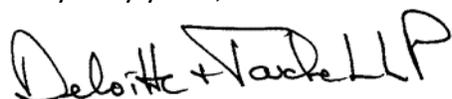
A description of the responsibility of management for establishing and maintaining internal control over financial reporting and of the objectives of and inherent limitations of internal control over financial reporting, is set forth in the attached Appendix II and should be read in conjunction with 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,



SECTION I - DEFICIENCIES

We identified, and have included below, certain deficiencies involving MWSC's internal control over financial reporting as of September 30, 2020 that we wish to bring to your attention:

1) Revenues - Customer Master File Update

Five customer accounts were tagged as "ACTB" (Active and Billable) yet were not completely billed during the year. Either water meters had technical issues or readings did not occur. We recommend management timely revisit and improve internal controls over the review of water meters, water readings, and invoicing of gallons delivered to/used by customers. This matter was discussed in our previous letters to management for fiscal years 2016 through 2019.

2) Debit Accounts Payable Balances

At September 30, 2020, MWSC recorded three debit payable balances aggregating \$7,990, which pertain to vendor overpayments. As the amount was not considered material to the financial statements, no audit adjustment was proposed. We recommend management revisit payable accounts with debit balances and assess whether such be alternatively recognized. This matter was discussed in our previous letters to management for fiscal years 2018 and 2019.

3) Credit Accounts Receivable Balances

At September 30, 2020, MWSC recorded 392 customer utility accounts with credit balances aggregating \$74,409, which pertain to customer utility billing overpayments. As the amount was not considered material to the financial statements, no audit adjustment was proposed. We recommend management revisit customer utility accounts with credit balances and assess whether such be recognized as revenue. This matter was discussed in our previous letters to management for fiscal years 2018 and 2019.

4) Capital Assets

MWSC's capital asset policy requires that assets with acquisition costs of \$500 and above be capitalized and be depreciated based on estimated useful lives; however, office equipment with a cost of \$1,595 met the capitalization policy criteria and was not capitalized. In addition, import taxes and shipping costs aggregating \$35,295 associated with the acquisition of a dump truck were not capitalized. An audit adjustment was proposed to correct this misstatement. We recommend management establish internal control policies and procedures requiring compliance with MWSC's capitalization policy, including the capitalization of costs directly related to placing assets into service. This matter was discussed in our previous letters to management for fiscal years 2016 through 2019.

5) Financial Reporting

MWSC did not close fiscal year September 30, 2020 financial information (trial balance and subsidiary ledgers) until February 8, 2021. Additionally, during the year ended September 30, 2020, various accounting records do not appear to have been timely processed and updated including, but not limited to the following:

<u>Account Name</u>	<u>Sub Ledger</u>	<u>General Ledger</u>	<u>Difference</u>
Inventory	\$ 764,788	\$ 673,431	\$ 91,357
Fixed Assets	\$ 1,346,596	\$ 1,431,764	\$ (85,168)
Revenue	\$ 933,809	\$ 975,572	\$ (41,763)

We recommend management establish internal control policies and procedures to facilitate timely general ledger and subsidiary ledger reconciliation processes.

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) Local Noncompliance - Income Tax Act

MWSC filed and paid income taxes withheld for the year ended September 30, 2020 in a manner inconsistent with the Income Tax Act of 1989, specifically, withholding taxes of \$42,332 were not timely remitted. We recommend management establish internal control policies and procedures requiring compliance with the Income Tax Act. This matter was discussed in our previous letters to management for fiscal years 2016 through 2019.

2) Local Noncompliance - RMI Procurement Code

The following purchases were not adequately documented to evidence compliance with applicable procurement requirements set forth in the RMI Procurement Code:

- a. Check # 23613: Purchase of a \$1,595 sofa set.
- b. Check # 24943: Purchase of \$1,908 of vehicle insurance.

We recommend management require that documentation be adequate to comply with applicable procurement requirements. Specifically, documentation should indicate the history of procurement, including the rationale for contractor or vendor selection. This matter was discussed in our previous letters to management for fiscal years 2018 and 2019.

3) Local Noncompliance - Social Security Act and the Social Security Health Fund Act

MWSC filed and paid employer and employee contributions withheld for the year ended September 30, 2019 in a manner inconsistent with the Social Security Act and the Social Security Health Fund Act. Specifically, social security contributions for the following quarters were not timely remitted:

<u>Quarter Ended</u>	<u>Amount Owed</u>	<u>Due Date</u>	<u>Date Filed</u>	<u>Date Paid</u>
December 31, 2019	\$ 35,463	01/10/2020	01/13/2020	03/31/2020
March 31, 2020	\$ 31,366	04/10/2020	03/31/2020	05/06/2020
June 30, 2020	\$ 35,609	07/10/2020	07/06/2020	09/15/2020
September 30, 2020	\$ 30,844	10/10/2020	10/09/2020	02/25/2021

We recommend management establish internal control policies and procedures requiring compliance with the Social Security Act and the Social Security Health Fund Act. This matter was discussed in our previous letters to management for fiscal years 2016 through 2019.

4) Collection of Utility Receivables

During the year ended September 30, 2020, water utility receivables increased from \$2,126,732 to \$2,295,198 for which a corresponding allowance for uncollectible accounts of \$2,225,196 as of September 30, 2020 was recognized. Furthermore, the September 30, 2020 receivable aging indicated that customer water accounts with balances greater than 90 days represent 97% of the total receivable balance. We recommend management reassess collectability of receivables and adopt appropriate internal control policies over collections. Furthermore, we recommend management continue to review the subsidiary ledger to determine uncollectible accounts to be written-off and to obtain requisite Board approval. Finally, we recommend management continue its efforts to improve receivable collections. This matter was discussed in our previous letters to management for fiscal years 2007 through 2019.

SECTION II - OTHER MATTERS, CONTINUED5) Disconnection of Non-paying Customers

Of 66 customer utility accounts tested, 5 pertain to users of fresh water and salt and sewer meters, having balances of more than \$150 and which have been unpaid for over 90 days. These accounts were not disconnected at September 30, 2020 despite the outstanding balances and insufficient subsequent collections from October 2020 to December 2020. The current MWSC disconnection policy is to disconnect nonpaying customers with balances 30 days overdue that exceed \$150. We recommend management enforce procedures compliant with this policy. This matter was discussed in our previous letters to management for the audits of fiscal years 2007 through 2019.

6) Meter Status

Based on examination of the billing system usage history from October 2019 to September 2020, we noted 32 of 43 active sewer and saltwater customers. Per inquiry with MWSC management, Active/Disconnected status in the billing system pertains only to Freshwater services. Thus, customers may still be obtaining freshwater services despite only being billed for sewer and saltwater service at a fixed rate of \$12 a month. We recommend performing annual surveys of households to detect illegal connections and to update the meter status of each customer. Further, we recommend to separately provide the status in the billing system according to the type of services (Sewer and salt or Freshwater services).

7) Retirement Savings Plan

Taxes are currently not withheld on MWSC's matching of employee contributions to the retirement plan. We recommend that management require applicable taxes be withheld on employer matching of retirement plan contributions and be remitted to taxing authorities. Taxing of employer contributions to the retirement savings plan was discussed in our previous letters to management for fiscal years 2018 and 2019.

8) Board Sitting Fees

During the year ended September 30, 2020, MWSC paid sitting fees of \$7,000 to Board members. These fees may constitute wages under the Income Tax Act 1989 and thus be subject to withholding taxes. No withholding taxes were withheld by MWSC. We recommend management obtain an interpretation from the Ministry of Finance, Banking and Postal Services Chief of Revenue and Taxation concerning the applicability of withholding taxes on sitting fees paid to Board members. Applicability of Board sitting fees being subject to withholding taxes was discussed in our previous letter to management for fiscal year 2019.

9) Non-Revenue Water

We compared water usage against water produced from 2017 to 2020 with the difference representing unbilled water revenues, which may be the result of water leakage, illegal connections and mechanical issues on the pipeline. Details are as follows:

<u>Fiscal Year</u>	<u>Water Produced</u> (In Gallons)	<u>Water Usage</u> (In Gallons)	<u>Non-Revenue</u> (In Gallons)	<u>Loss Rate</u>
2017	123,911,300	73,262,192	50,649,108	41%
2018	101,635,822	58,461,739	43,174,083	42%
2019	116,094,956	62,387,417	53,707,539	46%
2020	121,008,753	51,431,154	69,577,599	57%

We recommend management improve water usage by implementing existing water efficiency programs in conjunction with facility upgrades. This matter was discussed in our previous letters to management for the audits of fiscal years 2017 through 2019.

SECTION II - OTHER MATTERS, CONTINUED

10) Minutes of Board Meetings

Board minutes of meetings held during the year ended September 30, 2020 were not available for inspection. We recommend that minutes of Board meetings be formally documented by the Secretary and approved by the Board of Directors.

11) Prepayments

During the year ended September 30, 2020, we noted prepayments to local vendors for materials and supplies to be used in the subsequent period amounting to \$5,228. Section 146 (Subsection 1) of the Financial Management Act of 1990 states that for vendors located in the Republic of Marshall Islands, checks for bills of materials, supplies and incidentals of every kind and character, shall be made payable to the order of each individual person to whom the Republic is indebted, except for assignment of monies approved by the Secretary of Finance per Section 148 of the same Act, but only after an invoice and purchase order have been presented and certified that the materials, supplies, and incidentals have been received. MWSC appears non-compliant with the Act as the transaction does not represent payment of indebtedness. We recommend management comply with the Financial Management Act.

SECTION III - DEFINITIONS

The definition of a deficiency is as follows:

A *deficiency* in internal control over financial reporting 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 authority 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.