

**KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.**

**(A COMPONENT UNIT OF THE  
REPUBLIC OF THE MARSHALL ISLANDS)**

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**FINANCIAL STATEMENTS  
AND  
INDEPENDENT AUDITORS' REPORT**

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**YEARS ENDED SEPTEMBER 30, 2016 and 2015**

**KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.**

Years Ended September 30, 2016 and 2015  
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## **INDEPENDENT AUDITORS' REPORT**

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

### **Report on the Financial Statements**

We have audited the accompanying financial statements of Kwajalein Atoll Joint Utilities Resources, Inc. (KAJUR), a component unit of the Republic of the Marshall Islands, which comprise the statements of net position as of September 30, 2016 and 2015, and the related statements of revenues, expenses and changes in net position and of cash flows for the years then ended, and the related notes to the financial statements.

### ***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditors' Responsibility***

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## **Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of KAJUR as of September 30, 2016 and 2015, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

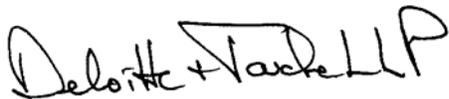
## **Other Matters**

### *Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 to 10 be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

## **Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated April 10, 2017, on our consideration of KAJUR'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 purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering KAJUR's internal control over financial reporting and compliance.



April 10, 2017

## **KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.**

Management's Discussion and Analysis  
Years Ended September 30, 2016 and 2015

The Kwajalein Atoll Joint Utilities Resources (KAJUR) was incorporated under the laws of the Republic of the Marshall Islands in September 1990. KAJUR was originally established as a private entity governed by the Kwajalein Atoll Development Authority (KADA) Board of Directors. In October 1999, RepMar and KADA awarded a two-year management contract to the American Samoa Power Authority (ASPA) to assume operational control of KAJUR. This management contract was extended for an additional two years and in April of 2003, ASPA's contract expired.

In May of 2006, the RMI Cabinet officially approved the transfer of all management responsibilities for KAJUR to the RMI Combined Utility Board of Directors as a component unit of RepMar. KAJUR is currently the sole provider of electricity, potable water and sanitation services for the community of Ebeye, which also include Gugeegue and smaller island communities connected to Ebeye by the causeway. At the closing of FY 2016, KAJUR has under its employment a total of eighty-five (85) employees manning all three functional elements of its operational structure.

### **FINANCIAL HIGHLIGHTS**

In spite of its continuing operational challenges, KAJUR continues to build on sustained improvements in fiscal performance and service delivery to the community as noted in its most recent audits. Even with deteriorated infrastructure and a relatively under-skilled local workforce managing all three of its major operational components (power, water, and sanitation), it is comforting to recognize that the community of Ebeye experienced no major disruption in service from all three service areas throughout this period. For five consecutive years, and with support from RMI and US governments, KAJUR was able to provide services to the community without any major breakdown. Starting in 2015, KAJUR started utilizing TenderLink®, an electronic tendering system, in an on-going effort toward full compliance existing RMI Procurement Code. KAJUR is continuously working with the central government towards a paperless tendering, procurement, and inventory system. All internal processes involving off-island procurement are now paperless, while on-island procurement is partially paperless. More local vendors are registering in TenderLink®, assisting KAJUR achieve its goal of a less time consuming and a fairer procurement, supply, and accounting system.

KAJUR continues to face many operational challenges. These continuing challenges will require some major changes in business practices through policy development and implementation as well as upgrades in technical skills and leadership. KAJUR will continue its current practice of monitoring its day to day operations and identify areas where operational improvements can be achieved with its existing resources while we wait for major system upgrades under the Ebeye Water Supply and Sanitation Project (EWSSP).

### **FINANCIAL ANALYSIS OF KAJUR**

The Statement of Net Position and the Statement of Revenues, Expenses and Changes in Net Position provide an indication of KAJUR's financial condition. KAJUR's net position reflects the difference between assets and liabilities. An increase in net position over time typically indicates an improvement in financial condition.

**KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.**

Management's Discussion and Analysis, Continued  
Years Ended September 30, 2016 and 2015

A summary of KAJUR's Statements of Net Position are presented below:

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Assets:			
Current and other assets	\$ 1,832,658	\$ 1,816,568	\$ 1,663,621
Capital assets	<u>1,913,316</u>	<u>2,000,780</u>	<u>2,127,727</u>
Total assets	<u>\$ 3,745,974</u>	<u>\$ 3,817,348</u>	<u>\$ 3,791,348</u>
Liabilities:			
Current liabilities	<u>\$ 2,602,142</u>	<u>\$ 2,517,617</u>	<u>\$ 2,967,807</u>
Total liabilities	<u>\$ 2,602,142</u>	<u>\$ 2,517,617</u>	<u>\$ 2,967,807</u>
Net Position:			
Investment in capital assets	\$ 1,913,316	\$ 2,000,780	\$ 2,127,727
Restricted	50,000	-	-
Unrestricted	<u>(819,484)</u>	<u>(701,049)</u>	<u>(1,304,186)</u>
Total net position	<u>\$ 1,143,832</u>	<u>\$ 1,299,731</u>	<u>\$ 823,541</u>

As indicated above, KAJUR's capital assets decreased by \$87,464 in FY 2016 as KAJUR's capital assets continued to lose value over time, while no major investment in capital assets was made during this period. On the other hand, other assets increased by \$16,090 with some investments in equipment and spare parts. Overall, there was a decrease of \$71,374 in KAJUR's total assets for FY 2016.

By the closing of FY 2016, KAJUR's current liabilities stood at \$2,602,142 due in great part to diesel fuel received on credit from the Marshalls Energy Company (MEC) throughout this period. This existing liability with MEC is the only major liability KAJUR incurred during this period after its long outstanding balance with MISSA was paid off in April 2014. As in the previous year, KAJUR continued to hold good credit standing with all its local vendors and service providers, as well as its off-island suppliers.

The RMI government continues to allocate funds from the U.S. Compact of Free Association to support KAJUR's power plant operations and other utility services. Consequently, KAJUR is able to meet fuel requirements for power generation and spare parts for its water and sanitation services while continuing to maintain tariff rates at levels that are well below cost, and therefore affordable to the Ebeye Community.

**KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.**

Management's Discussion and Analysis, Continued  
Years Ended September 30, 2016 and 2015

A comparative summary of KAJUR's Statements of Revenues, Expenses, and Changes in Net Position is presented below:

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Revenues:			
Net operating revenues	\$ 4,095,208	\$ 4,086,044	\$ 4,741,284
Non-operating revenues	<u>1,377,860</u>	<u>2,629,764</u>	<u>1,800,000</u>
Total revenues	<u>5,473,068</u>	<u>6,715,808</u>	<u>6,541,284</u>
Expenses:			
Net operating expenses	5,628,967	6,219,406	7,124,914
Non-operating expenses	<u>-</u>	<u>20,212</u>	<u>-</u>
Total expenses	<u>5,628,967</u>	<u>6,239,618</u>	<u>7,124,914</u>
Change in net position	<u>\$ (155,899)</u>	<u>\$ 476,190</u>	<u>\$ (583,630)</u>

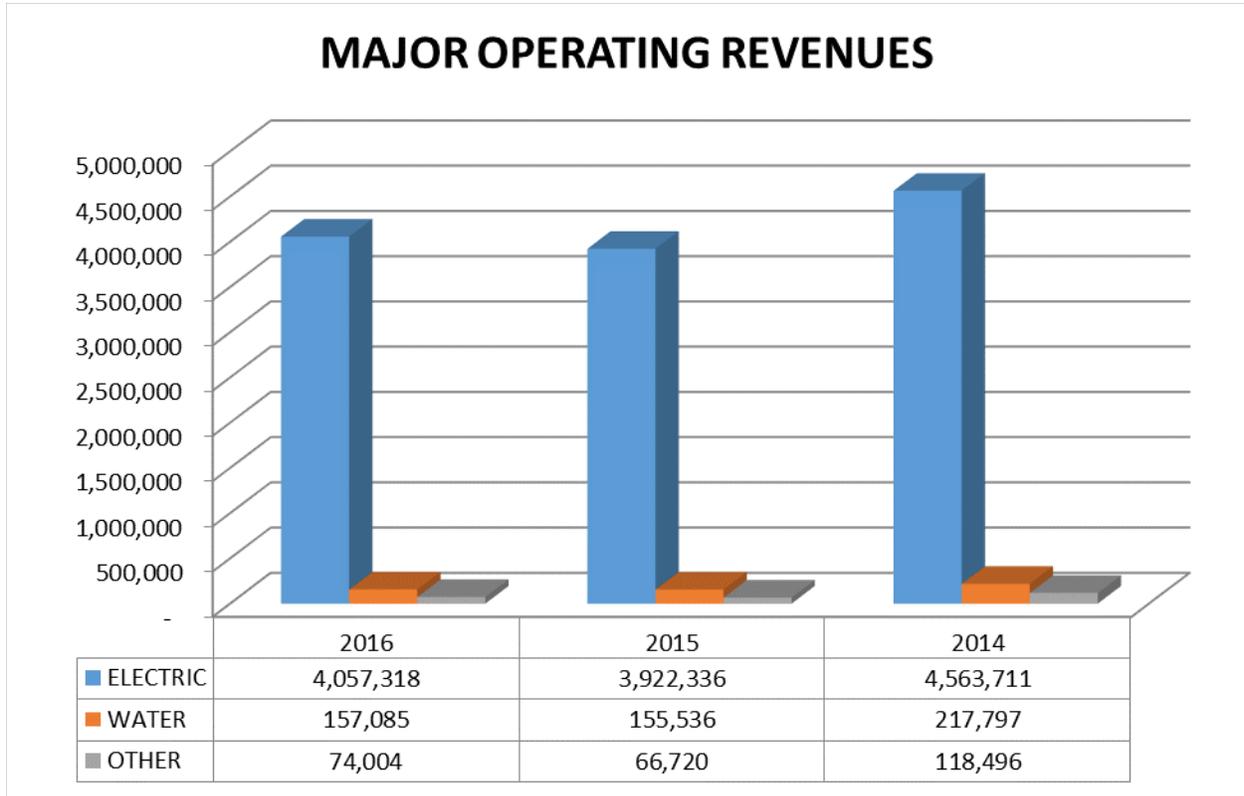
The Statements of Revenues, Expenses, and Changes in Net Position identify the various revenue and expense items that impacted the change in net position. As indicated above, KAJUR's total revenues decreased from \$6,715,808 in FY 2015 to \$5,473,068 in FY 2016. This represents a decrease of \$1,242,740 in revenue compared to FY 2015. This decrease in total revenue is primarily attributed to a substantial decrease in non-operating revenue (Compact subsidy) compared to the previous year. Within the operating revenues, electric revenue increased from \$3,922,336 in FY 2015 to \$4,057,318 in FY 2016. This increase in electric revenue is an adjustment to the temporary economic shock caused by the drop in world market price for fuel in 2014, leading to a reduction in electric tariff for KAJUR.

KAJUR had made several attempts in the past to start applying flat rate charges to the general public for the provision of water and saltwater through the public pipeline network. However, surveys conducted over the past few years continued to indicate the inconsistent and unreliable nature of these service deliveries. As such, KAJUR continues to provide water and saltwater services to the general public at no charge. This decision was based on the assumption that KAJUR will be inundated with customer complaints over "paid services," which are not consistent. On the other hand, KAJUR continues to apply service charges to the government and business community, most of which are on metered service lines. During this period, KAJUR was able to collect \$157,085 mostly from the provision of water and saltwater services to government organizations and the private sector. This amount represents a slight increase in comparison to the previous year as illustrated in the chart below.

**KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.**

Management's Discussion and Analysis, Continued  
 Years Ended September 30, 2016 and 2015

The graph below comparatively illustrates the major components of operating revenues for FY14, FY15, and FY16:



Fuel and lubricants expense remained by far the highest expense item for KAJUR in FY 2016. It represents approximately forty-nine percent (49%) of KAJUR's overall operating expenses. This figure also represents a substantial decrease of \$577,482 or 17% compared to that of the previous year. This decrease in fuel and lubricants expense reflected the drop in world market fuel prices throughout this period.

KAJUR's salaries and wages, the second-highest expense item for this organization, increased slightly by \$32,271 or approximately 2% compared to that of the previous year. For over five years, KAJUR had no annual merit pay increment awarded to employees. In FY 2016, the Board approved a salary and wage increase for FY 2017 based on merit. Additionally, it is important to note that KAJUR has inducted the 13 graduates from the CMI Jitok Kapeel and Job Corp programs to full-time positions.

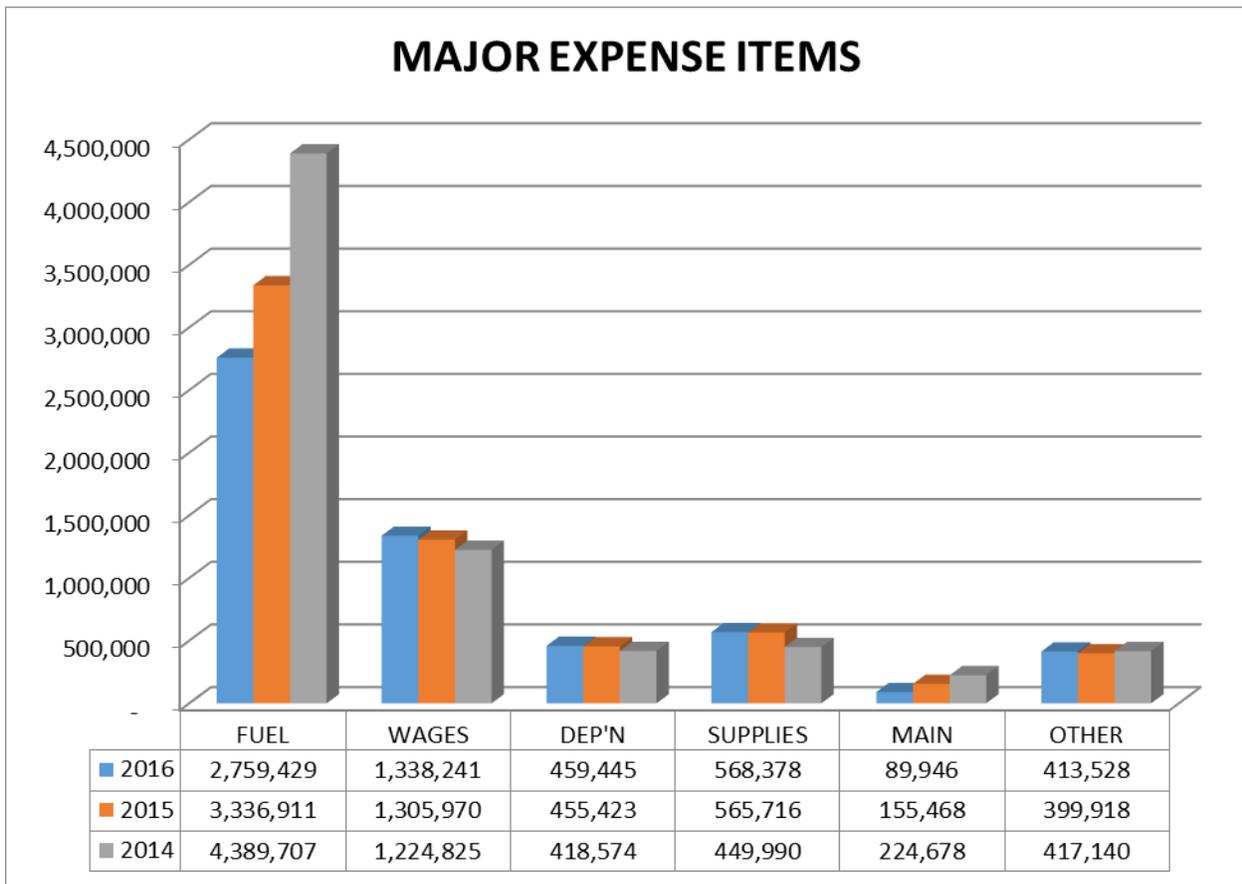
KAJUR selectively picks new employees who possess adequate skills and education background and who would therefore have higher probability for successful placement in more advanced training on new systems, which KAJUR is to acquire starting in 2017 under the Ebeye Water Supply and Sanitation Project (EWSSP). An added expense item to KAJUR's salary and wages includes the six temporary hires who were employed in 2015 on temporary status as part of KAJUR's response measures to developing drought conditions in the islands. They are now retained as facility maintenance and operational workers on temporary status.

**KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.**

Management's Discussion and Analysis, Continued  
 Years Ended September 30, 2016 and 2015

Overall, fuel and lubricants expense continues to be the only expense item with notable variances over the past three years, as noted on the chart below. All other major operating expense components were fairly predictable and had moderate variances. KAJUR, with its comparatively high fuel expense requirements and high dependency on fossil fuel, continues to look for ways to reduce this high overhead cost and high dependency on fossil fuel. In latter parts of this discussion, KAJUR has highlighted some projects that are already in the pipeline that would help improve KAJUR's financial performance and compliance with RMI procurement code.

The graph below shows a comparative analysis of major operating expense components for FY 2016 and the preceding two years:



**CAPITAL ASSETS**

KAJUR made no major investment in capital assets during this period as the organization continued to struggle with the high cost of fuel for power generation with limited means of generating adequate revenue to cover its operating expenses. As clearly shown in its summary of capital assets, the only major change in KAJUR's capital assets is one influenced by asset depreciation.

## KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

### Management's Discussion and Analysis, Continued Years Ended September 30, 2016 and 2015

A summary of KAJUR's capital assets for the past three years is presented below:

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Plant and machinery	\$ 5,378,323	\$ 5,299,742	\$ 5,299,742
Distribution system	2,056,634	2,016,590	2,016,590
Water system	1,635,775	1,427,924	1,270,243
Other equipment	<u>2,166,208</u>	<u>2,120,703</u>	<u>1,964,346</u>
	11,236,940	10,864,959	10,550,921
Less accumulated depreciation	<u>(9,380,398)</u>	<u>(8,920,953)</u>	<u>(8,479,968)</u>
	1,856,542	1,944,006	2,070,953
Construction work in progress/equipment in transit	<u>56,774</u>	<u>56,774</u>	<u>56,774</u>
	\$ 1,913,316	\$ 2,000,780	\$ 2,127,727

For additional information concerning capital assets, please refer to the Notes to the financial statements.

Management's Discussion and Analysis for the year ended September 30, 2015 is set for in the report on the audit of KAJUR's financial statements dated June 6, 2016. That Discussion and Analysis explains the major factors impacting the FY 2015 financial statements and may be obtained from the contact information below.

#### **FUTURE OUTLOOK ON SUSTAINABILITY**

KAJUR continues to make small but notable progress in improving quality of life for the community of Ebeye. Long-term planning continues to shape a more optimistic future outlook for KAJUR. Compared to previous years, there is obviously much less people going to the military base on Kwajalein to bring back drinking water for their families. However, there is still a handful of Kwajalein employees that normally bring back water from the military base. KAJUR sees this practice as being one driven by public perception on water quality and not on the availability of "safe" potable water on Ebeye. Power outages are sporadic and normally last less than an hour when they do occur. Despite all these improvements on KAJUR's service delivery, much needs to be done in the area of sustainability.

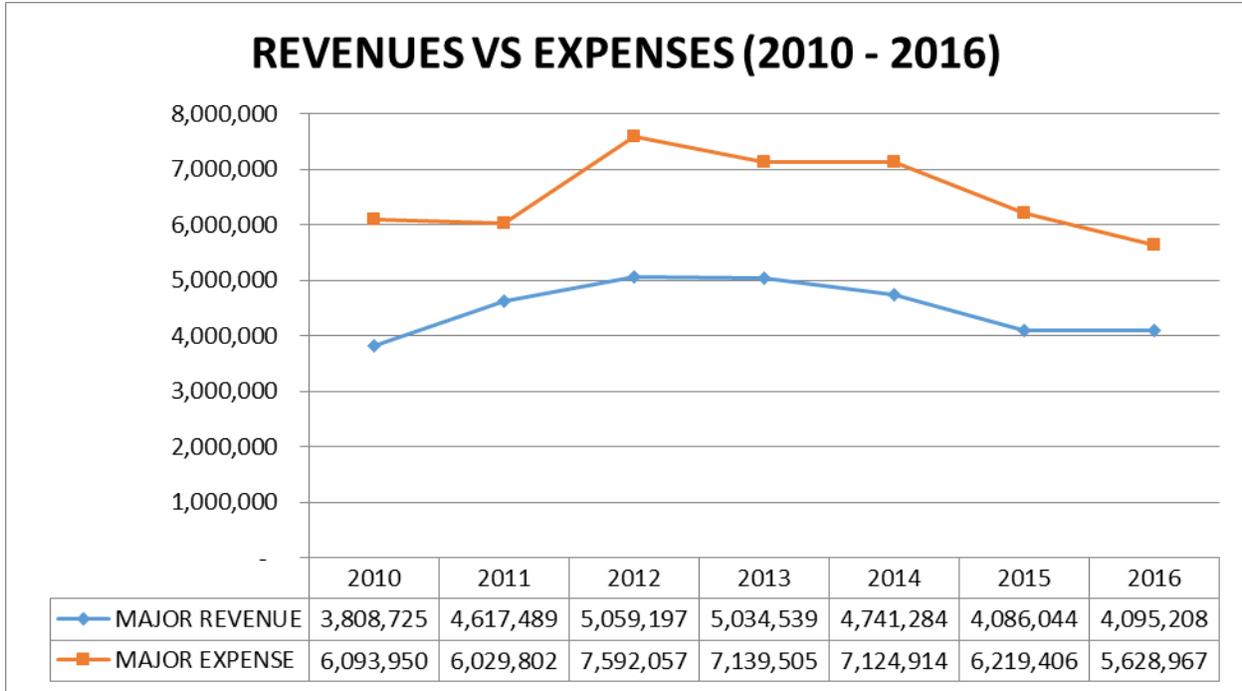
Like most utility companies in the region, the cost of fuel continues to be the primary determining factor relative to affordability and sustainability of KAJUR's utility services. Ebeye's remote location and limited resources are also limiting its ability to adequately address many of its operational challenges.

KAJUR's operational data clearly shows that there continues to be a substantial gap between revenue that KAJUR generates and its operational expenses - a clear indication that KAJUR continues to operate at a substantial loss. For the foreseeable future, KAJUR will continue to look to the government for funding support in order to make up for the difference in operational loss.

**KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.**

Management's Discussion and Analysis, Continued  
 Years Ended September 30, 2016 and 2015

The chart below shows a clear representation of the gap between KAJUR's revenue and expense over a span of a seven-year period:



As indicated in the chart above, over a span of a seven-year period, KAJUR's yearly loss averages \$2.1 million. Major contributing factors to these yearly losses include water and saltwater services, which KAJUR continues to provide to the community at no charge. As mentioned earlier, KAJUR continues to provide these services at no cost due to the inconsistent nature of these services. To help offset this operational gap, KAJUR continues to seek financial assistance from the U.S. and R.M.I central government. KAJUR also recognizes that several opportunities now exist for KAJUR to further narrow this operational gap between its revenues and expenses. As long-term planning relative to solar energy and fuel provisioning continues to evolve, KAJUR remains vigilant in exploring short-term methods it can employ to reduce costs associated with its power generation and distribution services. These include an existing plan to systematically retrofit all of Ebeye with energy efficient lights and household appliances through the use of an energy efficiency revolving fund and supported by local ordinances to ban conventional lights and other standard household appliances to enter Kwajalein Atoll. KAJUR continues to work with the local government and business community toward implementing this effort FY 2017-2018.

## **KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.**

Management's Discussion and Analysis, Continued  
Years Ended September 30, 2016 and 2015

### **KAJUR'S FOCUS IN THE COMING FISCAL YEAR**

The following are KAJUR's goals for the coming fiscal year 2017:

- 1) Continue to strengthen KAJUR's organizational structure so it can withstand additional strain on its resources with the implementation of the Ebeye Water Supply and Sanitation Project.
- 2) Secure KAJUR's Energy Efficiency Revolving Fund.
- 3) Continue to work with the Board and Kwajalein leadership to identify cheaper means of transporting fuel for the Ebeye power plant.
- 4) Complete reconfiguration of the fuel pipeline layout, fuel metering systems, and replacement of a settling tank at the power plant.
- 5) Continue to strengthen KAJUR's benchmarking efforts.
- 6) Strengthen fuel and material inventory within KAJUR's supply system.
- 7) Strengthen KAJUR's Supply and Procurement department.
- 8) Initiate merit pay increment for FY 2017.
- 9) Present TenderLink© to RepMar's Bidding Committee and seek approval.

### **ADDITIONAL FINANCIAL INFORMATION**

This discussion and analysis is designed to provide KAJUR's customers and other interested parties with an overview of KAJUR's financial operations and financial condition. Should the reader have questions regarding the information included in this report or wishes to request additional financial information please contact the Kwajalein Atoll Joint Utility Resources, Inc. Manager at P.O. Box 5819, Ebeye, MH 96970.

**KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.**

Statements of Net Position  
September 30, 2016 and 2015

<u>ASSETS</u>	<u>2016</u>	<u>2015</u>
Current assets:		
Cash	\$ 326,321	\$ 345,772
Receivables:		
Utility	2,032,786	1,957,451
Affiliate	1,231,329	1,242,386
Employees	7,512	8,192
Other	<u>195,993</u>	<u>151,990</u>
	3,467,620	3,360,019
Less allowance for doubtful accounts	<u>(3,038,951)</u>	<u>(2,845,752)</u>
Total receivables, net	<u>428,669</u>	<u>514,267</u>
Prepaid expenses	<u>385,910</u>	<u>181,941</u>
Inventories	<u>691,758</u>	<u>726,338</u>
Total current assets	<u>1,832,658</u>	<u>1,768,318</u>
Non current assets:		
Deposits for capital assets acquisition	-	48,250
Capital assets:		
Nondepreciable	56,774	56,774
Other capital assets, net of accumulated depreciation	<u>1,856,542</u>	<u>1,944,006</u>
Total noncurrent assets	<u>1,913,316</u>	<u>2,049,030</u>
	<u>\$ 3,745,974</u>	<u>\$ 3,817,348</u>
<u>LIABILITIES AND NET POSITION</u>		
Current liabilities:		
Accounts payable	\$ 53,167	\$ 24,318
Due to affiliates	2,454,137	2,381,427
Accrued liabilities	28,782	53,082
Unearned revenue	<u>66,056</u>	<u>58,790</u>
Total current liabilities	<u>2,602,142</u>	<u>2,517,617</u>
Contingencies		
Net position:		
Net investment in capital assets	1,913,316	2,000,780
Restricted	50,000	-
Unrestricted	<u>(819,484)</u>	<u>(701,049)</u>
Total net position	<u>1,143,832</u>	<u>1,299,731</u>
	<u>\$ 3,745,974</u>	<u>\$ 3,817,348</u>

See accompanying notes to financial statements.

**KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.**

Statements of Revenues, Expenses and Changes in Net Position  
Years Ended September 30, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Operating revenues:		
Electric and service billings	\$ 4,057,318	\$ 3,922,336
Water	157,085	155,536
Other	<u>74,004</u>	<u>66,720</u>
Total operating revenues	4,288,407	4,144,592
Less provision for doubtful accounts	<u>(193,199)</u>	<u>(58,548)</u>
Total net operating revenues	<u>4,095,208</u>	<u>4,086,044</u>
Operating expenses:		
Fuel and lubricants	2,759,429	3,336,911
Salaries, wages and benefits	1,338,241	1,305,970
Supplies and materials	568,378	565,716
Depreciation	459,445	455,423
Travel and transportation	144,769	151,767
Operations and maintenance	89,946	155,468
Contractual services	55,623	91,253
Communications	46,336	49,062
Insurance	32,136	-
Rental	26,268	26,268
Miscellaneous	<u>108,396</u>	<u>81,568</u>
Total operating expenses	<u>5,628,967</u>	<u>6,219,406</u>
Operating loss	<u>(1,533,759)</u>	<u>(2,133,362)</u>
Nonoperating revenues (expenses):		
Compact funding	1,327,860	2,629,764
Grant income	50,000	-
Loss on write-off of capital assets	<u>-</u>	<u>(20,212)</u>
Total nonoperating revenues (expenses), net	<u>1,377,860</u>	<u>2,609,552</u>
Change in net position	(155,899)	476,190
Net position at beginning of year	<u>1,299,731</u>	<u>823,541</u>
Net position at end of year	<u>\$ 1,143,832</u>	<u>\$ 1,299,731</u>

See accompanying notes to financial statements.

**KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.**

Statements of Cash Flows  
Years Ended September 30, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Cash flows from operating activities:		
Cash received from customers	\$ 4,237,392	\$ 3,985,897
Cash payments to suppliers for goods and services	(3,904,040)	(4,821,240)
Cash payments to employees for services	<u>(1,356,932)</u>	<u>(1,312,131)</u>
Net cash used for operating activities	<u>(1,023,580)</u>	<u>(2,147,474)</u>
Cash flows from noncapital financing activities:		
Operating subsidies received from RepMar	<u>1,327,860</u>	<u>2,580,624</u>
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets	<u>(323,731)</u>	<u>(252,748)</u>
Net change in cash	(19,451)	180,402
Cash at beginning of year	<u>345,772</u>	<u>165,370</u>
Cash at end of year	<u>\$ 326,321</u>	<u>\$ 345,772</u>
Reconciliation of operating loss to net cash used for operating activities:		
Operating loss	\$ (1,533,759)	\$ (2,133,362)
Adjustments to reconcile operating loss to net cash used for operating activities:		
Depreciation	459,445	455,423
Provision for doubtful accounts	193,199	58,548
(Increase) decrease in assets:		
Receivables:		
Utility	(75,335)	13,081
Affiliate	61,057	(142,562)
Employees	680	78
Other	(44,003)	(35,412)
Prepaid expenses	(203,969)	(33,482)
Inventories	34,580	120,404
Increase (decrease) in liabilities:		
Accounts payable	28,849	8,735
Due to affiliates	72,710	(459,905)
Unearned revenue	7,266	6,198
Other current and accrued liabilities	<u>(24,300)</u>	<u>(5,218)</u>
Net cash used for operating activities	<u>\$ (1,023,580)</u>	<u>\$ (2,147,474)</u>

See accompanying notes to financial statements.

**KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.**

Statements of Cash Flows, Continued  
Years Ended September 30, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Noncash capital and related financing activities:		
Capital assets	\$ 48,250	\$ -
Deposits for capital assets acquisition	<u>(48,250)</u>	<u>-</u>
	<u>\$ -</u>	<u>\$ -</u>
Capital assets	\$ -	\$ (34,650)
Accumulated depreciation	-	14,438
Loss on write-off of capital assets	<u>-</u>	<u>20,212</u>
	<u>\$ -</u>	<u>\$ -</u>
Noncash noncapital financing activities:		
Receivable from affiliate	\$ 50,000	\$ -
Grant income	<u>(50,000)</u>	<u>-</u>
	<u>\$ -</u>	<u>\$ -</u>
Receivable from RepMar	\$ -	\$ 49,140
Compact funding	<u>-</u>	<u>(49,140)</u>
	<u>\$ -</u>	<u>\$ -</u>

See accompanying notes to financial statements.

## KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Notes to Financial Statements  
September 30, 2016 and 2015

### (1) Organization

The Kwajalein Atoll Joint Utilities Resources, Inc. (KAJUR), a component unit of the Republic of the Marshall Islands, was incorporated under the laws of the Republic of the Marshall Islands (RepMar) on September 13, 1990, to generate and distribute utilities on the island of Ebeye. On October 19, 1990, the Board of Directors of the Kwajalein Atoll Development Authority (KADA) authorized the transfer of \$14,075,046 in utility plant and equipment to KAJUR.

On May 2, 2006, the Cabinet of RepMar approved the transfer of all management responsibilities of KAJUR to the Board of Directors of the Marshalls Energy Company, Inc., a component unit of RepMar. On July 24, 2006, the Cabinet of RepMar approved the introduction of legislation to the Nitijela (RepMar's legislature) to repeal the enabling legislation that created KADA.

KAJUR is governed by a seven-member RMI Combined Utilities Board of Directors appointed by the Cabinet of RepMar. The RMI Combined Utilities Board of Directors also have governance over the Marshalls Energy Company, Inc. and the Majuro Water and Sewer Company, Inc., which are component units of RepMar.

KAJUR's financial statements are incorporated into the financial statements of RepMar as a component unit.

### (2) Summary of Significant Accounting Policies

The accounting policies of KAJUR conform to accounting principles generally accepted in the United States of America as applicable to governmental entities, specifically proprietary funds.

KAJUR considers utility and nonutility revenues and costs that are directly related to utility and nonutility operations to be operating revenues and expenses. Revenues and expenses related to financing and other activities are reflected as nonoperating.

GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, which was subsequently amended by Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus*, and modified by Statement No. 38, *Certain Financial Statement Note Disclosures*, establish financial reporting standards for governmental entities which require that management's discussion and analysis of the financial activities be included with the basic financial statements and notes and modify certain other financial statement disclosure requirements.

To conform to the requirements of GASB Statement No. 34, equity is presented in the following net position categories:

- Net investment in capital assets - capital assets, net of accumulated depreciation and related debt, plus construction or improvement of those assets.
- Restricted - net position that results when constraints are placed on net position use that are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law.
- Unrestricted - net position that is not subject to externally imposed stipulations. Unrestricted net position may be designated for specific purposes by action of management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

## KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Notes to Financial Statements  
September 30, 2016 and 2015

### (2) Summary of Significant Accounting Policies, Continued

When both restricted and unrestricted resources are available for use for the same purpose, it is KAJUR's policy to use unrestricted resources first, then restricted resources as they are needed.

#### Basis of Accounting

Proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and deferred outflows of resources, and liabilities and deferred inflows of resources associated with the operation of the fund are included in the statements of net position. Proprietary fund operating statements present increases and decreases in net position. The accrual basis of accounting is utilized by proprietary funds. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

#### Revenue Recognition

Sales of electricity and water are recorded as billed to customers on a monthly billing cycle basis. Unbilled revenues are not accrued as the most recent meter reading date approximates the end of the reporting period.

#### Cash

Custodial credit risk is the risk that, in the event of a bank failure, KAJUR's deposits may not be returned to it. Such deposits are not covered by depository insurance and are either uncollateralized or collateralized with securities held by the pledging financial institution or held by the pledging financial institution but not in the depositor-government's name. KAJUR does not have a deposit policy for custodial credit risk.

For purposes of the statements of net position and cash flows, cash is defined as cash on hand and cash in checking accounts. As of September 30, 2016 and 2015, the carrying amount of cash was \$326,321 and \$345,772, respectively, and the corresponding bank balances were \$346,537 and \$356,957, respectively. Of the bank balances, \$69,212 and \$61,249, respectively, are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. Bank deposits of \$277,325 and \$295,708, respectively, are maintained in financial institutions not subject to depository insurance. As of September 30, 2016 and 2015, bank deposits in the amount of \$69,212 and \$61,249, respectively, were subject to FDIC insurance. KAJUR does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk.

#### Receivables

KAJUR provides electric services to government agencies, businesses and individuals located on the island of Ebeye and bills for these services on a monthly basis. The allowance for doubtful accounts is stated at an amount which management believes will be adequate to absorb possible losses on accounts receivable that may become uncollectible based on evaluations of the collectability of these accounts and prior collection experience. The allowance is established through a provision for bad debts charged to expense. Bad debts are charged off against the allowance on the specific identification method. Receivables are not collateralized.

## KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Notes to Financial Statements  
September 30, 2016 and 2015

### (2) Summary of Significant Accounting Policies, Continued

#### Inventories

Inventories of fuel and supplies are stated at the lower of cost (first-in, first-out) or market (net realizable value) at September 30, 2016 and 2015. Bulk fuel inventories are held for power plant use.

#### Prepayments

Certain payments to vendors or persons for goods and services reflect costs applicable to future accounting periods and are recorded as prepaid expenses in the accompanying financial statements.

#### Plant and Equipment

KAJUR does not have a formal capitalization policy for plant and equipment; however, items with a cost that equals or exceeds \$500 are generally capitalized at the time of acquisition. Depreciation of plant and equipment is calculated on the straight-line method based on the estimated useful lives of the respective assets, which are as follows:

Plant and machinery	20 - 25 years
Distribution system	20 - 25 years
Water system	20 - 25 years
Other equipment	5 years

#### Deferred Outflows of Resources

In addition to assets, the statement of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element represents a consumption of net position that applies to a future period and so will not be recognized as an outflow of resources (deduction of net position) until then. KAJUR has no items that qualify for reporting in this category.

#### Deferred Inflows of Resources

In addition to liabilities, the statement of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element represents an acquisition of net position that applies to a future period and so will not be recognized as an inflow of resources (additions to net position) until then. KAJUR has no items that qualify for reporting in this category.

#### Taxes

Corporate profits are not subject to income tax in the Republic of the Marshall Islands. The Government of the Republic of the Marshall Islands imposes a gross revenue tax of 3% on revenues. Pursuant to the Income Tax Act of 1989, as amended, sales of electricity, water and sewer services by public utility companies are exempt from gross revenue tax. Accordingly, KAJUR is exempt from gross revenue tax on the sale of electric, water and sewer services.

## KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Notes to Financial Statements  
September 30, 2016 and 2015

### (2) Summary of Significant Accounting Policies, Continued

#### New Accounting Standards

During the year ended September 30, 2016, KAJUR implemented the following pronouncements:

- GASB Statement No. 72, *Fair Value Measurement and Application*, which addresses accounting and financial reporting issues related to fair value measurements and requires entities to expand their fair value disclosures by determining major categories of debt and equity securities within the fair value hierarchy on the basis of the nature and risk of the investment.
- GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, which eliminates two of the four categories of authoritative GAAP that exist under the existing hierarchy prescribed by Statement No. 55. The two categories that will remain under the new standard are (1) GASB Statements and (2) GASB technical bulletins and implementation guides in addition to AICPA guidance that the GASB clears.
- GASB Statement No. 79, *Certain External Investment Pools and Pool Participants*, addresses for certain external investment pools and their participants the accounting and financial reporting implications that result from changes in the regulatory provisions referenced by previous accounting and financial reporting standards. Those provisions were based on the Investment Company Act of 1940, Rule 2a7. Rule 2a7 contains the Securities and Exchange Commission's regulations that apply to money market funds and were significantly amended in 2014.

The implementation of these statements did not have a material effect on the accompanying financial statements.

In June 2015, GASB issued Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not Within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*, which aligns the reporting requirements for pensions and pension plans not covered in GASB Statements 67 and 68 with the reporting requirements in Statement 68. The provisions in Statement No. 73 are effective for fiscal years beginning after June 15, 2015, with the exception of the provisions that address employers and governmental nonemployer contributing entities for pensions that are not within the scope of Statement 68, which are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In June 2015, GASB issued Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which replaces Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and addresses financial reporting requirements for governments whose employees are provided with postemployment benefits other than pensions (other postemployment benefits or OPEB). The provisions in Statement No. 74 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

## KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Notes to Financial Statements  
September 30, 2016 and 2015

### (2) Summary of Significant Accounting Policies, Continued

#### New Accounting Standards, Continued

In June 2015, GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, which replaces the requirements of Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and provides guidance on reporting by governments that provide OPEB to their employees and for governments that finance OPEB for employees of other governments. The provisions in Statement No. 75 are effective for fiscal years beginning after June 15, 2017. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In August 2015, GASB issued Statement No. 77, *Tax Abatement Disclosures*, which requires governments that enter into tax abatement agreements to disclose certain information about the agreements. The provisions in Statement No. 77 are effective for fiscal years beginning after December 15, 2015. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In December 2015, GASB issued Statement No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*, which addresses a practice issue regarding the scope and applicability of Statement No. 68, *Accounting and Financial Reporting for Pensions*. The provisions in Statement No. 78 are effective for fiscal years beginning after December 15, 2015. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In January 2016, GASB issued Statement No. 80, *Blending Requirements for Certain Component Units - an amendment of GASB Statement No. 14*, which improves financial reporting by clarifying the financial statement presentation requirements for certain component units. The provisions in Statement No. 80 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In March 2016, GASB issued Statement No. 81, *Irrevocable Split-Interest Agreements*, which improves accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement. The provisions in Statement No. 81 are effective for fiscal years beginning after December 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In March 2016, GASB issued Statement No. 82, *Pension Issues - an amendment of GASB Statements No. 67, No. 68, and No. 73*, which addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements. The provisions in Statement No. 82 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

**KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.**

Notes to Financial Statements  
September 30, 2016 and 2015

(2) Summary of Significant Accounting Policies, Continued

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and deferred outflows of resources, liabilities and deferred inflows of resources, and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(3) Risk Management

KAJUR is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions, injuries to employees; and natural disasters. KAJUR has elected to purchase commercial insurance for the risks of loss to which it is exposed. Settled claims and losses as a result of these risks have not been considered material to the financial statements by management for the past three years.

(4) Inventories

Inventories at September 30, 2016 and 2015, consist of the following:

	<u>2016</u>	<u>2015</u>
Materials and supplies	\$ 539,886	\$ 486,975
Fuel	116,228	149,122
Lubricants	<u>35,644</u>	<u>90,241</u>
	\$ <u>691,758</u>	\$ <u>726,338</u>

(5) Capital Assets

Capital assets activities for the years ended September 30, 2016 and 2015 was as follows:

	<u>2016</u>			
	<u>October</u> <u>1, 2015</u>	<u>Additions</u> <u>and Transfers</u>	<u>Retirements</u>	<u>September</u> <u>30, 2016</u>
Plant and machinery	\$ 5,299,742	\$ 78,581	\$ -	\$ 5,378,323
Distribution system	2,016,590	40,044	-	2,056,634
Water system	1,427,924	207,851	-	1,635,775
Other equipment	<u>2,120,703</u>	<u>45,505</u>	<u>-</u>	<u>2,166,208</u>
	10,864,959	371,981	-	11,236,940
Less accumulated depreciation	<u>(8,920,953)</u>	<u>(459,445)</u>	<u>-</u>	<u>(9,380,398)</u>
	1,944,006	(87,464)	-	1,856,542
Construction in progress	<u>56,774</u>	<u>-</u>	<u>-</u>	<u>56,774</u>
	\$ <u>2,000,780</u>	\$ <u>(87,464)</u>	\$ <u>-</u>	\$ <u>1,913,316</u>

**KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.**

Notes to Financial Statements  
September 30, 2016 and 2015

(5) Capital Assets, Continued

	2015			
	<u>October 1, 2014</u>	<u>Additions and Transfers</u>	<u>Retirements</u>	<u>September 30, 2015</u>
Plant and machinery	\$ 5,299,742	\$ -	\$ -	\$ 5,299,742
Distribution system	2,016,590	-	-	2,016,590
Water system	1,270,243	192,331	(34,650)	1,427,924
Other equipment	<u>1,964,346</u>	<u>156,357</u>	<u>-</u>	<u>2,120,703</u>
	10,550,921	348,688	(34,650)	10,864,959
Less accumulated depreciation	<u>(8,479,968)</u>	<u>(455,423)</u>	<u>14,438</u>	<u>(8,920,953)</u>
	2,070,953	(106,735)	(20,212)	1,944,006
Construction in progress	<u>56,774</u>	<u>-</u>	<u>-</u>	<u>56,774</u>
	<u>\$ 2,127,727</u>	<u>\$ (106,735)</u>	<u>\$ (20,212)</u>	<u>\$ 2,000,780</u>

During the year ended September 30, 2015, management of KAJUR determined that certain capital assets in the amount of \$34,650 no longer existed. Accordingly, these capital assets were written-off resulting in a loss of \$20,212.

(6) Related Party Transactions

KAJUR is a component unit of RepMar and is therefore affiliated with all RepMar-owned and affiliated entities.

KAJUR's utility service is provided to RepMar and all RepMar-owned and affiliated entities. Services are extended to these entities at more favorable terms and conditions than those afforded to third parties. KAJUR utilizes services from certain affiliated entities at substantially more favorable terms and conditions than those provided to third parties. A summary of related party transactions for the years ended September 30, 2016 and 2015 and the related receivable and payable balances as of September 30, 2016 and 2015, are as follows:

	2016		
	<u>Expenses</u>	<u>Receivables</u>	<u>Payables</u>
Marshall's Energy Company, Inc.	\$ 2,697,830	\$ 60,213	\$ 2,365,958
Marshall Islands National Telecommunications Authority	46,336	11,920	3,299
Marshall Islands Marine Resources Authority	26,268	188,678	-
RepMar	12,247	929,370	19,434
Others	<u>121,680</u>	<u>41,148</u>	<u>65,446</u>
	<u>\$ 2,904,361</u>	<u>\$ 1,231,329</u>	<u>\$ 2,454,137</u>

**KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.**

Notes to Financial Statements  
September 30, 2016 and 2015

(6) Related Party Transactions, Continued

	2015		
	<u>Expenses</u>	<u>Receivables</u>	<u>Payables</u>
Marshall's Energy Company, Inc.	\$ 3,251,326	\$ -	\$ 2,307,917
Marshall Islands National Telecommunications Authority	49,062	9,906	253
Marshall Islands Marine Resources Authority	26,268	164,336	-
RepMar	9,492	1,018,480	11,788
Others	<u>122,257</u>	<u>49,664</u>	<u>61,469</u>
	<u>\$ 3,458,405</u>	<u>\$ 1,242,386</u>	<u>\$ 2,381,427</u>

During the years ended September 30, 2016 and 2015, KAJUR received \$1,327,860 and \$2,580,624, respectively, of appropriations from RepMar in cash which were subsequently paid to Marshall's Energy Company, Inc. for the purchase of fuel.

(7) Contingencies

KAJUR has incurred losses from operations of \$1,533,759 and \$2,133,362 during the years ended September 30, 2016 and 2015, respectively. KAJUR depends on RepMar for cash and noncash funding to continue its operations. Although RepMar has provided funding in the past, no formal agreement exists to provide funds in the future. The continuation of KAJUR's operations is dependent upon future financial support from RepMar in the form of operating subsidies and/or significant improvements in operations through the collection of long outstanding utility receivables and other matters. Additionally, in order for KAJUR to continue as a going concern, it may need to delay payments to the Marshall's Energy Company, Inc. for fuel purchases.

KAJUR participates in a number of federally assisted grant programs. These programs are subject to financial and compliance audits to ascertain if Federal laws and guidelines have been followed. KAJUR's management believes that liabilities, if any, for reimbursement which may arise as a result of these audits will not be material to the financial position of KAJUR.

In the ordinary course of business, claims have been filed against KAJUR. Management does not believe that the plaintiffs will prevail and the ultimate outcome is currently not determinable. Therefore, no provision has been recorded in the accompanying financial statements for losses, if any, that may result.

**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER  
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS  
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN  
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

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

We have audited, 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, the financial statements of Kwajalein Atoll Joint Utilities Resources, Inc. (KAJUR), which comprise the statement of net position as of September 30, 2016, and the related statements of revenues, expenses, and changes in net position and of cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated April 10, 2017.

### **Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered KAJUR's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of KAJUR's internal control. Accordingly, we do not express an opinion on the effectiveness of KAJUR's internal control.

*A deficiency in internal control* 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 material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did identify certain deficiencies in internal control, described in the accompanying Schedule of Findings and Questioned Costs as items 2016-001 and 2016-002, which we consider to be material weaknesses.

## Compliance and Other Matters

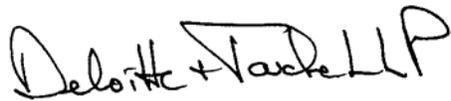
As part of obtaining reasonable assurance about whether KAJUR's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect 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 or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Findings and Questioned Costs as item 2016-003.

## KAJUR's Responses to Findings

KAJUR's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. KAJUR's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

## Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

A handwritten signature in black ink that reads "Deloitte + Tuck LLP". The signature is written in a cursive, stylized font.

April 10, 2017

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE FOR EACH MAJOR  
FEDERAL PROGRAM; REPORT ON INTERNAL CONTROL OVER COMPLIANCE;  
AND REPORT ON THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
REQUIRED BY THE UNIFORM GUIDANCE**

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

### **Report on Compliance for Each Major Federal Program**

We have audited Kwajalein Atoll Joint Utilities Resources, Inc.'s (KAJUR) compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on KAJUR's major federal program for the year ended September 30, 2016. KAJUR's major federal program is identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs.

#### ***Management's Responsibility***

Management is responsible for compliance with federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

#### ***Auditor's Responsibility***

Our responsibility is to express an opinion on compliance for KAJUR's major federal program based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about KAJUR's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for the major federal program. However, our audit does not provide a legal determination of KAJUR's compliance.

#### ***Opinion on the Major Federal Program***

In our opinion, KAJUR complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on its major federal program for the year ended September 30, 2016.

## Report on Internal Control Over Compliance

Management of KAJUR is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered KAJUR's internal control over compliance with the types of requirements that could have a direct and material effect on the major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for the major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of KAJUR's internal control over compliance.

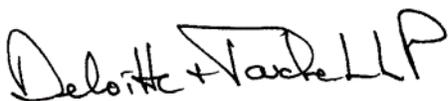
*A deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

## Report on Schedule of Expenditures of Federal Awards Required by the Uniform Guidance

We have audited the financial statements of KAJUR as of and for the year ended September 30, 2016, and have issued our report thereon dated April 10, 2017, which contained an unmodified opinion on those financial statements. Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by the Uniform Guidance and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards is fairly stated in all material respects in relation to the financial statements as a whole.



April 10, 2017

**KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.**

Schedule of Expenditures of Federal Awards  
Year Ended September 30, 2016

<u>Program Title</u>	<u>Expenditures FY16</u>
<u>U.S. Department of the Interior:</u> <u>CFDA #15.875</u> Compact of Free Association, As Amended, Section 211(b)(2) Kwajalein Atoll Landowners Special Needs	
Power Generation, Distribution, and Maintenance	<u>\$ 1,327,860</u>

The Schedule of Expenditures of Federal Awards is presented on the accrual basis of accounting.

The above expenditures reconcile to the underlying basic financial statements as follows:

Power Generation, Distribution, and Maintenance (included within fuel and lubricants expense of \$2,759,429)

**KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.**

Schedule of Findings and Questioned Costs  
Year Ended September 30, 2016

**SECTION I - SUMMARY OF AUDITORS' RESULTS**

*Financial Statements*

Type of report the auditor issued on whether the financial statements audited were prepared in accordance with GAAP: Unmodified

Internal control over financial reporting:

- Material weakness(es) identified? Yes
- Significant deficiency(ies) identified? None reported

Noncompliance material to financial statements noted? Yes

*Federal Awards*

Internal control over major federal programs:

- Material weakness(es) identified? No
- Significant deficiency(ies) identified? None reported

Type of auditors' report issued on compliance for major federal programs: Unmodified

Any audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516 (a)? No

Identification of major federal programs:

<u>CFDA Number</u>	<u>Name of Federal Program</u>
15.875	Compact of Free Association, as Amended: Kwajalein Atoll Landowners Special Needs Kwajalein Impact Fund

Dollar threshold used to distinguish between Type A and Type B programs: \$750,000

Auditee qualified as low-risk auditee? No

**SECTION II - FINANCIAL STATEMENT FINDINGS**

<u>Reference Number</u>	<u>Findings</u>
2016-001	Accounts Receivable
2016-002	Materials and Supplies Inventory
2016-003	Local Noncompliance

**SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

No matters were reported.

**KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2016

Finding No. 2016-001

Accounts Receivable

Criteria: Effective internal controls over receivables necessitate timely collection to maximize cash flows and to minimize possible bad debts.

Condition: As of September 30, 2016, electric trade receivables aggregated \$2,062,563. Of this amount, \$1,970,297 has been outstanding over 90 days and this balance has been fully provided with an allowance. In addition, \$698,607 of electric receivables remained the same as in FY2015. Of total electric trade receivables, 80% comprises fifteen accounts.

Several non-current customers continue to receive utility services. Other customers pay current amounts without resolution of long outstanding balances. It appears that KAJUR lacks adequate internal control over pursuing collections of long outstanding balances.

Cause: The cause of the above condition is the lack of adequate internal control policies and procedures that facilitate timely collections. In addition, a formal policy has not been implemented to standardize customer deductions, which involve long outstanding receivables. Furthermore, KAJUR lacks mitigating measures including entering into collection agreements to recover long outstanding receivables.

Effect: The effect of the condition is potential limitations on KAJUR's cash flows and an increase in the provision for doubtful accounts.

Prior Year Status: The lack of adequate internal controls over timely collection of receivables was reported as a finding in prior Single Audits as item 2015-001.

Recommendation: We recommend KAJUR adopt internal control policies and procedures to recover long outstanding receivables and to minimize potential losses from noncollection. In addition, we recommend KAJUR implement effective collection measures or enter into collection agreements with customers with long outstanding balances.

Auditee Response and Corrective Action Plan: KAJUR agrees with this finding and its recommendations. KAJUR also agrees with the cause for the condition identified in this finding. KAJUR also recognizes that final resolution to certain elements within KAJUR's business environment will help reduce and even eliminate many (even all) of these conditions described above. These elements include land leases on areas that KAJUR uses and final resolution to customer bills under dispute. KAJUR will continue to work on internal policies and procedures and continue to work on business environment issues with its governing board, the Kwajalein leadership, and with the few customers whose billings are still under dispute.

Corrective Action:

- 1) Seek final resolution to outstanding electric bill that are still under dispute.
- 2) The land lease agreement for KAJUR has been signed and will make electric bill collection for land owners less awkward.

**KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2016

Finding No. 2016-002

Materials and Supplies Inventory

Criteria: Effective internal controls over materials and supplies inventory necessitate adequate monitoring and recording of materials and supplies inventory.

Condition: A \$185,527 decrease in materials and supplies inventory resulted from a reconciliation of actual inventory on hand. In addition, a \$16,108 deduction of lubricants was recorded to agree with the year-end actual count. This is a result of materials and supplies that were not supported by appropriate issuance tickets. Approved work orders are not always prepared prior to inventory requests. Several issuance tickets lacked issuer and receiver signatures to evidence authorized issuances and acknowledgement of inventory receipt.

Cause: The cause of the above condition is a lack of adequate documentation, periodic monitoring and reconciliation, and incomplete recording of materials and supplies inventory transactions.

Effect: The effect of the condition is a significant number of year-end reconciling adjustments and potential loss of materials and supplies inventory.

Recommendation: We recommend KAJUR perform periodic reconciliation of materials and supplies inventory. Adequate review of journal entries is also recommended.

Auditee Response and Corrective Action Plan: KAJUR also agrees with this finding and its prescribed recommendations. Similar to the first finding (2016-001), certain elements within KAJUR physical work environment will also need to improve to compliment the recommendation prescribed above. These include properly review and reconcile the materials and supplies inventory on a routine basis.

Corrective Action:

- 1) KAJUR agrees with the recommendation to apply consistent practices in reviewing of journal entries.
- 2) Will also continue on-going effort to develop internal policies and procedures and refine existing ones.

**KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2016

Finding No. 2016-003

Local Noncompliance

Criteria: RepMar Procurement Code states the following:

- a) Section 124 - unless otherwise authorized by law, all Government contracts shall be awarded by competitive sealed bidding.
- b) Section 127 - procurement of goods and services not exceeding \$25,000 may be in accordance with small purchases procedures promulgated by RepMar's Policy Office; provided, however that procurement requirements shall not be artificially divided so as to constitute a small purchase under this Section.
- c) Section 128 - a contract may be awarded for a supply, service, or construction item without competition when it is determined in writing that there is only one source for the required supply service, or construction item.

Condition: The purchase orders (PO) below did not undergo competitive sealed bidding processes and documentation that quotations were requested from an adequate number of qualified sources was not in file.

PO No.	PO Date	Description	Amount
15-EN-2270	10/18/2015	Mitsubishi L200 pick up	\$ 28,500
15-EN-006	10/09/2015	4x4 Double cab 2016 Ford Ranger	\$ 29,948
16-EN-5081	11/12/2015	2013 Ford F750 Water Truck	\$ 59,521
16-EN-5583	09/07/2016	Tires	\$ 26,928
16-EN-5345	04/29/2016	Pumps and hoses	\$ 27,537
16-EN-5402	05/24/2016	Pressure exchanger, cartridge, spare parts	\$ 89,084
16-EN-5475	07/07/2016	Micron filter, membrane	\$ 40,540
16-EN-5484	07/11/2016	Grundfos pump and motors	\$ 42,534
16-EN-5572	09/01/2016	fittings, saddles, clamps, PVC	\$ 50,320

In addition, small capital asset purchases lack adequate quotations from qualified vendors.

Cause: The cause of the above condition is a lack of adequate internal control policies and procedures ensuring compliance with RepMar's Procurement Code.

Effect: The effect of the above condition is noncompliance with RepMar's Procurement Code.

Prior Year Status: Lack of compliance with RMI procurement requirements was reported as a finding in prior Single Audits as items 2015-003 and 2014-001.

Recommendation: We recommend KAJUR adhere to RepMar's Procurement Code. In addition, documentation on file should include a history of the procurement including an assessment of vendor selection.

**KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.**

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2016

Finding No. 2016-003, Continued

Local Noncompliance, Continued

Auditee Response and Corrective Action Plan: KAJUR agrees with this finding and the listed recommendations. KAJUR concurs that in order to alleviate this issue, internal control policies and procedures in compliance with RepMar's Procurement Code need to be created and enforced. This will improve the documentation and paper trails to ensure total transparency and satisfactory operations.

In order to address this issue, as it has been a finding in prior audits, KAJUR has started using TenderLink©, an online procurement facilitator that links together buyers and suppliers throughout the world. This membership ails KAJUR's previous failure to undergo the competitive sealed bidding process from an adequate number of qualified sources. TenderLink© also ensures proper documentation and history of procurement, including assessment of the vendor's selection, as well as procuring items and services in a timely fashion.

Regarding the POs listed above, each were acquired through Iron Planet, an online auction market for used heavy equipment. The method in which items are procured is through an upfront bidding process that calls for the bidder to remain active during the online auctioning. Iron Planet offers affordable and certified good-quality equipment; however, to acquire these goods before they are sold off, the bidder has to actively bid.

This impedes on the RepMar Procurement Code, which requires all goods and services to pass through the bidding committee. KAJUR intends to inquire with the bidding committee and the RMICU Board if the practice of procuring goods through Iron Planet can continue.

Corrective Action:

- 1) Establish and enforce internal control policies and procedures in compliance with RepMar's Procurement Code.
- 2) Continue to utilize TenderLink© to ensure transparency and compliancy of RepMar's Procurement Code.
- 3) Present TenderLink© and Iron Planet to RepMar's Bidding Committee for approval.

**KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.**

Unresolved Prior Year Findings and Questioned Costs  
Year Ended September 30, 2016

The status of unresolved prior year findings is discussed within the Schedule of Findings and Questioned Costs section of this report.