

**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, 2018 AND 2017**

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

Years Ended September 30, 2018 and 2017  
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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, 2018 and 2017, 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, 2018 and 2017, 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.

## **Emphasis-of-Matter**

### *Going Concern*

The accompanying financial statements have been prepared assuming that KAJUR will continue as a going concern. As discussed in Note 7 to the financial statements, KAJUR's recurring losses from operations raise substantial doubt about its ability to continue as a going concern. Management's plans concerning these matters are also discussed in Note 7 to the financial statements. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

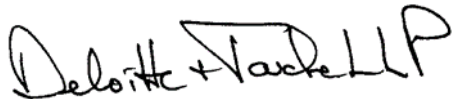
## **Other Matters**

### *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 8 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 of 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 June 6, 2019, 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 solely 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 the effectiveness of KAJUR's 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.



June 6, 2019

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

Management's Discussion and Analysis  
Years Ended September 30, 2018 and 2017

### **Overview**

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 FY2018, KAJUR has under its employment a total of seventy seven (77) employees working in all three functional elements of its operational structure.

In September of 2015, a \$19.02 million project was awarded to RMI and KAJUR under a multi-country grant scheme provided by the US government, the Australian government, and the Asian Development Bank. Under this grant, the Ebeye Water Supply and Sanitation Project (EWSSP) continues to make notable improvements in the quality of services KAJUR provides to the community of Ebeye. Two years later in 2017 a new RO plant was commissioned which essentially increase the production and frequency of water distribution by two-fold and brings the community much closer to their ultimate desire for 24/7 fresh water service to the whole island. Other improvement to KAJUR's existing infrastructure now visible on the ground include extension of utility services (water and sanitation) to North Camp, refurbishment of saltwater pump stations, upgrade to freshwater and saltwater networks throughout Ebeye, as well as major improvement to the island's sewage outfall. All these continuing project activities are infusing funds into KAJUR's capital infrastructure as reflected in notable improvements to KAJUR's capital assets.

### **FINANCIAL HIGHLIGHTS**

KAJUR continues to struggle in its ability to recover cost for the services it provides to the population of 11,000 people in Ebeye. However, as financial and technical experts under the EWSSP project are now engaged with their local counterparts within KAJUR, there is renewed hope that the engagement of younger members of KAJUR's workforce will also build KAJUR's internal capacity and accountability in the operation and maintenance of these advance systems being built under EWSSP.

As in other Pacific utility operations, local capacity building continues to be a top priority area for KAJUR. As such, a select group of KAJUR's EWSSP local counterparts continued direct engagements with off-island experts in financial management, project management, RO plant operation and maintenance, and leak detection capability among others. Unfortunately, Ebeye's limited skilled labor-pool and KAJUR's weak financial position places the organization at a great disadvantage when it comes to competing for younger and higher skilled employees with other competing organizations such as the military base on Kwajalein.

## KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Management's Discussion and Analysis, Continued  
Years Ended September 30, 2018 and 2017

Leading into Fiscal Year 2019, KAJUR is now positioning itself for three major plans that have taken shape and will hopefully make some positive improvements to KAJUR's financial footprint. These changes include the decision to install prepaid electrical meters in all government buildings; decision to install prepaid water meters for all water consumers in Ebeye; and for MEC to provide technical assistance to KAJUR in managing its financial and supply systems. In addition, KAJUR has identified and will soon hire an off-island technical manager with experience in power generation operation and maintenance as well as RO plant operations and maintenance.

KAJUR recognizes the adverse impact other government organizations have on KAJUR when these government agencies fail to budget adequately for their utility needs. Without the installation of prepaid metering on government facilities, KAJUR will continue to have little to no control over unpaid government utility bills. This same principle applies to water being provided to government facilities. Consequently, government organizations have been given notice that starting FY2019, all government facilities will be retrofitted with prepaid electric metering systems. Prepaid water metering systems will follow as soon as the new fresh water and saltwater distribution systems are in place.

KAJUR also recognizes the small "baby steps" it can take immediately to improve its accounting and supply system. As noted from KAJUR's 2018 financial audit exercises, some improvement in KAJUR inventory practices will eliminate most deficiencies noted in this recent financial audit. As such, with assistance from MEC, KAJUR has taken the initial steps toward adopting the same steps MEC took earlier to improve its own supply and inventory systems. Over the course of a six month period, a small group of MEC Finance and Supply staff will make several short trips to Ebeye to help KAJUR set up its supply and inventory systems. Some internal accounting processes within KAJUR have already been modified as part of these overall improvements.

### 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.

A comparative summary of KAJUR's Statement of Net Position is presented below:

	<u>2018</u>	<u>2017</u>	<u>2016</u>
Assets:			
Current and other assets	\$ 1,492,033	\$ 1,613,716	\$ 1,832,658
Capital assets	<u>7,720,760</u>	<u>5,434,009</u>	<u>1,913,316</u>
Total assets	<u>9,212,793</u>	<u>7,047,725</u>	<u>3,745,974</u>
Liabilities:			
Current liabilities	<u>5,539,296</u>	<u>3,791,509</u>	<u>2,602,142</u>
Net Position:			
Invested in capital assets	7,720,760	5,434,009	1,913,316
Restricted	22,478	22,478	50,000
Unrestricted	<u>(4,069,741)</u>	<u>(2,200,271)</u>	<u>(819,484)</u>
Total net position	\$ <u>3,673,497</u>	\$ <u>3,256,216</u>	\$ <u>1,143,832</u>

## KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Management's Discussion and Analysis, Continued  
Years Ended September 30, 2018 and 2017

As indicated above, there was a slight decrease in KAJUR current and other assets by \$121,683. On the other hand, KAJUR's capital assets increased substantially by \$2,286,751 for an overall increase in KAJUR's total assets by \$2,165,068 in 2018. This substantial increase in assets is attributed to the continuing infusion of funds for infrastructure from the Ebeye Water Supply and Sanitation Project (EWSSP).

KAJUR is current and up-to-date in its reporting requirement for all RMI taxes including RMI Social Security. However, KAJUR sustained a significant amount in liabilities in 2018. This significant amount is mostly attributed to diesel fuel KAJUR received on credit from the Marshalls Energy Company (MEC) throughout that period and, added on top of that, fuel balance carried over from previous years. By the closing of 2018, the current liabilities for KAJUR increased by \$1,747,787 for a total of \$5,539,296. It is anticipated that approximately two million in allocated subsidy in 2019 from US Compact funds for KAJUR will all be used to bring down this amount to more manageable levels. Several attempts by KAJUR to secure a loan with local banks in Majuro were all rejected by the Combined Utility Board. KAJUR now looks to more aggressive means of collecting its Account Receivables along with other means of generating more revenue as short term alternatives to improving KAJUR's cash position to address this situation.

For the foreseeable future, KAJUR, as a State Owned Enterprise (SOE), will continue to rely heavily on the RMI government for funding support to subsidize services to the community in Ebeye and other nearby island communities in order to maintain tariff at a level that is affordable to these communities.

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

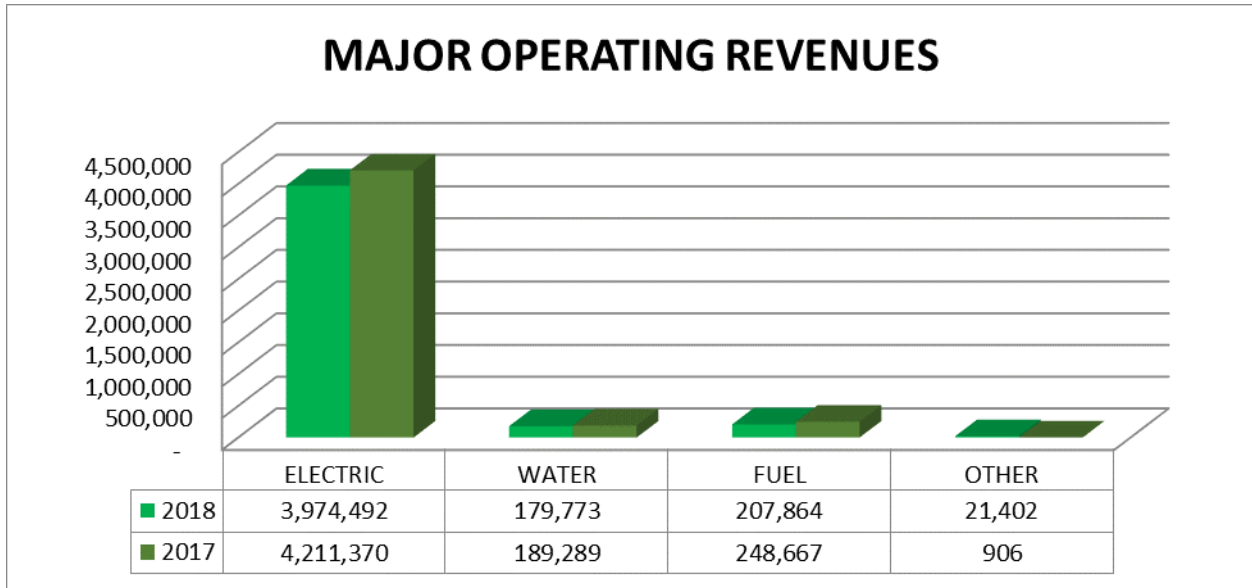
	<u>2018</u>	<u>2017</u>	<u>2016</u>
Revenues:			
Net operating revenues	\$ 4,146,468	\$ 4,366,109	\$ 4,159,744
Non-operating revenues	1,327,860	1,327,860	1,377,860
Capital contributions	<u>2,792,744</u>	<u>3,213,670</u>	<u>-</u>
Total revenues	<u>8,267,072</u>	<u>8,907,639</u>	<u>5,537,604</u>
Expenses:			
Net operating expenses	7,718,537	6,697,820	5,693,503
Non-operating expenses	<u>131,254</u>	<u>97,435</u>	<u>-</u>
Total expenses	<u>7,849,791</u>	<u>6,795,255</u>	<u>5,693,503</u>
Change in net position	\$ <u>417,281</u>	\$ <u>2,112,384</u>	\$ <u>(155,899)</u>

The Statement of Revenues, Expenses and Changes in Net Position identifies the various revenue and expense items that impacted change in net position. As indicated above, KAJUR's total revenues decreased from \$8,907,639 in FY17 to \$8,267,072 in FY18. This decrease can be attributed to electrical generator breakdown that started toward the end of FY18 forcing KAJUR to go into rotating black-outs for half of the island. It is also important to note that Ebeye's main source of water comes from its Saltwater Water Reverse Osmosis (SWRO) Plant. As the plant needs power to produce water, the power situation that occurred in early September 2018 also had a slight impact on KAJUR's revenue generated from water. See chart below for a closer analysis of KAJUR's income and their sources.

The graph below shows a comparative analysis of revenue trends from major components of KAJUR's operating revenues for both 2017 and 2018.

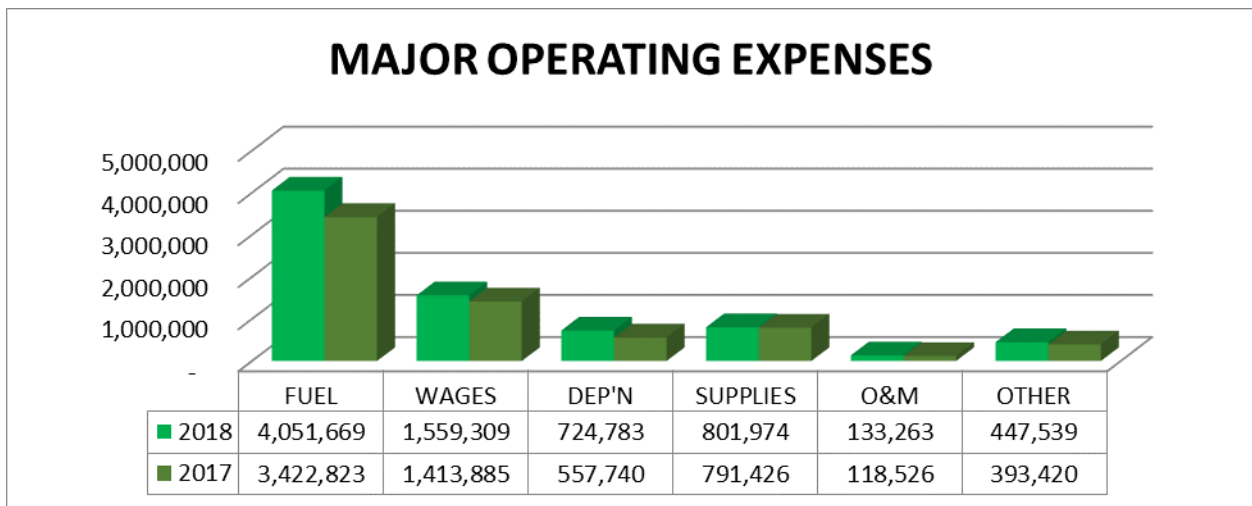
**KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.**

Management's Discussion and Analysis, Continued  
 Years Ended September 30, 2018 and 2017



As expected, fuel and lube continued to be the leading expense items among KAJUR's operational expenses. The increase in operating expense from \$6,697,820 to \$7,718,537 (\$1,020,717 increase) can also be attributed to the unforeseen power situation described above. To help minimize the adverse impact that the power situation had on the community of Ebeye, fuel was provided at no charge to major businesses who own private generators to continuously run their generators during the whole period that the island was running on one and one-half power generation units. Employee wages also increased significantly by \$145,424. This increase in employee wages is attributed to employees overtime both as a result of added work imposed on KAJUR resulting from upgrades being done on KAJUR's water and sanitation as well as overtime needed for bunkering operations during bi-weekly fuel when employees are required to work extended hours to ensure a quick turn-around time for vessels that normally deliver fuel for Ebeye. It is also important to note that of all 77 employees that now work for KAJUR, sixty employees or seventy-eight percent at the "low" spectrum of KAJUR's payscale. The major components of KAJUR's operational expenses are highlighted in the graph below.

See graph below for a comparative analysis of major components of KAJUR's operating expenses for both 2017 and 2018.





## KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Management's Discussion and Analysis, Continued  
Years Ended September 30, 2018 and 2017

### CAPITAL ASSETS

Over the past three years, KAJUR acquired major investments in capital assets from the Ebeye Water Supply and Sanitation Project (EWSSP). A summary of KAJUR's capital assets for the past three years is presented below:

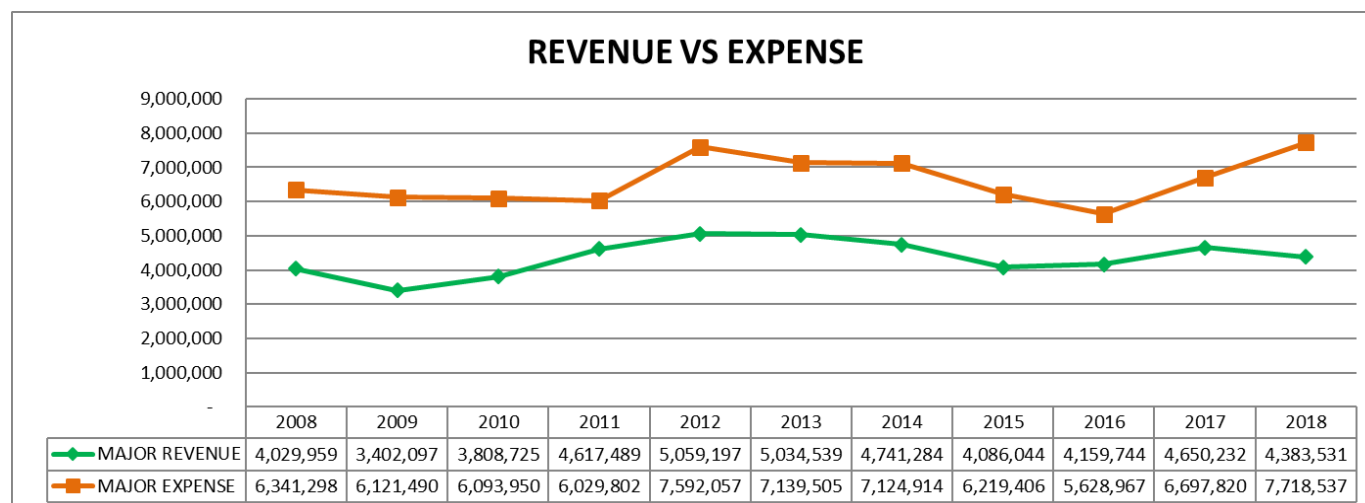
	<u>2018</u>	<u>2017</u>	<u>2016</u>
Plant and machinery	\$ 5,424,285	\$ 5,405,697	\$ 5,378,323
Distribution system	2,167,074	2,134,149	2,056,634
Water system	5,291,945	1,965,890	1,635,775
Other equipment	<u>2,415,876</u>	<u>2,324,248</u>	<u>2,166,208</u>
	15,297,180	11,829,984	11,236,940
Less accumulated depreciation	<u>(10,430,830)</u>	<u>(9,834,004)</u>	<u>(9,380,398)</u>
	4,868,350	1,995,980	1,856,542
Construction in progress	<u>2,852,110</u>	<u>3,438,029</u>	<u>56,774</u>
	<u>\$ 7,720,460</u>	<u>\$ 5,434,009</u>	<u>\$ 1,913,316</u>

Please refer to note 5 to the accompanying financial statements for additional information regarding KAJUR's capital assets.

Management's Discussion and Analysis for the year ended September 30, 2017 is set for in the report on the audit of KAJUR's financial statements dated June 5, 2018. That Discussion and Analysis explains the major factors impacting the FY 2017 financial statements and may be obtained from the contact information below.

### FUTURE OUTLOOK ON SUSTAINABILITY

KAJUR's future outlook on sustainability remains bleak. To sustain its services, KAJUR continues to depend heavily on the US and RMI governments to help cover for over three million gap (2018) that is needed yearly to maintain essential utility services to Ebeye and Gugeegue. As discussed in earlier part of this report, electric sales remain the top source of revenue generation for KAJUR. However, as depicted in the chart below, it is obviously becoming more costly for KAJUR to generate electricity as the aging generators gets closer to retirement. Two major projects - the EWSSP (\$19M), which is currently being implemented and the Ebeye Solar Project (\$10M), which is tentatively scheduled for bid-out in May 2019 are providing greater likelihood of a more sustainable future for KAJUR.



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

Management's Discussion and Analysis, Continued  
Years Ended September 30, 2018 and 2017

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

The following are KAJUR's focus for the coming year:

1. Hire a Technical Manager for KAJUR primarily to help management build KAJUR's local capacity to operate and maintain its power generation and RO water production systems and build within KAJUR a culture of learning and professional growth.
2. Update KAJUR's strategic plan and formulate a clear direction that will lead KAJUR toward self-dependency and sustainability.
3. Establish a more proactive approach toward information sharing with EWSSP stakeholders including donor countries, local and national government, as well as communities of Ebeye and neighboring islands.
4. Further strengthen KAJUR's capacity within its supply and inventory system through technical support from MEC.
5. Further strengthen KAJUR's data collection capabilities.
6. Reshuffle employees within KAJUR to beef-up areas that are in greater need of support without incurring substantial overhead cost and encourage cross-utilization of employees where appropriate.
7. Active look for other means for KAJUR to generate more revenues and lower amount owed to MEC.

**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 wish to request additional financial information, please contact the Kwajalein Atoll Joint Utility Resources, Inc manager at PO Box 5819, Ebeye MH 96970.

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

Statements of Net Position  
September 30, 2018 and 2017

	<u>2018</u>	<u>2017</u>
<u>ASSETS</u>		
Current assets:		
Cash	\$ 299,210	\$ 398,277
Receivables:		
Utility	2,392,030	2,180,568
Affiliates	1,159,329	1,137,745
Due from related party	154,358	131,968
Due from grantor	47,552	212,449
Employees	9,001	7,784
Other	<u>275,681</u>	<u>150,136</u>
	4,037,951	3,820,650
Less allowance for doubtful accounts	<u>(3,560,137)</u>	<u>(3,323,074)</u>
Total receivables, net	<u>477,814</u>	<u>497,576</u>
Prepaid expenses	<u>61,531</u>	<u>149,430</u>
Inventories	<u>653,478</u>	<u>538,412</u>
Total current assets	<u>1,492,033</u>	<u>1,583,695</u>
Noncurrent assets:		
Deposits for capital assets acquisition	-	30,021
Capital assets:		
Nondepreciable	2,852,110	3,438,029
Other capital assets, net of accumulated depreciation	<u>4,868,650</u>	<u>1,995,980</u>
Total noncurrent assets	<u>7,720,760</u>	<u>5,464,030</u>
	<u>\$ 9,212,793</u>	<u>\$ 7,047,725</u>
<u>LIABILITIES AND NET POSITION</u>		
Current liabilities:		
Accounts payable	\$ 384,863	\$ 75,026
Due to affiliates	5,032,966	3,619,001
Accrued liabilities	46,591	30,323
Unearned revenue	<u>74,876</u>	<u>67,159</u>
Total current liabilities	<u>5,539,296</u>	<u>3,791,509</u>
Contingencies		
Net position:		
Net investment in capital assets	7,720,760	5,434,009
Restricted	22,478	22,478
Unrestricted	<u>(4,069,741)</u>	<u>(2,200,271)</u>
Total net position	<u>3,673,497</u>	<u>3,256,216</u>
	<u>\$ 9,212,793</u>	<u>\$ 7,047,725</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, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Operating revenues:		
Electric and service billings	\$ 3,974,492	\$ 4,211,370
Fuel sales	207,864	248,667
Water	179,773	189,289
Other	<u>21,402</u>	<u>906</u>
Total operating revenues	4,383,531	4,650,232
Less provision for doubtful accounts	<u>(237,063)</u>	<u>(284,123)</u>
Total net operating revenues	<u>4,146,468</u>	<u>4,366,109</u>
Operating expenses:		
Fuel and lubricants	4,051,669	3,422,823
Salaries, wages and benefits	1,559,309	1,413,885
Supplies and materials	801,974	791,426
Depreciation	724,783	557,740
Travel and transportation	141,608	163,906
Operations and maintenance	133,263	118,526
Contractual services	115,173	62,080
Communications	64,837	32,465
Rental	26,268	26,268
Insurance	22,800	16,536
Board activities	20,068	21,388
Entertainment	18,811	10,139
Bank charges	3,991	5,908
Membership fees	3,983	10,730
Miscellaneous	<u>30,000</u>	<u>44,000</u>
Total operating expenses	<u>7,718,537</u>	<u>6,697,820</u>
Operating loss	<u>(3,572,069)</u>	<u>(2,331,711)</u>
Nonoperating revenues (expenses):		
Compact funding	1,327,860	1,327,860
Loss on write-off of capital assets	<u>(131,254)</u>	<u>(97,435)</u>
Total nonoperating revenues, net	<u>1,196,606</u>	<u>1,230,425</u>
Loss before capital contributions	(2,375,463)	(1,101,286)
Capital contributions	<u>2,792,744</u>	<u>3,213,670</u>
Change in net position	417,281	2,112,384
Net position at beginning of year	<u>3,256,216</u>	<u>1,143,832</u>
Net position at end of year	<u>\$ 3,673,497</u>	<u>\$ 3,256,216</u>

See accompanying notes to financial statements.

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

Statements of Cash Flows  
Years Ended September 30, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Cash flows from operating activities:		
Cash received from customers	\$ 4,175,164	\$ 4,213,085
Cash payments to suppliers for goods and services	(3,737,494)	(3,152,678)
Cash payments to employees for services	<u>(1,544,574)</u>	<u>(1,409,584)</u>
Net cash used for operating activities	<u>(1,106,904)</u>	<u>(349,177)</u>
Cash flows from noncapital financing activities:		
Operating subsidies received from RepMar	<u>1,327,860</u>	<u>1,327,860</u>
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets	<u>(320,023)</u>	<u>(906,727)</u>
Net change in cash	(99,067)	71,956
Cash at beginning of year	<u>398,277</u>	<u>326,321</u>
Cash at end of year	<u>\$ 299,210</u>	<u>\$ 398,277</u>
Reconciliation of operating loss to net cash used for operating activities:		
Operating loss	\$ (3,572,069)	\$ (2,331,711)
Adjustments to reconcile operating loss to net cash used for operating activities:		
Depreciation	724,783	557,740
Provision for doubtful accounts	237,063	284,123
(Increase) decrease in assets:		
Receivables:		
Utility	(211,462)	(147,782)
Affiliate	(21,584)	93,584
Employees	(1,217)	(272)
Other	16,962	(384,052)
Prepaid expenses	87,899	236,480
Inventories	(115,066)	153,346
Increase in liabilities:		
Accounts payable	309,837	21,859
Due to affiliates	1,413,965	1,164,864
Unearned revenue	7,717	1,103
Other current and accrued liabilities	<u>16,268</u>	<u>1,541</u>
Net cash used for operating activities	<u>\$ (1,106,904)</u>	<u>\$ (349,177)</u>

See accompanying notes to financial statements.

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

Statements of Cash Flows, Continued  
Years Ended September 30, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Noncash capital and related financing activities:		
Ebeye Water Supply and Sanitation Project contributions:		
Capital assets	\$ 2,792,744	\$ 3,213,670
Capital contributions	<u>(2,792,744)</u>	<u>(3,213,670)</u>
	<u>\$ -</u>	<u>\$ -</u>
Write-off of capital assets:		
Capital assets	\$ (259,211)	\$ (201,569)
Accumulated depreciation	127,957	104,134
Loss on write-off of capital assets	<u>131,254</u>	<u>97,435</u>
	<u>\$ -</u>	<u>\$ -</u>

See accompanying notes to financial statements.

## KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Notes to Financial Statements  
September 30, 2018 and 2017

### (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 (GAAP) 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*, amended by GASB Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus*, GASB Statement No. 38, *Certain Financial Statement Note Disclosures*, and GASB Statement No. 61, *The Financial Reporting Entity: Omnibus - an amendment of GASB Statement No. 14 and No. 34*, 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* consists of capital assets, net of accumulated depreciation and related debt, plus construction or improvement of those assets.
- *Restricted net position* - nonexpendable net position subject to externally imposed stipulations that require KAJUR to maintain such permanently. As of September 30, 2018 and 2017, KAJUR does not have nonexpendable restricted net position. Expendable net position whose use by KAJUR is subject to externally imposed stipulations that can be fulfilled by actions of KAJUR pursuant to those stipulations or that expire with the passage of time. As of September 30, 2018 and 2017, KAJUR has expendable restricted net position of \$22,478 for a power plant fuel and waste oil management system upgrade project.

## KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Notes to Financial Statements  
September 30, 2018 and 2017

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

- *Unrestricted net position* consists of net position, which 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.

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. 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, 2018 and 2017, the carrying amount of cash was \$299,210 and \$398,277, respectively, and the corresponding bank balances were \$321,235 and \$400,239, respectively. Of the bank balances, \$48,255 and \$24,580, respectively, are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. Bank deposits of \$272,980 and \$375,659, respectively, are maintained in financial institutions not subject to depository insurance. As of September 30, 2018 and 2017, bank deposits in the amount of \$48,255 and \$24,580, 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, 2018 and 2017

### (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, 2018 and 2017. 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 using 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.

#### Reclassifications

Certain reclassifications have been made to the 2017 financial statements to conform to the 2018 presentation. These reclassifications had no impact on operating loss, net position or cash flows as previously reported.

## KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Notes to Financial Statements  
September 30, 2018 and 2017

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

#### New Accounting Standards

During the year ended September 30, 2018, KAJUR implemented the following pronouncements:

- GASB 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.
- GASB 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.
- GASB Statement No. 85, *Omnibus 2017*, which address practice issues that have been identified during implementation and application of certain GASB Statements including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefits).
- GASB Statement No. 86, *Certain Debt Extinguishment Issues*, which improves consistency in accounting and financial reporting for in-substance defeasance of debt.

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

In November 2016, GASB issued Statement No. 83, *Certain Asset Retirement Obligations*, which addresses accounting and financial reporting for certain asset retirement obligations (AROs) associated with the retirement of a tangible capital asset. The provisions in Statement No. 83 are effective for fiscal years beginning after June 15, 2018. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In January 2017, GASB issued Statement No. 84, *Fiduciary Activities*, which establishes criteria for identifying fiduciary activities of all state and local governments. The provisions in Statement No. 84 are effective for fiscal years beginning after December 15, 2018. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In June 2017, GASB issued Statement No. 87, *Leases*, which establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. The provisions in Statement No. 87 are effective for fiscal years beginning after December 15, 2019. Management has yet to determine whether the implementation of this statement will have a material effect on the financial statements.

In April 2018, GASB issued Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*, which improves the information that is disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements. The provisions in Statement No. 88 are effective for fiscal years beginning after June 15, 2018. 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, 2018 and 2017

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

#### New Accounting Standards, Continued

In June 2018, GASB issued Statement No. 89, *Accounting for Interest Cost Incurred before the End of a Construction Period*, which requires that interest cost incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred for financial statements prepared using the economic resources measurement focus. The provisions in Statement No. 89 are effective for fiscal years beginning after December 15, 2019. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In August 2018, GASB issued Statement No. 90, *Majority Equity Interests – an Amendment of GASB Statements No. 14 and No. 61*, which improves the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and the relevance of financial statement information for certain component units. The provisions in Statement No. 90 are effective for fiscal years beginning after December 15, 2018. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

#### Estimates

The preparation of financial statements in conformity with GAAP 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.

### (4) Inventories

Inventories at September 30, 2018 and 2017, consist of the following:

	<u>2018</u>	<u>2017</u>
Materials and supplies	\$ 347,749	\$ 433,059
Fuel	305,729	66,243
Lubricants	_____ -	_ 39,110
	<u>\$ 653,478</u>	<u>\$ 538,412</u>

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

Notes to Financial Statements  
September 30, 2018 and 2017

(5) Capital Assets

Capital asset activity for the years ended September 30, 2018 and 2017 are as follows:

	2018			
	October 1, 2017	Additions	Reductions	September 30, 2018
Plant and machinery	\$ 5,405,697	\$ 188,715	\$ (170,127)	\$ 5,424,285
Distribution system	2,134,149	32,925	-	2,167,074
Water system	1,965,890	3,415,439	(89,084)	5,292,245
Other equipment	<u>2,324,248</u>	<u>91,628</u>	<u>-</u>	<u>2,415,876</u>
	11,829,984	3,728,707	(259,211)	15,299,480
Less accumulated depreciation	<u>(9,834,004)</u>	<u>(724,783)</u>	<u>127,957</u>	<u>(10,430,830)</u>
	1,995,980	3,003,924	(131,254)	4,868,350
Construction in progress	<u>3,438,029</u>	<u>2,792,744</u>	<u>(3,378,663)</u>	<u>2,852,110</u>
	<u>\$ 5,434,009</u>	<u>\$ 5,796,668</u>	<u>\$ (3,509,917)</u>	<u>\$ 7,720,760</u>
	2017			
	October 1, 2016	Additions	Reductions	September 30, 2017
Plant and machinery	\$ 5,378,323	\$ 58,317	\$ (30,943)	\$ 5,405,697
Distribution system	2,056,634	167,797	(90,282)	2,134,149
Water system	1,635,775	410,459	(80,344)	1,965,890
Other equipment	<u>2,166,208</u>	<u>158,040</u>	<u>-</u>	<u>2,324,248</u>
	11,236,940	794,613	(201,569)	11,829,984
Less accumulated depreciation	<u>(9,380,398)</u>	<u>(557,740)</u>	<u>104,134</u>	<u>(9,834,004)</u>
	1,856,542	236,873	(97,435)	1,995,980
Construction in progress	<u>56,774</u>	<u>3,381,255</u>	<u>-</u>	<u>3,438,029</u>
	<u>\$ 1,913,316</u>	<u>\$ 3,618,128</u>	<u>\$ (97,435)</u>	<u>\$ 5,434,009</u>

During the years ended September 30, 2018 and 2017, management of KAJUR determined that certain capital assets in the amount of \$259,211 and \$201,569, respectively, no longer existed. Accordingly, these capital assets were written-off resulting in a loss of \$131,254 and \$97,435, respectively.

During the years ended September 30, 2018 and 2017, KAJUR was the recipient of capital contributions in the amount of \$2,792,744 and \$3,213,670, respectively, associated with the Ebeye Water Supply and Sanitation Project. These contributions related to the following project components:

	2018	2017
Salt Water Reverse Osmosis (SWRO) Plant	\$ 164,993	\$ 3,213,670
Water and Sewer System Rehabilitation	<u>2,627,751</u>	<u>-</u>
	<u>\$ 2,792,744</u>	<u>\$ 3,213,670</u>

On October 7, 2017, the SWRO Plant with a total cost of \$3,378,663 was commissioned and placed into service.

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

Notes to Financial Statements  
September 30, 2018 and 2017

(6) Related Party Transactions

KAJUR is a component unit of RepMar and is therefore affiliated with all RepMar-owned and affiliated entities, including the Marshalls Energy Company, Inc. (MEC).

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, 2018 and 2017 and the related receivable and payable balances as of September 30, 2018 and 2017, are as follows:

	2018		
	<u>Expenses</u>	<u>Receivables</u>	<u>Payables</u>
Marshalls Energy Company, Inc.	\$ 3,922,695	\$ 31,585	\$ 4,913,428
Marshall Islands National Telecommunications Authority	64,837	3,216	23,340
Marshall Islands Marine Resources Authority	26,268	239,547	-
RepMar	-	829,850	15,555
Others	<u>152,676</u>	<u>55,131</u>	<u>80,643</u>
	<u>\$ 4,166,476</u>	<u>\$ 1,159,329</u>	<u>\$ 5,032,966</u>
	2017		
	<u>Expenses</u>	<u>Receivables</u>	<u>Payables</u>
Marshalls Energy Company, Inc.	\$ 3,358,793	\$ 53,445	\$ 3,516,291
Marshall Islands National Telecommunications Authority	32,465	780	3,259
Marshall Islands Marine Resources Authority	26,268	214,531	1,521
RepMar	-	824,456	18,372
Others	<u>133,822</u>	<u>44,533</u>	<u>79,558</u>
	<u>\$ 3,551,348</u>	<u>\$ 1,137,745</u>	<u>\$ 3,619,001</u>

During each of the years ended September 30, 2018 and 2017, KAJUR received \$1,327,860 of appropriations from RepMar in cash which were subsequently paid to Marshalls Energy Company, Inc. for the purchase of fuel.

During the years ended September 30, 2018 and 2017, KAJUR generated fuel sales of \$93,247 and \$149,429, respectively, from a local company in which a Board member has share ownership. As of September 30, 2018 and 2017, receivables due from this related party total \$154,358 and \$131,968, respectively. During the year ended September 30, 2018, KAJUR purchased a vehicle from this related party amounting to \$24,900.

## KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Notes to Financial Statements  
September 30, 2018 and 2017

### (6) Related Party Transactions, Continued

On October 26, 2015, RepMar entered into a sub-grant agreement with the International Union for Conservation of Nature and Natural Resources, in which the Ministry of Natural Resources and Commerce will manage all the necessary works needed to facilitate the implementation of the MEC and KAJUR Power Plants Fuel and Waste Oil Management System Upgrade Phase 1. During the year ended September 30, 2016, KAJUR received \$50,000 under this grant agreement. During the year ended September 30, 2017, KAJUR incurred expenditures of \$27,522 associated with this grant. As of September 30, 2018 and 2017, the unexpended amount of \$22,478 is restricted within net position.

### (7) Contingencies

KAJUR has incurred losses from operations of \$3,572,069 and \$2,331,711 during the years ended September 30, 2018 and 2017, 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 Marshalls 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.

### (8) Capital Contributions

On October 13, 2015, the Asian Development Bank (ADB) approved two grants (Grant Nos. 0438-RMI and 0439-RMI) to RepMar in the aggregate amount of \$9,000,000 for the Ebeye Water Supply and Sanitation Project. Simultaneously, the ADB entered into a project agreement with KAJUR for the purpose of implementing the Project by improving water and sanitation systems on Ebeye. The grant agreements required that the grant proceeds be made available to KAJUR for the purpose of financing expenditures of the Project. During the years ended September 30, 2018 and 2017, certain Project capital expenditures were incurred under the following funding sources:

	<u>2018</u>	<u>2017</u>
Grant No. 0438-RMI (ADB)	\$ 1,030,817	\$ 1,038,015
Grant No. 0439-RMI (Government of Australia)	694,250	829,127
RepMar	<u>1,067,677</u>	<u>1,346,528</u>
	<u>\$ 2,792,744</u>	<u>\$ 3,213,670</u>

**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, 2018, 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, which collectively comprise KAJUR's basic financial statements, and have issued our report thereon dated June 6, 2019. Our report included an emphasis-of-matter paragraph regarding going concern.

### **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.

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 2018-001 and 2018-002, which we consider to be material weaknesses.

## Compliance and Other Matters

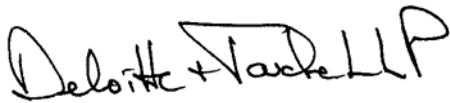
As part of obtaining reasonable assurance about whether KAJUR's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect 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 2018-003.

## KAJUR's Responses to Findings

KAJUR's responses to the findings identified in our audit are described in the accompanying Corrective Action Plan. 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.



June 6, 2019



**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 Compliance Supplement* that could have a direct and material effect on KAJUR's major federal program for the year ended September 30, 2018. 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, 2018.

## 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.

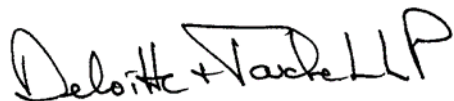
*A deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement 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.

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, 2018, and have issued our report thereon dated June 6, 2019, 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.



June 6, 2019

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

Schedule of Expenditures of Federal Awards  
Year Ended September 30, 2018

<u>Program Title</u>	<u>Expenditures FY18</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	<u>\$ 1,327,860</u>
Power Generation, Distribution, and Maintenance	

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 \$4,051,669)

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

Schedule of Findings and Questioned Costs  
Year Ended September 30, 2018

**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>
2018-001	Accounts Receivable
2018-002	Materials and Supplies Inventory
2018-003	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, 2018

Finding No. 2018-001

Accounts Receivable

Criteria: Timely collection of accounts receivables should be monitored to maximize collections and minimize future losses.

Condition:

- a. As of September 30, 2018, electric trade receivables aggregated \$2,254,600. Of this amount, \$1,802,173 has been long outstanding for years without adequate collection. Twenty customer accounts comprise 80% of this total. Receivable aging was not properly performed.
- b. Certain customers continue to receive utility services without resolution of long outstanding balances.
- c. Outstanding balances from diesel fuel sales at September 30, 2018 amounted to \$252,043. Due to insufficient collection, an allowance for doubtful debts was recognized by KAJUR. Of that total, \$154,358 is due from a related party.
- d. During the year ended September 30, 2018, KAJUR recorded \$66,020 bad debts related to grant expenditures incurred that exceeded the contract amount. No written communication occurred between the grantor and KAJUR indicating that such will be reimbursed.
- e. During the year ended September 30, 2018, KAJUR reversed the prior year recorded prepayment of \$50,900 for the purchase of Lube Oil paid in FY17 to an Hawaiian company. These items were not yet received as of September 30, 2018. KAJUR is claiming a full refund from this company; however, this amount has not been billed or collected and resulted in a proposed audit adjustment of \$50,900 to recognize an allowance for doubtful debts.

Cause: The cause of the above condition is a lack of adequate internal control policies and procedures that facilitate timely collections. In addition, a formal policy has not been implemented to standardize customer collections, 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 potential losses due to collectability.

Identification as a Repeat Finding: Finding 2017-001, 2016-001 and 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 monitor grant related expenditures and implement effective collection measures or enter into collection agreements with customers that have long outstanding balances.

Auditee Response and Corrective Action Plan: See the auditee-prepared corrective action plan.

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

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2018

Finding No. 2018-002

Materials and Supplies Inventory

Criteria: Materials and supplies inventory should be periodically reviewed for accuracy and ongoing performance.

Condition:

- a. A \$133,951 year-end net adjustment of materials and supplies inventory resulted from a reconciliation of actual inventory on hand. a) Materials and supplies were not supported with signed issuance tickets to evidence authorized issuance and acknowledge inventory receipts. b) Prepaid inventory is not correctly recorded and is not timely monitored. c) Items purchased and received during the year were not properly supported by receiving reports. d) Approved work orders are not always prepared prior to inventory requests.
- b. Of the six samples tested during our year-end inventory cut off procedure, four did not agree with final inventory valuation report which resulted in audit adjustment of \$17,572.

Cause: The cause of the above condition is due to ineffective internal controls over monitoring, reconciliation, and recording inventory transactions.

Effect: A significant number of year-end reconciling adjustments and a potential loss of materials and supplies result from this condition.

Identification as a Repeat Finding: Finding 2017-002, 2016-002.

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: See the auditee-prepared corrective action plan.

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

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2018

Finding No. 2018-003

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:

- a. KAJUR does not have a formal procurement policy that requires procurement rationale be documented and be maintained in file. Additionally, competitive procurement was not determinable for various expenditures tested that occurred during the year. This includes the purchase of vehicle from a related party for \$24,900.
- b. During the year ended September 30, 2018, KAJUR was a signatory to an independent technical review service for an ongoing water supply and sanitation project. The initial cost of the service agreement was \$49,040. However, effective October 12, 2017, the service fee increased to \$73,880. Documentation was not available to support compliance with the above criteria. This has been reported as a Finding 2017-003 in FY17 report.

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

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

Identification as a Repeat Finding: Finding 2017-003, 2016-003, 2015-003 and 2014-001.

Recommendation: We recommend KAJUR adhere to RepMar's Procurement Code. In addition, competitive procurement rationale should be documented and be maintained in file.

Auditee Response and Corrective Action Plan: See the auditee-prepared corrective action plan.

**CORRECTIVE ACTION PLAN  
2 CFR § 200.511(c)  
Year Ended September 30, 2018**



**Finding No. 2018-001: Accounts Receivable**

Name of Contact Person: Romeo Alfred (General Manager)

Corrective Action Plan: KAJUR agrees to finding No. 2018-001 (Account Receivable) and further noted it being a repeated finding since 2015. As noted in our 2018 audit, KAJUR continues to struggle in its ability to collect long outstanding (AR) balances. There are a series of contributing factors, the leading being the one noted by the independent auditing firm as lack of internal control policies and procedures. Another contributing factor is KAJUR's inability to address Kwajalein's landowners' request that they be provided with the same utility allowances that landowners in Majuro receive. This has been an ongoing policy issue which needs attention at the policy/governance level.

There are also ongoing efforts under the Ebeye Water Supply and Sanitation Project (EWSSP) to develop and increase KAJUR's capacity in financial management and to improve KAJUR's ability to collect its accounts receivable over the course of the EWSSP project implementation phase. A Financial Advisor has been contracted not only to handle EWSSP contract finances but also to build capacity within KAJUR.

In the shorter term, this year MEC has started providing assistance to KAJUR in streamlining its procurement, inventory and accounting procedures to mirror some of the improvements now being observed at MEC. Over a course of three visits to Ebeye this year, KAJUR will meet specific milestones which have been mutually established between KAJUR and MEC.

Proposed Completion Date: Ongoing

**Finding No. 2018-002: Materials and Supplies Inventory**

Name of Contact Person: Romeo Alfred (General Manager)

Corrective Action Plan: KAJUR agrees to finding No. 2018-002 (Materials and Supply Inventory) and further noted it being a repeated finding since 2016. As with finding 2018-01 (Accounts Receivable), KAJUR also recognizes the need to strengthen its internal control and reconciliation of material and supply inventory. In March of 2019, MEC conducted an internal analysis of KAJUR's Accounting and Supply system. From this analysis, a series of visits to Ebeye have been scheduled for MEC to help KAJUR strengthen its procurement and inventory work processes. In addition, KAJUR's EWSSP Finance Advisor was requested to help KAJUR develop policies and procedures to help strengthen KAJUR's capacity to monitor, reconcile, and properly record its inventory. From these initial exercises described above, it was mutually agreed that KAJUR will fully utilize the inventory functionality in its Microix Supply and Procurement system which is currently not in use. As such, tasks have been assigned and scheduled over the course of the next four months where assistance from MEC will be provided to get this functionality up and running.

Proposed Completion Date: Ongoing



**CORRECTIVE ACTION PLAN**  
**2 CFR § 200.511(c)**  
**Year Ended September 30, 2018**

**Finding No. 2018-003: Local Noncompliance**

Name of Contact Person: Romeo Alfred (General Manager)

Corrective Action Plan: KAJUR agrees to finding No. 2018-003 (Local Noncompliance) and further noted it being a repeated finding since 2014. For purpose of clarification, KAJUR also wishes to note for record that management decision to purchase the used vehicle cited under this finding was viewed as "in the best interest of the company and the government". KAJUR own a similar vehicles (Pajero) which went out of commission in 2017. Since some parts from this older Pajero are still in good condition, KAJUR's management felt that KAJUR could used these as spare parts if it could purchase a used vehicle of the same model which is what KAJUR ended up doing. However, there are other instances where KAJUR recognizes it fails to comply with RepMar's Procurement Code. KAJUR strongly feels that if KAJUR employees are more diligent in utilizing the ©Tenderlink Procurement system both locally and internationally, it would help ensure compliance to RepMar's Procurement Code. Going forward, KAJUR management will closely monitor all purchases to ensure that ©Tenderlink is used. Additionally, as noted above, plans are already in place where MEC is providing training and assistance in monitoring KAJUR's supply and inventory processes.

While it is taking longer than expected for KAJUR to address these deficiencies noted above, KAJUR assures its board and the Public Accounts Committee that by next fiscal year, these deficiencies will no longer be repeated findings.

Proposed Completion Date: Ongoing

**Summary Schedule of Prior Audit Findings and  
Questioned Costs  
Year Ended September 30, 2018**



Questioned Costs:

There are no questioned costs reported as of September 30, 2018.

Summary Schedule of Prior Audit Findings

<u>Finding No.</u>	<u>Status</u>
2017-001	Not corrected. Refer to the planned corrective actions in the Corrective Action Plan for Finding 2018-001.
2017-002	Not corrected. Refer to the planned corrective actions in the Corrective Action Plan for Finding 2018-002.
2017-003	Not corrected. Refer to the planned corrective actions in the Corrective Action Plan for Finding 2018-003.
2017-004	Resolved. Corrective action taken.