

August 18, 2020

Mr. Joseph Batol
General Manager
Majuro Water and Sewer Company, Inc.

Dear Mr. Batol:

In planning and performing our audit of the financial statements of Majuro Water and Sewer Company, Inc. (MWSC) as of and for the year ended September 30, 2019 (on which we have issued our report dated August 18, 2020) in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, we considered MWSC's internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of MWSC's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of MWSC's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting. However, in connection with our audit, we identified, and included in the attached Appendix I, certain deficiencies related to MWSC's internal control over financial reporting and other matters as of September 30, 2019 that we wish to bring to your attention.

We have also issued a separate report to the Board of Directors, also dated August 18, 2020, on our consideration of MWSC's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters.

The definition of a deficiency is also set forth in the attached Appendix I.

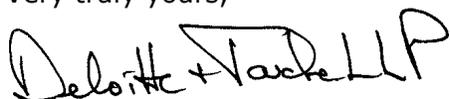
A description of the responsibility of management for establishing and maintaining internal control over financial reporting and of the objectives of and inherent limitations of internal control over financial reporting, is set forth in the attached Appendix II and should be read in conjunction with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

This report is intended solely for the information and use of the Board of Directors, management, others within the organization, and the Office of the Auditor-General and is not intended to be and should not be used by anyone other than these specified parties.

We will be pleased to discuss the attached comments with you and, if desired, to assist you in implementing any of the suggestions.

We wish to thank the staff and management of MWSC for their cooperation and assistance during the course of this engagement.

Very truly yours,



SECTION I - DEFICIENCIES

We identified, and have included below, certain deficiencies involving MWSC's internal control over financial reporting as of September 30, 2019 that we wish to bring to your attention:

1) Revenues*Customer Master File Update*

Six customer accounts were tagged as "ACTB", active and billable, but were not completely billed during the year. Either water meters had technical issues or readings did not occur. We recommend management timely revisit and improve internal controls over the review of water meters, water readings and invoicing of gallons delivered to/used by customers.

2) Inventories

We examined the inventory listing valuation and noted various items tagged as fixed assets or items with quantity on hand without corresponding unit cost amounting to \$92,954 and \$11,182, respectively. Additionally, the inventory valuation report did not agree with the corresponding inventory general ledger balance with an unreconciled variance of \$5,498. As the amount was not considered material to the financial statements, no audit adjustment was proposed. We recommend management periodically scrutinize the inventory valuation listing for items that do not represent inventory and for items without unit costs, and reconcile the valuation report to the corresponding inventory general ledger balance.

3) Debit Accounts Payable Balances

At September 30, 2019, MWSC recorded three debit payable balances aggregating \$9,432, which pertain to vendor overpayments. As the amount was not considered material to the financial statements, no audit adjustment was proposed. We recommend management revisit payable accounts with debit balances and assess whether such be recognized as expense.

4) Credit Accounts Receivable Balances

At September 30, 2019, MWSC recorded 341 customer utility accounts with credit balances aggregating \$62,921, which pertain to customer utility billing overpayments. As this amount was not considered material to the financial statements, no audit adjustment was proposed. We recommend management revisit customer utility accounts with credit balances and assess whether such be recognized as revenue.

5) Invalid Accounts Payable

At September 30, 2019, MWSC recognized a \$16,391 accounts payable owing to a vendor, which had already been paid. The recordation of this liability arose from a vendor invoice being recorded twice. We proposed an audit adjustment to correct this error. We recommend management establish policies and procedures over the review and monitoring of transactions to mitigate the multiple recording of vendor invoices.

SECTION II - OTHER MATTERS

Our observations concerning other matters related to operations, compliance with laws and regulations, and best practices involving internal control over financial reporting that we wish to bring to your attention at this time are as follows:

1) Local Noncompliance - Income Tax Act

MWSC filed and paid income taxes withheld for the year ended September 30, 2019 in a manner inconsistent with the Income Tax Act of 1989, specifically, withholding taxes of \$43,361 were not timely remitted. We recommend management establish adequate internal control policies and procedures requiring compliance with the Income Tax Act.

SECTION II - OTHER MATTERS

2) Local Noncompliance - RMI Procurement Code

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

- a. Check # 23116 – purchase of vehicle spare parts for \$1,557
- b. Check # 22800 – purchase of two (2) art painting for \$1,500
- c. Check #s 22505 and 22704 – vehicle rental for \$5,400
- d. Check #s 22744 and 23120 - purchase of maintenance supplies for \$7,500
- e. Check # 22625 - freight charges for Portable CCTV Sewer Inspection System for \$1,754

We recommend management establish adequate internal control policies and procedures requiring compliance with the RMI Procurement Code.

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

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

<u>Quarter Ended</u>	<u>Amount Owed</u>	<u>Due Date</u>	<u>Date filed</u>	<u>Date fully paid</u>
December 31, 2018	\$ 37,393	01/10/2019	01/10/2019	02/28/2019
March 31, 2019	\$ 37,349	04/10/2019	04/10/2019	05/08/2019
June 30, 2019	\$ 37,333	07/10/2019	07/10/2019	08/27/2019
September 30, 2019	\$ 30,362	10/10/2019	10/09/2019	11/14/2019
2015 to 2018 deficiency	\$ 8,801	Various	09/02/2019	09/18/2019

We recommend management establish adequate internal control policies and procedures requiring compliance with the Social Security Act and the Social Security Health Fund Act.

4) Collection of Utility Receivables

During the year ended September 30, 2019, water utility receivables increased from \$1,818,191 to \$2,126,732 for which a corresponding allowance for uncollectible accounts of \$1,978,219 was recognized. Furthermore, the September 30, 2019 receivable aging indicated that customer water accounts with balances greater than 90 days represent 94% of the total receivable balance. We recommend management reassess collectability of receivables and adopt appropriate internal control policies over collections. Furthermore, we recommend management continue to review the subsidiary ledger to determine uncollectible accounts to be written-off and to obtain requisite approval from the Board. Finally, we recommend management continue its efforts to improve receivable collections. This matter was discussed in our previous letters to management for the audits of fiscal years 2007 through 2018.

5) Disconnection of Non-paying Customers

Of 67 customer utility accounts tested, 10 pertain to users of fresh water and salt and sewer meters, having balances of more than \$150 and which have been unpaid for over 90 days. These accounts were not disconnected at September 30, 2019 despite the outstanding balances and insufficient subsequent collections from October 2019 to December 2019. Current MWSC disconnection policy is to disconnect nonpaying customers with balances 30 days overdue that exceed \$150. We recommend management enforce procedures compliant with this policy. This matter was discussed in our previous letters to management for the audits of fiscal years 2007 through 2018.

SECTION II - OTHER MATTERS, CONTINUED

6) Retirement Savings Plan

Taxes are currently not withheld on MWSC’s matching of employee contributions to the retirement plan. We recommend that management require applicable taxes be withheld on employer matching of retirement plan contributions and be remitted to taxing authorities.

7) Board Sitting Fees

During the year ended September 30, 2019, MWSC paid sitting fees of \$3,200 to Board members. These fees may constitute wages under the Income Tax Act 1989 and thus be subject to withholding taxes. No withholding taxes were withheld by MWSC. We recommend management obtain an interpretation from the Ministry of Finance, Banking and Postal Services Chief of Revenue and Taxation concerning the applicability of withholding taxes on sitting fees paid to Board members.

8) Non-Revenue Water

We compared water usage against water produced from 2015 to 2019 with the difference representing unbilled water revenues, which may be the result of water leakage, illegal connections and mechanical issues on the pipeline. Details are as follows:

<u>Fiscal Year</u>	<u>Water Produced</u> (In Gallons)	<u>Water Usage</u> (In Gallons)	<u>Non-Revenue</u> (In Gallons)	<u>Loss Rate</u>
2015	99,800,000	41,951,647	57,848,353	58%
2016	85,480,000	48,981,647	36,498,353	43%
2017	123,911,300	73,262,192	50,649,108	41%
2018	101,635,822	65,338,939	36,296,883	36%
2019	116,094,956	67,286,237	48,808,719	42%

We recommend management improve water usage by implementing existing water efficiency programs in conjunction with facility upgrades.

SECTION III - DEFINITIONS

The definition of a deficiency is as follows:

A *deficiency* in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A deficiency in design exists when (a) a control necessary to meet the control objective is missing or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective would not be met. A deficiency in operation exists when (a) a properly designed control does not operate as designed, or (b) the person performing the control does not possess the necessary authority or competence to perform the control effectively.

MANAGEMENT’S RESPONSIBILITY FOR, AND THE OBJECTIVES AND LIMITATIONS OF, INTERNAL CONTROL OVER FINANCIAL REPORTING

The following comments concerning management’s responsibility for internal control over financial reporting and the objectives and inherent limitations of internal control over financial reporting are adapted from auditing standards generally accepted in the United States of America.

Management’s Responsibility

MWSC’s management is responsible for the overall accuracy of the financial statements and their conformity with generally accepted accounting principles. In this regard, management is also responsible for establishing and maintaining effective internal control over financial reporting.

Objectives of Internal Control over Financial Reporting

Internal control over financial reporting is a process affected by those charged with governance, management, and other personnel and designed to provide reasonable assurance about the achievement of the entity’s objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. Internal control over the safeguarding of assets against unauthorized acquisition, use, or disposition may include controls related to financial reporting and operations objectives. Generally, controls that are relevant to an audit of financial statements are those that pertain to the entity’s objective of reliable financial reporting (i.e., the preparation of reliable financial statements that are fairly presented in conformity with generally accepted accounting principles).

Inherent Limitations of Internal Control over Financial Reporting

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.