

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.
(A COMPONENT UNIT OF THE
REPUBLIC OF THE MARSHALL ISLANDS)

FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT

YEARS ENDED SEPTEMBER 30, 2010 AND 2009

INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying statements of net assets of the Kwajalein Atoll Joint Utilities Resources, Inc. (KAJUR), a component unit of the Republic of the Marshall Islands, as of September 30, 2010 and 2009, and the related statements of revenues, expenses and changes in net assets and of cash flows for the years then ended. These financial statements are the responsibility of KAJUR's management. Our responsibility is to express an opinion on these financial statements based on our audits.

Except as discussed in the following paragraph, 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 of material misstatement. An audit includes consideration of 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 KAJUR's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

Because of the inadequacy of accounting records, we were unable to form an opinion regarding the amounts at which receivables, net of an allowance for uncollectible accounts, were recorded at September 30, 2008 and thus were unable to determine whether material modification should be made to operating revenues and the provision for doubtful accounts for the year ended September 30, 2009.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to determine whether a material modification should be made to operating revenues and the provision for doubtful accounts for the year ended September 30, 2009, as discussed in the third paragraph above, the financial statements present fairly, in all material respects, the financial position of KAJUR as of September 30, 2010 and 2009, and its changes in net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in note 9 to the financial statements, prepaid expenses, accounts payable, deferred revenue, Compact funding revenue, supplies and materials expense and net assets at beginning of year as of and for the year ended September 30, 2009 have been restated.

The Management's Discussion and Analysis on pages 3 through 7 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of KAJUR's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated May 18, 2011, 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Deloitte & Touche LLC

May 18, 2011



Kwajalein Atoll Joint Utility Resources

P.O.Box 5819

Ebeye, Marshall Islands, 96970.

Tel.: (692) 329-3799 Fax: (692) 329-6722

Management's Discussion and Analysis Year Ended September 30, 2010

This section of the Kwajalein Atoll Joint Utility Resources, Inc. (KAJUR) annual financial report presents our discussion and analysis of KAJUR's financial performance during the fiscal year ended on September 30, 2010, with selected comparative information for the fiscal years ended September 30, 2009 and 2008. It is to be read in conjunction with the financial statements, which follow this section.

FINANCIAL HIGHLIGHTS

KAJUR's net assets decreased by \$1,043,791 in 2010. This significant decrease in net assets can be attributed in part to a decrease in grant support for KAJUR from \$3,431,612 in 2009 to \$1,548,782 received in 2010. KAJUR's net assets increased by \$74,962 in 2009 compared to 2008. In 2008, KAJUR was the recipient of capital grants from the Republic of the Marshall Islands (RepMar), of which \$466,419 was paid directly by RepMar to vendors for the acquisition and construction of capital assets. In 2009, KAJUR did not receive capital contributions.

The use of prepaid meters and an improved billing system has positively contributed to KAJUR's overall operations as evidenced by the increase in net operating revenues. KAJUR's total net operating revenues increased by \$525,174 in 2010, while total operating expenses decreased by \$27,540. Electric and service billings increased by \$448,980, which is in direct correlation to the continuing increase in fuel prices and the corresponding increase in the tariff. Decreases in the provision for doubtful accounts are attributed to improved billing and collection efforts. Total net operating revenues decreased from \$3,248,558 in 2008 to \$3,043,796 in 2009. Electric and service, water and other billings decreased by \$531,060 from 2008 to 2009. The provision for doubtful account decreased from \$781,401 in 2008 to \$358,301 in 2009.

Total operating expenses decreased from \$6,121,490 in 2009 to \$6,093,950 in 2010 and from \$6,341,298 in 2008 to \$6,121,490 in 2009. Although fuel and lubricant expenses increased slightly other costs, including but not limited to depreciation and operations and maintenance expenses, decreased by \$28,891 from 2009 to 2010 and increased by \$601,925 from 2008 to 2009. Overall total operating expenses decreased by \$27,540 from 2009 to 2010 and by \$219,808 from 2008 to 2009.

FINANCIAL ANALYSIS OF KAJUR

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

A summary of KAJUR's Statements of Net Assets is presented below:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Current and other assets	\$ 1,577,532	\$ 2,235,598	\$ 1,623,068
Capital assets	<u>3,487,583</u>	<u>4,241,345</u>	<u>5,060,129</u>
Total assets	<u>5,065,115</u>	<u>6,476,943</u>	<u>6,683,197</u>
Current liabilities	389,032	682,506	1,015,358
Noncurrent liabilities	<u>807,270</u>	<u>881,833</u>	<u>830,197</u>
Total liabilities	<u>1,196,302</u>	<u>1,564,339</u>	<u>1,845,555</u>
Net assets:			
Invested in capital assets	3,487,583	4,241,345	5,060,129
Unrestricted	<u>381,230</u>	<u>671,259</u>	<u>(222,487)</u>
Total net assets	\$ <u>3,868,813</u>	\$ <u>4,912,604</u>	\$ <u>4,837,642</u>

As indicated above, KAJUR's capital assets decreased significantly by \$753,762 in 2010 and by \$818,784 in 2009. Other assets also decreased significantly by \$658,066 for an overall decrease of \$1,411,828 in total assets for 2010. In 2009, other assets increased by \$716,630 and total assets decreased by \$206,254.

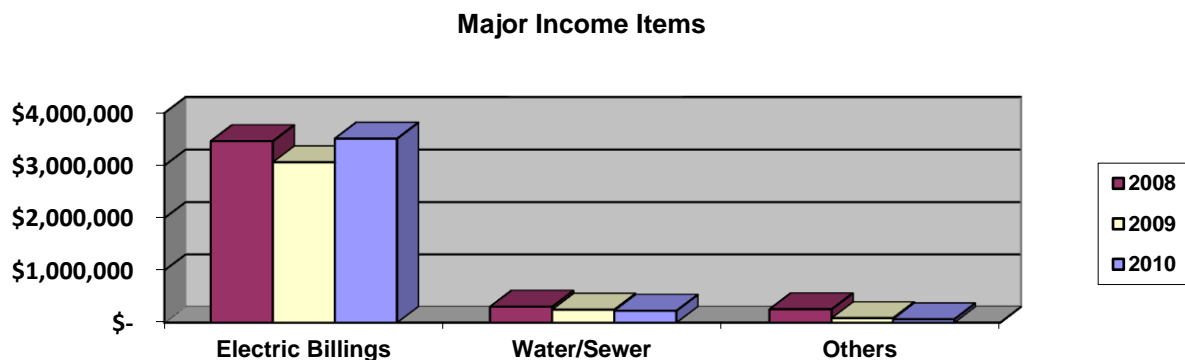
As in previous years, there continues to be a trending decrease in KAJUR's liabilities. A decrease of \$368,037 in total liabilities was realized between 2009 and 2010 and \$281,216 was realized between 2008 and 2009. This significant decrease in liabilities can be attributed to an aggressive effort to pay-off KAJUR's long outstanding debt with the Marshall Islands Social Security Administration (MISSA).

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

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Revenues:			
Net operating revenues	\$ 3,568,970	\$ 3,043,796	\$ 3,248,558
Nonoperating revenues	<u>1,548,782</u>	<u>3,431,612</u>	<u>3,005,611</u>
Total revenues	<u>5,117,752</u>	<u>6,475,408</u>	<u>6,254,169</u>
Expenses:			
Operating expenses	6,093,950	6,121,490	6,341,298
Nonoperating expenses	<u>67,593</u>	<u>528,253</u>	<u>491,061</u>
Total expenses	<u>6,161,543</u>	<u>6,649,743</u>	<u>6,832,359</u>
Loss before capital contributions	(1,043,791)	(174,335)	(578,190)
Capital contributions	<u>-</u>	<u>-</u>	<u>750,199</u>
Change in net assets	\$ <u>(1,043,791)</u>	\$ <u>(174,335)</u>	\$ <u>172,009</u>

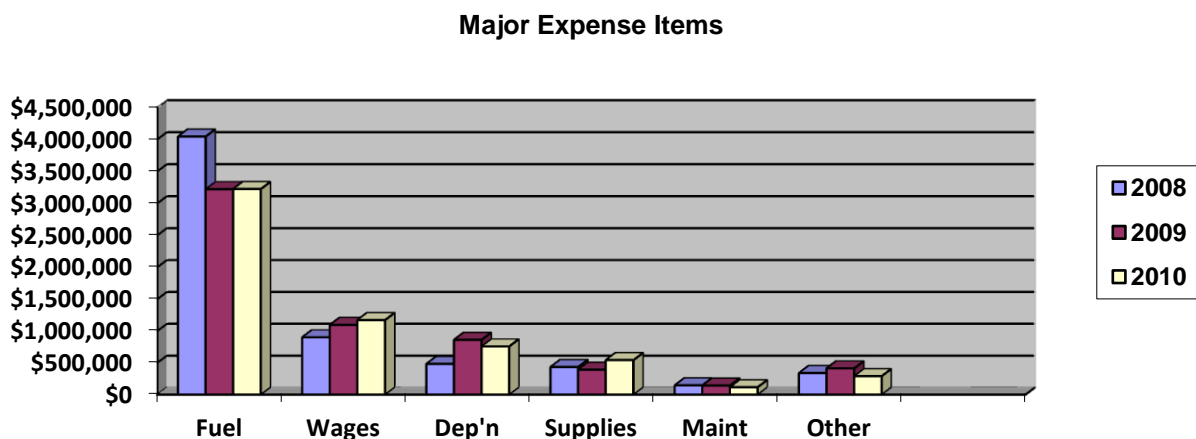
The Statement of Revenues, Expenses and Changes in Net Assets identify the various revenue and expense items that impacted the change in net assets. As indicated above, KAJUR's total revenues decreased from \$6,475,408 in 2009 to \$5,117,752 in 2010 and increased from \$6,254,169 in 2008 to \$6,475,408 in 2009. Within operating revenues, electric and service billings increased from \$3,065,106 in 2009 to \$3,514,086 in 2010 and decreased from \$3,465,768 in 2008 to \$3,065,106 in 2009. This increase in electric and service billings in 2010 can be attributed to increased efficiency in the use of debit meters and an improved electric billing and collection system that has been put in place. However, freshwater and saltwater billings continue to be an ongoing challenge for KAJUR. Freshwater revenues decreased by \$21,241 in 2010 and by \$56,800 in 2009 while services for saltwater remained uncollected. An island-wide survey on freshwater and saltwater services was planned for late 2010 but was postponed due to the sudden passing of the former General Manager of KAJUR. This survey has been rescheduled for late June 2011 after a new manager was hired.

The graph below shows the major components of operating revenues for 2008, 2009 and 2010.



Fuel and lubricant expenses accounted for approximately 53% of KAJUR's operating expenses in 2010. Salaries and wages were second at \$1,169,682, representing 19% of KAJUR's total operating expenses. Total operating expenses for KAJUR decreased slightly by \$27,540 in 2010. This slight decrease is also representative of a comparable decrease in operation and maintenance expenses.

The graph below shows the major components of operating expenses for 2008, 2009 and 2010.



A summary of KAJUR's Statements of Cash Flows is presented below:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Cash flows from operating activities	\$ (1,123,102)	\$ (2,872,493)	\$ (2,733,342)
Cash flows from noncapital financing activities	1,388,782	3,303,612	2,731,000
Cash flows from capital and related financing activities	<u>(2,328)</u>	<u>(368,296)</u>	<u>(281,492)</u>
Net change in cash	263,352	62,823	(283,834)
Cash as beginning of year	<u>235,401</u>	<u>172,578</u>	<u>456,412</u>
Cash at end of year	\$ <u>498,753</u>	\$ <u>235,401</u>	\$ <u>172,578</u>

CAPITAL ASSETS

No major capital assets were acquired in 2010. With a continued increase in fuel prices in the world market throughout 2010, scarce resources that would have allowed for the acquisition of much needed capital assets were reserved for higher priority needs. Consequently, cash resources were directed towards the organization's fuel requirements thereby securing uninterrupted operation of the power plant in Ebeye throughout 2010.

A summary of KAJUR's capital assets is presented below:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Plant and machinery	\$ 5,047,589	\$ 5,038,589	\$ 4,859,959
Distribution system	2,215,325	2,215,325	2,215,325
Water system	1,192,532	1,181,172	1,077,072
Other equipment	<u>1,655,680</u>	<u>1,491,952</u>	<u>1,305,416</u>
	10,111,126	9,927,038	9,457,772
Less accumulated depreciation	<u>(6,623,543)</u>	<u>(5,867,453)</u>	<u>(5,007,361)</u>
	3,487,583	4,059,585	4,450,411
Construction work-in-progress/ equipment in transit	<u>-</u>	<u>181,760</u>	<u>609,718</u>
	\$ <u>3,487,583</u>	\$ <u>4,241,345</u>	\$ <u>5,060,129</u>

Please refer to note 5 in the accompanying financial statements for additional information relating to capital assets.

FUTURE OUTLOOK ON SUSTAINABILITY

KAJUR will continue to monitor operating expenses and maintain tight fiscal constraints and control over utility receivables in order to improve cash collections. The ongoing viability of KAJUR as a going concern will continue to be dependent upon future financial support from RepMar, the United States government and other donor countries in the form of:

- Subsidies and grants to help offset the increasing price of fuel in the world market;
- Collection of long outstanding utility receivables primarily from RepMar; and
- Continued improvements in operational efficiency.

For the past three consecutive years (2007, 2008 and 2009), KAJUR had encountered an increasing trend of operating losses in its overall operations. However, with an improved billing system in place and with the introduction of other systemic efficiency measures, a more positive future outlook for KAJUR's operations is beginning to take shape. In 2010, the overall operating loss for KAJUR decreased by \$552,714.

It is essential that management continue to identify the root causes of the operating loss, implement a full cost recovery structure, promote systemic efficiencies and quantify and rectify system losses. Toward this end, management will need to capture critical data from both the technical and non-technical aspects of KAJUR's operations to use in making critical decisions that promote program efficiency.

KAJUR'S FOCUS IN THE COMING FISCAL YEAR

The following are some of KAJUR's highlighted goals for fiscal year 2011:

- 1) Continue to improve on the existing billing system while KAJUR awaits the implementation and employee training on the new IMP Enterprise System currently being implemented at the Marshall Energy Company, Inc. (MEC) in Majuro.
- 2) Adopt accounting policies and procedures currently being used at MEC in Majuro and ensure employees receive adequate training on these policies and procedures.
- 3) Complete and analyze the results of an island-wide survey on freshwater and saltwater services to ensure the billing system works properly for such services.
- 4) Continue improvements on the existing prepaid billing system through the acquisition of 3-Phase Prepaid Meters to be installed on government and commercial establishments that are having difficulty maintaining their outstanding balances at manageable levels.
- 5) Continue the current level of engagement with government and commercial entities relative to payment schemes for unmanageable outstanding debts payable to KAJUR.

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. The Management's Discussion and Analysis for the year ended September 30, 2009 is set forth in the report on the audit of KAJUR's financial statements which is dated June 30, 2010. That Discussion and Analysis explains the major factors impacting the 2009 financial statements. 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 P.O. Box 5819, Ebeye MH 96970 or call (692) 329-3799.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Statements of Net Assets
September 30, 2010 and 2009

	<u>ASSETS</u>	<u>2010</u>	<u>2009</u> <u>(As Restated)</u>
Current assets:			
Cash		\$ 498,753	\$ 235,401
Receivables:			
Utility		950,898	4,672,515
Affiliate		448,133	638,734
Employees		10,028	20,511
Other		100,177	242,803
		1,509,236	5,574,563
Less allowance for doubtful accounts		(1,209,532)	(5,072,640)
Total receivables, net		299,704	501,923
Prepaid expenses		274,034	1,192,626
Inventories		505,041	305,648
Total current assets		1,577,532	2,235,598
Capital assets, net		3,487,583	4,241,345
		<u>\$ 5,065,115</u>	<u>\$ 6,476,943</u>
<u>LIABILITIES AND NET ASSETS</u>			
Current liabilities:			
Note payable, current portion		\$ 39,742	\$ 48,598
Accounts payable		110,459	255,712
Due to affiliates		15,974	189,161
Accrued liabilities		182,789	141,325
Deferred revenue		40,068	47,710
Total current liabilities		389,032	682,506
Accrued sick leave - long-term		64,833	55,845
Note payable, net of current portion		742,437	825,988
Total liabilities		1,196,302	1,564,339
Contingencies			
Net assets:			
Invested in capital assets		3,487,583	4,241,345
Unrestricted		381,230	671,259
Total net assets		3,868,813	4,912,604
		<u>\$ 5,065,115</u>	<u>\$ 6,476,943</u>

See accompanying notes to financial statements.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Statements of Revenues, Expenses and Changes in Net Assets
Years Ended September 30, 2010 and 2009

	<u>2010</u>	<u>2009</u> <u>(As Restated)</u>
Operating revenues:		
Electric and service billings	\$ 3,514,086	\$ 3,065,106
Water	228,269	249,510
Other	<u>66,370</u>	<u>87,481</u>
Total operating revenues	3,808,725	3,402,097
Less provision for doubtful accounts	<u>(239,755)</u>	<u>(358,301)</u>
Total net operating revenues	<u>3,568,970</u>	<u>3,043,796</u>
Operating expenses:		
Fuel and lubricants	3,222,639	3,221,288
Salaries, wages and benefits	1,169,682	1,093,612
Depreciation	756,090	860,092
Supplies and materials	541,254	392,093
Travel and transportation	125,400	216,779
Operations and maintenance	115,126	142,491
Contractual services	20,244	16,447
Rental	17,453	-
Communications	6,900	14,752
Miscellaneous	<u>119,162</u>	<u>163,936</u>
Total operating expenses	<u>6,093,950</u>	<u>6,121,490</u>
Operating loss	<u>(2,524,980)</u>	<u>(3,077,694)</u>
Nonoperating revenues (expenses):		
Compact funding	1,548,782	3,431,612
Interest	(67,593)	(97,165)
Loss on write-off of fixed assets	<u>-</u>	<u>(431,088)</u>
Total nonoperating revenues (expenses), net	<u>1,481,189</u>	<u>2,903,359</u>
Change in net assets	(1,043,791)	(174,335)
Net assets at beginning of year	<u>4,912,604</u>	<u>5,086,939</u>
Net assets at end of year	<u>\$ 3,868,813</u>	<u>\$ 4,912,604</u>

See accompanying notes to financial statements.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Statements of Cash Flows
Years Ended September 30, 2010 and 2009

	<u>2010</u>	<u>2009</u> (As Restated)
Cash flows from operating activities:		
Cash received from customers	\$ 3,753,064	\$ 2,981,730
Cash payments to suppliers for goods and services	(3,825,259)	(4,786,623)
Cash payments to employees for services	<u>(1,050,907)</u>	<u>(1,067,600)</u>
Net cash used for operating activities	<u>(1,123,102)</u>	<u>(2,872,493)</u>
Cash flows from noncapital financing activities:		
Promissory note repayment	(92,407)	(77,526)
Interest paid	(67,593)	(50,474)
Operating subsidies received from RepMar	<u>1,548,782</u>	<u>3,431,612</u>
Net cash provided by noncapital financing activities	<u>1,388,782</u>	<u>3,303,612</u>
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets	<u>(2,328)</u>	<u>(368,296)</u>
Net cash used for capital and related financing activities	<u>(2,328)</u>	<u>(368,296)</u>
Net change in cash	263,352	62,823
Cash at beginning of year	<u>235,401</u>	<u>172,578</u>
Cash at end of year	<u><u>\$ 498,753</u></u>	<u><u>\$ 235,401</u></u>
Reconciliation of operating loss to net cash used for operating activities:		
Operating loss	\$ (2,524,980)	\$ (3,077,694)
Adjustments to reconcile loss from operations to net cash used for operating activities:		
Depreciation	756,090	860,092
Provision for doubtful accounts	239,755	358,301
(Increase) decrease in assets:		
Receivables:		
Utility	(381,246)	141,347
Affiliate	190,601	(638,734)
Employees	10,483	(4,331)
Other	142,626	(38,892)
Prepaid expenses	918,592	(1,163,506)
Inventories	(199,393)	692,008
Increase (decrease) in liabilities:		
Accounts payable	(145,253)	206,339
Social security taxes payable	-	(15,070)
Due to affiliates	(173,187)	(256,876)
Deferred revenue	(7,642)	19,110
Other current and accrued liabilities	<u>50,452</u>	<u>45,413</u>
Net cash used for operating activities	<u><u>\$ (1,123,102)</u></u>	<u><u>\$ (2,872,493)</u></u>

See accompanying notes to financial statements.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Statements of Cash Flows, Continued
Years Ended September 30, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Noncash investing, capital and financing activities:		
Capital assets	\$ -	\$ 326,988
Prepaid expenses	-	104,100
Loss on write-off of capital assets	-	(431,088)
	<u>\$ -</u>	<u>\$ -</u>

See accompanying notes to financial statements.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Notes to Financial Statements September 30, 2010 and 2009

(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'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. Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, requires that proprietary activities apply all applicable GASB pronouncements as well as Statements and Interpretations issued by the Financial Accounting Standards Board (FASB), Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989. KAJUR has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

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 34, retained earnings are presented in the following net asset categories:

- Invested in capital assets; capital assets, net of accumulated depreciation, plus construction or improvement of those assets.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Notes to Financial Statements September 30, 2010 and 2009

(2) Summary of Significant Accounting Policies, Continued

- Unrestricted; net assets that are not subject to externally imposed stipulations. Unrestricted net assets 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.

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 liabilities 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.

Basis of Accounting

Proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operation of the fund are included in the statements of net assets. Proprietary fund operating statements present increases and decreases in net assets. 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.

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 assets and cash flows, cash is defined as cash on hand and cash in checking accounts. As of September 30, 2010 and 2009, the carrying amount of cash was \$498,753 and \$235,401, respectively, and the corresponding bank balances were \$564,605 and \$255,191, respectively. At September 30, 2010 and 2009, substantially all of KAJUR's cash is with a non-federally insured bank.

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. Receivables are not collateralized.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Notes to Financial Statements September 30, 2010 and 2009

(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, 2010 and 2009. 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

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 services by public utility companies are exempt from gross revenue tax. Accordingly, KAJUR is exempt from this tax relating to gross revenue from sales of electric services.

Compensated Absences

Vested or accumulated vacation leave is recorded as an expense and liability as the benefits accrue to employees. The liability as of September 30, 2010 and 2009, is \$73,420 and \$53,035, respectively, and is included within the statements of net assets as accrued liabilities. Sick pay benefits vest at 50% and are recorded as an expense and a liability as the benefits accrue to employees. The liability as of September 30, 2010 and 2009, is \$129,667 and \$111,789, respectively, and is included within the statements of net assets as accrued liabilities and accrued sick leave - long-term.

New Accounting Standards

During fiscal year 2010, KAJUR implemented the following pronouncements:

- GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, which addresses whether and when intangible assets should be considered capital assets for financial reporting purposes.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Notes to Financial Statements
September 30, 2010 and 2009

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

- GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, which is intended to improve how state and local governments report information about derivative instruments - financial arrangements used by governments to manage specific risks or make investments - in their financial statements.
- GASB Technical Bulletin No. 2008-1, *Determining the Annual Required Contribution Adjustment for Postemployment Benefits*, which clarifies the requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, for calculating the annual required contribution (ARC) adjustment.
- GASB Statement No. 58, *Accounting and Financial Reporting for Chapter 9 Bankruptcies*, which provides guidance for governments that have petitioned for protection from creditors by filing for bankruptcy under Chapter 9 of the United States Bankruptcy Code, and establishes requirements for recognizing and measuring the effects of the bankruptcy process on assets and liabilities, and for classifying changes in those items and related costs.

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

In March 2009, GASB issued Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, which enhances the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. The provisions of this statement are effective for periods beginning after June 15, 2010. Management does not believe that the implementation of this statement will have a material effect on the financial statements of KAJUR.

In December 2009, GASB issued Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, which amends Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, and addresses issues related to measurement of OPEB obligations by certain employers participating in agent multiple-employer OPEB plans. The provisions of Statement 57 related to the use and reporting of the alternative measurement method are effective immediately. The provisions related to the frequency and timing of measurements are effective for actuarial valuations first used to report funded status information in OPEB plan financial statements for periods beginning after June 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of KAJUR.

In June 2010, GASB issued Statement No. 59, *Financial Instruments Omnibus*, which updates and improves existing standards regarding financial reporting of certain financial instruments and external investment pools. The provisions of this statement are effective for periods beginning after June 15, 2010. Management has not evaluated the effect that the implementation of this statement will have on the financial statements of KAJUR.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Notes to Financial Statements September 30, 2010 and 2009

(2) Summary of Significant Accounting Policies, Continued

Reclassification

Certain 2009 balances in the accompanying financial statements have been reclassified to conform to the 2010 presentation.

(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 not to purchase commercial insurance for the risks of loss to which it is exposed. Instead, KAJUR believes it is more economical to manage its risks internally. Claims expenses and liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. 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, 2010 and 2009, consist of the following:

	<u>2010</u>	<u>2009</u>
Materials and supplies	\$ 334,625	\$ 177,572
Fuel	148,576	109,053
Lubricants	<u>21,840</u>	<u>19,023</u>
	<u>\$ 505,041</u>	<u>\$ 305,648</u>

(5) Capital Assets

Capital assets activity for the years ended September 30, 2010 and 2009 is as follows:

	October 1, 2009	Additions and Transfers	2010 Retirements	September 30, 2010
Plant and machinery	\$ 5,038,589	\$ 9,000	\$ -	\$ 5,047,589
Distribution system	2,215,325	-	-	2,215,325
Water system	1,181,172	11,360	-	1,192,532
Other equipment	<u>1,491,952</u>	<u>163,728</u>	<u>-</u>	<u>1,655,680</u>
	9,927,038	184,088	-	10,111,126
Less accumulated depreciation	<u>(5,867,453)</u>	<u>(756,090)</u>	<u>-</u>	<u>(6,623,543)</u>
	4,059,585	(572,002)	-	3,487,583
Equipment in-transit	<u>181,760</u>	<u>(181,760)</u>	<u>-</u>	<u>-</u>
	<u>\$ 4,241,345</u>	<u>\$ (753,762)</u>	<u>\$ -</u>	<u>\$ 3,487,583</u>

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Notes to Financial Statements
September 30, 2010 and 2009

(5) Capital Assets, Continued

	2009			
	October 1, 2008	Additions and Transfers	Retirements	September 30, 2009
Plant and machinery	\$ 4,859,959	\$ 178,630	\$ -	\$ 5,038,589
Distribution system	2,215,325	-	-	2,215,325
Water system	1,077,072	104,100	-	1,181,172
Other equipment	<u>1,305,416</u>	<u>186,536</u>	<u>-</u>	<u>1,491,952</u>
	9,457,772	469,266	-	9,927,038
Less accumulated depreciation	<u>(5,007,361)</u>	<u>(860,092)</u>	<u>-</u>	<u>(5,867,453)</u>
	4,450,411	(390,826)	-	4,059,585
Construction work-in-progress	609,718	-	(609,718)	-
Equipment in-transit	<u>-</u>	<u>181,760</u>	<u>-</u>	<u>181,760</u>
	<u>\$ 5,060,129</u>	<u>\$ (209,066)</u>	<u>\$ (609,718)</u>	<u>\$ 4,241,345</u>

At September 30, 2010 and 2009, management of KAJUR determined that certain capital assets in the amount of \$-0- and \$431,088, respectively, no longer existed. Accordingly, these capital assets were written-off resulting in a loss of \$-0- and \$431,088, respectively, for the years ended September 30, 2010 and 2009.

(6) MISSA Note Payable

At September 30, 2010 and 2009, KAJUR was liable for taxes, including certain delinquent taxes, interest and penalties, payable to the Marshall Islands Social Security Administration (MISSA) in the amounts of \$782,179 and \$874,586, respectively. On October 12, 2007, KAJUR and MISSA entered into a promissory note agreement for the delinquent taxes. The terms of this agreement include monthly payments of \$8,000, interest of 12% per annum, commencing October 31, 2007. For the years ended September 30, 2010 and 2009, KAJUR incurred interest relating to these delinquent taxes of \$67,593 and \$94,304, respectively.

During the years ended September 30, 2010 and 2009, employer contributions incurred by KAJUR for MISSA taxes amounted to \$97,337 and \$86,676, respectively.

Annual repayment requirements to maturity for principal and interest are as follows:

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2011	\$ 39,742	\$ 56,258	\$ 96,000
2012	45,780	50,220	96,000
2013	51,768	44,232	96,000
2014	57,272	38,728	96,000
2015	62,605	33,395	96,000
2016 - 2020	387,076	92,924	480,000
2021 - 2022	<u>137,936</u>	<u>5,455</u>	<u>143,391</u>
	<u>\$ 782,179</u>	<u>\$ 321,212</u>	<u>\$ 1,103,391</u>

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Notes to Financial Statements
September 30, 2010 and 2009

(6) MISSA Note Payable, Continued

Long-term debt activity during the years ended September 30, 2010 and 2009 were as follows:

	Balance at October 1, 2009	Additions	Reductions	Balance at September 30, 2010	Amount due in One Year
Note payable: MISSA	\$ 874,586	\$ -	\$ (92,407)	\$ 782,179	\$ 39,742
Other: Compensated absences	<u>164,824</u>	<u>38,263</u>	<u>-</u>	<u>203,087</u>	<u>138,253</u>
Total	\$ <u>1,039,410</u>	\$ <u>38,263</u>	\$ <u>(92,407)</u>	\$ <u>985,266</u>	\$ <u>177,995</u>

	Balance at October 1, 2008	Additions	Reductions	Balance at September 30, 2009	Amount due in One Year
Note payable: MISSA	\$ 873,941	\$ 78,171	\$ (77,526)	\$ 874,586	\$ 48,598
Other: Compensated absences	<u>161,218</u>	<u>3,606</u>	<u>-</u>	<u>164,824</u>	<u>108,880</u>
Total	\$ <u>1,035,159</u>	\$ <u>81,777</u>	\$ <u>(77,526)</u>	\$ <u>1,039,410</u>	\$ <u>157,478</u>

(7) Related Party Transactions

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

KAJUR utilizes services from certain affiliated entities at substantially the same terms and conditions as those incurred from third parties. A summary of related party transactions, in addition to the MISSA note payable discussed in the preceding footnote, for the years ended September 30, 2010 and 2009 and the related receivable and payable balances as of September 30, 2010 and 2009, are as follows:

	2010		
	Expenses	Receivable	Payable
Marshall's Energy Company, Inc.	\$ 3,285,594	\$ -	\$ 15,974
Marshall Islands National Telecommunications Authority	21,671	11,781	-
RepMar	<u>-</u>	<u>436,352</u>	<u>-</u>
	\$ <u>3,307,265</u>	\$ <u>448,133</u>	\$ <u>15,974</u>

	2009		
	Expenses	Receivable	Payable
American Samoa Power Authority (ASPA)	\$ -	\$ -	\$ 85,459
Marshall's Energy Company, Inc.	2,394,642	-	45,595
Marshall Islands National Telecommunications Authority	14,752	86,620	-
RepMar	<u>-</u>	<u>552,114</u>	<u>58,107</u>
	\$ <u>2,409,394</u>	\$ <u>638,734</u>	\$ <u>189,161</u>

During the years ended September 30, 2010 and 2009, KAJUR received appropriations from RepMar in the amounts of \$1,548,782 and \$3,431,612, respectively, which were paid by RepMar directly to vendors for the purchase of fuel and lubricants.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Notes to Financial Statements September 30, 2010 and 2009

(7) Related Party Transactions, Continued

As of September 30, 2010 and 2009, KAJUR maintained demand deposit accounts with a related financial institution in the amount of \$564,605 and \$255,191, respectively.

(8) Going Concern

KAJUR has incurred significant net operating losses since inception. 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.

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. Cumulative questioned costs of \$1,375,456 relating to fiscal years 2004 through 2006 have been set forth in KAJUR's Single Audit Report for the year ended September 30, 2010. The ultimate disposition of these questioned costs can be determined only by final action of the respective grantor agencies. Therefore, no provision for any liability that may result upon resolution of this matter has been made in the accompanying financial statements.

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.

(9) Restatement

The financial statements as of and for the year ended September 30, 2009 had been restated to reflect \$355,900 of unrecorded Compact funding prepaid to a vendor, \$50,000 recorded as supplies and materials expense that was actually a prepayment, and \$216,164 and \$118,592 of accounts payable and deferred revenues, respectively, that were determined to be invalid. The following accounts have been restated for the year ended September 30, 2009:

	<u>As Originally Stated</u>	<u>As Restated</u>
Prepaid expenses	\$ 786,726	\$ 1,192,626
Supplies and materials	\$ 442,093	\$ 392,093
Compact funding	\$ 3,075,712	\$ 3,431,612
Accounts payable	\$ 386,417	\$ 255,712
Deferred revenue	\$ 166,302	\$ 47,710
Net assets at beginning of year	\$ 4,837,642	\$ 5,086,939

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.
(A COMPONENT UNIT OF THE
REPUBLIC OF THE MARSHALL ISLANDS)

INDEPENDENT AUDITORS' REPORTS ON
INTERNAL CONTROL AND ON COMPLIANCE

YEAR ENDED SEPTEMBER 30, 2010

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 the financial statements of the Kwajalein Atoll Joint Utilities Resources, Inc. (KAJUR) as of and for the year ended September 30, 2010, and have issued our report thereon dated May 18, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered KAJUR's internal control over financial reporting as a basis for designing our auditing procedures 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 over financial reporting. Accordingly, we do not express an opinion on the effectiveness of KAJUR'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 that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying Schedule of Findings and Questioned Costs (pages 6 through 12), we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and one other deficiency that we consider to be a significant deficiency.

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. We consider the deficiencies described in the accompanying Schedule of Findings and Questioned Costs as items 2010-2 through 2010-4 to be material weaknesses.

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. We consider the deficiency described in the accompanying Schedule of Findings and Questioned Costs as item 2010-1 to be a significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether KAJUR's financial statements are free of 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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of KAJUR in a separate letter dated May 18, 2011.

KAJUR's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. We did not audit KAJUR's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the Board of Directors, management, federal awarding agencies, the cognizant audit and other federal agencies, and others with the entity and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte & Touche LLC

May 18, 2011

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS
THAT COULD HAVE A DIRECT AND MATERIAL EFFECT ON EACH MAJOR PROGRAM
AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB
CIRCULAR A-133 AND ON THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

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

Compliance

We have audited the 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 one major federal program for the year ended September 30, 2010. KAJUR's major federal program is identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs (pages 6 through 12). Compliance with the requirements of laws, regulations, contracts, and grants applicable to its one major federal program is the responsibility of KAJUR's management. Our responsibility is to express an opinion on KAJUR's compliance based on our audit.

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 OMB Circular A-133. Those standards and OMB Circular A-133 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. Our audit does not provide a legal determination of KAJUR's compliance with those requirements.

In our opinion, KAJUR complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on its one major federal program for the year ended September 30, 2010.

Internal Control Over Compliance

Management of KAJUR is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered KAJUR's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, 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 deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

Schedule of Expenditures of Federal Awards

We have audited the basic financial statements of KAJUR as of and for the year ended September 30, 2010, and have issued our report thereon dated May 18, 2011. Our audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying Schedule of Expenditures of Federal Awards (page 5) is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. This schedule is the responsibility of the management of KAJUR. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

This report is intended solely for the information and use of the Board of Directors, management, federal awarding agencies, the cognizant audit and other federal agencies, and others within the entity and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte & Touche LLC

May 18, 2011

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Expenditures of Federal Awards
Year Ended September 30, 2010

<u>Program Title</u>	<u>Expenditures</u>
<u>U.S. Department of the Interior</u> <u>Compact of Free Association, as Amended:</u> <u>Section 211(b)(2) Kwajalein Atoll Landowners Special Needs</u> <u>CFDA #15.875</u>	
Kwajalein Development Fund	\$ <u>1,548,782</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:

Expenses (included within total operating expenses of \$6,093,950)	\$ <u>1,548,782</u>
--	---------------------

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs
Year Ended September 30, 2010

A. SUMMARY OF AUDITORS' RESULTS

Financial Statements

- | | | |
|----|--|-------------|
| 1. | Type of auditors' report issued: | Unqualified |
| | Internal control over financial reporting: | |
| 2. | Material weakness(es) identified? | Yes |
| 3. | Significant deficiency(ies) identified that is not considered to be a material weakness? | No |
| 4. | Noncompliance material to the financial statements noted? | No |

Federal Awards

- | | | |
|-----|---|-------------|
| | Internal control over major programs: | |
| 5. | Material weakness(es) identified? | No |
| 6. | Significant deficiency(ies) identified that is not considered to be a material weakness? | No |
| 7. | Type of auditors' report issued on compliance for major programs: | Unqualified |
| 8. | Any audit findings disclosed that are required to be reported in accordance with Section 510(a) of OMB Circular A-133? | No |
| 9. | KAJUR's major program was as follows: | |
| | CFDA
<u>Number</u> <u>Federal Program</u> | |
| | 15.875 Compact of Free Association, as Amended:
Kwajalein Atoll Landowners Special Needs
Infrastructure Development Projects | |
| 10. | Dollar threshold used to distinguish between Type A and Type B Programs, as those terms are defined in OMB Circular A-133: | \$300,000 |
| 11. | KAJUR qualified as a low-risk auditee, as that term is defined in OMB Circular A-133? | No |

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs
Year Ended September 30, 2010

B. FINDINGS RELATING TO THE FINANCIAL STATEMENTS, WHICH ARE REQUIRED TO BE REPORTED IN ACCORDANCE WITH GAGAS

<u>Reference Number</u>	<u>Findings</u>	<u>Questioned Costs</u>	<u>Refer Page #</u>
2010-1	Revenues	\$ -	8 - 9
2010-2	Inventories	\$ -	10
2010-3	Receivables	\$ -	11
2010-4	Grants	\$ -	12

C. FINDINGS AND QUESTIONED COSTS - MAJOR FEDERAL AWARD PROGRAMS AUDIT

No findings reported.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2010

B. FINDINGS RELATING TO THE FINANCIAL STATEMENTS, WHICH ARE REQUIRED TO BE REPORTED IN ACCORDANCE WITH GAGAS

Finding No. 2010-1

Revenues

Criteria: Management is responsible for establishing adequate internal control to assist in ensuring that revenues are accurately identified, recorded and collected.

Condition: Our tests of revenues, prepaid and postpaid, noted the following:

- Of thirty-two receipts tested, two token receipts in May 2010 (receipt nos. 221119 and 92009) used the old residential rate of 29.8 cents per kilowatt-hour (kwh) unit instead of the approved rate of 32.2 cents per kwh unit, effective May 1, 2010.
- Of sixty-three billing statements tested, we noted the following:
 - a. Three billing statements were in error as follows:

Customer Account No.	Month	Per Billing Statements (In Kwh)			Per Reading Reports (In Kwh)				Multiplier	Variance (In Kwh)	Rate (In USD)	Variance (In USD)
		Previous	Current	Usage	Previous	Current	Usage	Variance				
170910	04/10	1,210	1,210	-	1,210	1,788	578	(578)	1	(578)	\$ 0.358	\$ (207)
305003	03/10	54,552	56,506	1,954	55,462	56,506	1,044	910	1	910	\$ 0.298	\$ 271
152541	11/09	1,817	1,817	-	1,817	1,871	54	(54)	80	4,320	\$ 0.300	\$ (1,296)

- b. Five billing statements erroneously billed 32 cents per kwh instead of the approved rate of 31 cents per kwh as follows:

Customer Account No.	Month	Usage (In Kwh)	Rate (In USD)	Electricity Charge	Rate (In USD)	Electricity Charge	Variance (In USD)
162611	11/09	3,007	\$ 0.320	\$ 962	\$ 0.310	\$ 932	\$ 30
132300	12/09	1,877	\$ 0.320	\$ 601	\$ 0.310	\$ 582	\$ 19
163100	12/09	4,537	\$ 0.320	\$ 1,452	\$ 0.310	\$ 1,406	\$ 45
136871	11/09	17,600	\$ 0.320	\$ 5,632	\$ 0.310	\$ 5,456	\$ 176
163120	01/10	3,311	\$ 0.320	\$ 1,060	\$ 0.310	\$ 1,026	\$ 33

- KAJUR did not recognize revenue for metered water (except for RMI Hospital and mid-corridor) and sewer services. A survey performed during the year discovered that certain customers were receiving those services.
- Our tests of receivables noted that the amount due per the September 2010 water billing to one customer (the new hospital) was in excess of the balance in the subsidiary ledger by \$15,130.

Cause: The cause of the above condition is the lack of review and reconciliation of utility revenues.

Effect: The effect of the above condition is the potential misstatement of utility revenues.

Recommendation: We recommend that KAJUR review billing statements, recognize revenue for metered water and reconcile billings to subledgers.

Prior Year Status: Errors in billings was reported as a finding in the Single Audits of KAJUR for fiscal years 2004 through 2009.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2010

Finding No. 2010-1, Continued

Auditee Response and Corrective Action Plan:

Name of Contact Person: Ms. Saeko Shoniber, Board Fiscal Officer

Corrective Action: KAJUR is in agreement with this finding and its recommendation. The new General Manager has confirmed that in late 2010 KAJUR began the accounting procedures currently in use at the Marshalls Energy Company, Inc. (MEC). Unfortunately, these procedures were not properly implemented due to the sudden passing of the former General Manager. To properly address this finding, the following actions will be taken:

1. KAJUR will ensure the accounting policies and procedures acquired from MEC are properly implemented within the Accounting Department.
2. A periodic review and reconciliation process for subledgers is being established and will be properly implemented within KAJUR's Accounting Department.
3. Results from a recent utility survey of all living quarters on Ebeye will be analyzed to ensure proper water billings for island-wide customers.

Proposed Completion Date: Ongoing

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2010

Finding No. 2010-2

Inventories

Criteria: Reconciliation of subsidiary ledgers to the general ledger should be performed on a periodic basis.

Condition: At September 30, 2010, fuel inventory was overstated by \$349,490; which was adjusted by management upon our request.

Cause: The cause of the above condition is the lack of internal control policies and procedures to ensure that subsidiary ledger inventory balances are updated and reconciled to the general ledger on a regular basis.

Effect: The effect of the above condition is a misstatement of inventories.

Recommendation: We recommend that KAJUR establish policies and procedures to require subsidiary ledger inventory balances to be updated and reconciled to the general ledger on a periodic basis.

Prior Year Status: Lack of internal control policies and procedures over subsidiary ledger inventory balances was reported as a finding in the Single Audits of KAJUR for fiscal years 2007 through 2009.

Auditee Response and Corrective Action Plan:

Name of Contact Person: Ms. Saeko Shoniber, Board Fiscal Officer

Corrective Action: KAJUR is in agreement with this finding and its recommendation. To properly address this finding, the following actions will be taken:

1. KAJUR will ensure the accounting policies and procedures acquired from MEC are properly implemented within the Accounting Department.
2. A periodic review and reconciliation process for subledgers will be developed and implemented within KAJUR's Accounting Department.
3. A Benchmarking Liaison Officer was appointed to help ensure critical data is captured and periodically analyzed so discrepancies are determined and corrected.
4. As of October 2010, the frequency of physical inventories has been increased from "sporadically over a 12-month period" to once every month.

Proposed Completion Date: Ongoing

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2010

Finding No. 2010-3

Receivables

Criteria: The allowance for doubtful accounts should be stated at an amount which management believes is adequate to absorb possible losses on accounts receivable that may become uncollectible based on evaluations and prior collection experience.

Condition: Our analysis of the adequacy of the allowance for doubtful accounts resulted in a proposed audit adjustment to increase the allowance by \$226,899.

Cause: The cause of the above condition is the lack of policies and procedures to ensure that doubtful receivables are adequately provided for.

Effect: The effect of the above condition is a possible misstatement of receivables and the related allowance for doubtful accounts.

Recommendation: We recommend that KAJUR establish policies and procedures to ensure that doubtful receivables are adequately provided for.

Prior Year Status: The lack of an analysis to support the allowance for doubtful accounts was reported as a finding in the Single Audits of KAJUR for fiscal years 2005 through 2009.

Auditee Response and Corrective Action Plan:

Name of Contact Person: Ms. Saeko Shoniber, Board Fiscal Officer

Corrective Action: KAJUR is in agreement with this finding and its recommendation. To properly address this finding, the following actions will be taken:

1. KAJUR will ensure the accounting policies and procedures acquired from MEC are properly implemented within the Accounting Department.
2. As of October 2010, KAJUR's Accounting Department converted to a new accounting system that will allow better accounting and evaluation of doubtful accounts.

Proposed Completion Date: Ongoing

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2010

Finding No. 2010-4

Grants

Criteria: Revenues should be recorded when earned.

Condition: Grant funds paid directly to the vendor in FY 2009 of \$355,900 were not recorded by KAJUR. This condition was corrected through a proposed audit adjustment.

Cause: The cause of the above condition is the lack of monitoring and recording of funds requested from the grantor.

Effect: The effect of the above condition was a restatement of prior year amounts.

Recommendation: We recommend that KAJUR establish procedures to ensure monitoring and recording of funds requested.

Auditee Response and Corrective Action Plan:

Name of Contact Person: Ms. Saeko Shoniber, Board Fiscal Officer

Corrective Action: KAJUR is in agreement with this finding and its recommendation. To properly address this finding, the following actions will be taken:

1. KAJUR will ensure the accounting policies and procedures acquired from MEC are properly implemented within the Accounting Department.
2. Improved coordination between MEC and KAJUR will be established to ensure proper monitoring and recording of grants awarded to KAJUR.

Proposed Completion Date: Ongoing

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Unresolved Prior Year Comments
Year Ended September 30, 2010

Questioned Costs

The prior year Single Audit report on compliance with laws and regulations noted the following questioned costs and comments that were unresolved at September 30, 2010:

Questioned costs of KAJUR as previously reported:

Fiscal year 2004 Single Audit	\$ 488,494
Fiscal year 2005 Single Audit	434,069
Fiscal year 2006 Single Audit	<u>452,893</u>

1,375,456

Questioned costs of fiscal year 2010 Single Audit

-

Unresolved questioned costs at September 30, 2010

\$ 1,375,456

Unresolved Findings

The status of unresolved findings is discussed in the Schedule of Findings and Questioned Costs section of this report (pages 6 through 12).