

HEALTH CARE REVENUE FUND

**FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED SEPTEMBER 30, 2006 AND 2005

INDEPENDENT AUDITORS' REPORT

Honorable Minister Alvin Jacklick
Ministry of Health
Republic of the Marshall Islands:

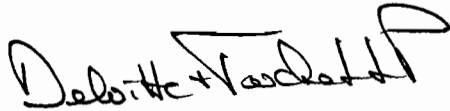
We have audited the accompanying financial statements of the Health Care Revenue Fund (the Fund), a special revenue fund of the Republic of the Marshall Islands (RepMar), as of and for the years ended September 30, 2006 and 2005. These financial statements are the responsibility of the Fund's management. 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 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 the Fund'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.

As discussed in Note 1 to the financial statements, the financial statements referred to above present only the Health Care Revenue Fund and are not intended to present fairly the financial position and results of operations of the Republic of the Marshall Islands in conformity with accounting principles generally accepted in the United States of America.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Health Care Revenue Fund as of September 30, 2006 and 2005, and the results of that fund's operations for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 6, 2007, on our consideration of the Fund'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 read in conjunction with this report in considering the results of our audit.

A handwritten signature in black ink, appearing to read "Deloitte + Touche LLP", with a large, stylized flourish at the end.

June 6, 2007

HEALTH CARE REVENUE FUND

Balance Sheets
September 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
<u>ASSETS</u>		
Cash	\$ 206,642	\$ 1,043,231
Receivables:		
Affiliates	1,292,536	1,052,574
Other	8,951	28,356
Deposit	<u>16,912</u>	<u>18,534</u>
	<u>\$ 1,525,041</u>	<u>\$ 2,142,695</u>
<u>LIABILITIES AND FUND BALANCE</u>		
Liabilities:		
Accounts payable	\$ 598,193	\$ 351,915
Other liabilities and accruals	31,123	1,579
Payable to affiliates	<u>219,150</u>	<u>250,619</u>
Total liabilities	<u>848,466</u>	<u>604,113</u>
Fund balance	<u>676,575</u>	<u>1,538,582</u>
Total liabilities and fund balance	<u>\$ 1,525,041</u>	<u>\$ 2,142,695</u>

See accompanying notes to financial statements.

HEALTH CARE REVENUE FUND

Statements of Revenues, Expenditures, and Changes in Fund Balance Years Ended September 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Revenues:		
Grants	\$ 365,830	\$ 145,914
Hospital charges	233,682	194,275
Other	<u>130,369</u>	<u>85,669</u>
Total revenues	<u>729,881</u>	<u>425,858</u>
Expenditures:		
Pharmaceutical	1,877,272	1,460,602
Medical supplies	1,822,763	1,196,906
Freight and delivery	159,648	101,916
Professional and consulting fees	163,286	58,683
Hospital equipment	18,090	20,289
Other hospital expenses	-	425
Administrative:		
Other administrative expenses	200,459	146,921
Travel	94,674	70,653
Salaries and wages	<u>58,856</u>	<u>24,794</u>
Total expenditures	<u>4,395,048</u>	<u>3,081,189</u>
Deficiency of revenues under expenditures	(3,665,167)	(2,655,331)
Other financing sources:		
Contributions from RepMar's Health Fund	<u>2,803,160</u>	<u>2,419,918</u>
Total other financing sources	<u>2,803,160</u>	<u>2,419,918</u>
Net change in fund balance	(862,007)	(235,413)
Fund balance at beginning of year	<u>1,538,582</u>	<u>1,773,995</u>
Fund balance at end of year	<u>\$ 676,575</u>	<u>\$ 1,538,582</u>

See accompanying notes to financial statements.

HEALTH CARE REVENUE FUND

Notes to Financial Statements
September 30, 2006 and 2005

(1) Reporting Entity

The Health Care Revenue Fund (the Fund), a governmental fund type - special revenue fund of the Republic of the Marshall Islands (RepMar) was established pursuant to the Marshall Islands Health Care Revenue Fund Act of 2001. Administration, control and management of the Fund was transferred from the Marshall Islands Social Security Administration (MISSA) to RepMar's Ministry of Health (MOH). The Fund's enabling legislation also requires that 45% of contributions collected by the Basic Health Benefits Plan be transferred to the Fund. The Fund was established to use funds, provided through appropriation by the Nitijela of RepMar and revenue received from hospital charges and other health care charges collected by MOH, for the purchase of drugs, medical supplies and equipment and the provision and administration of other health services.

The accompanying financial statements relate solely to those accounting records maintained by the Fund, and do not incorporate any accounts related to RepMar's Ministry of Health or any other departments or agencies of RepMar that may be accounted for by RepMar's Treasury. The Fund is considered to be a blended component unit (governmental fund type-special revenue fund) of RepMar.

(2) Summary of Significant Accounting Policies

The financial statements of the Fund have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the recognized standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of the Fund's accounting policies are described below:

Measurement Focus and Basis of Accounting

The Fund reports its financial position and the results of its operations in one special revenue fund. A fund is a separate accounting entity with a self-balancing set of accounts. They are concerned only with the measurement of financial position and are not involved with measurement of results of operations. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain Fund functions or activities.

Governmental funds are used to account for all or most of a government's general activities, including the collection and disbursement of earmarked monies (special revenue funds).

Basis of Presentation

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. All special revenue funds are accounted for using a current financial resources measurement focus. With this measurement focus, only current assets and current liabilities generally are included on the balance sheet. Operating statements of these funds present increases (i.e., revenues and other financing sources) and decreases (i.e., expenditures and other financing uses) in net current assets.

HEALTH CARE REVENUE FUND

Notes to Financial Statements
September 30, 2006 and 2005

(2) Summary of Significant Accounting Policies, Continued

Basis of Presentation, Continued

The modified accrual basis of accounting is used by all governmental fund types. Under the modified accrual basis of accounting, revenues are recognized when susceptible to accrual (i.e. when they become both measurable and available). "Measurable" means the amount of the transaction can be determined and "available" means collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period. For this purpose, the Fund considers revenues to be available if they are collected within 90 days of the end of the current fiscal period. Expenditures are recorded when the related fund liability is incurred.

Budget

An annual appropriated budget has not been formally adopted on a legal basis or a basis consistent with GAAP. Accordingly, a budget to actual presentation is not required or presented.

Cash

Custodial credit risk is the risk that in the event of a bank failure, the Fund'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. The Fund does not have a deposit policy for custodial credit risk.

For the purposes of the balance sheet, cash is defined as cash in checking and savings accounts. As of September 30, 2006 and 2005, the carrying amounts of the Fund's cash were \$206,642 and \$1,043,231 and the corresponding bank balances were \$272,704 and \$1,075,312, respectively. Of the bank balance amounts, \$258,625 and \$958,193, respectively, is maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2006 and 2005, bank deposits in the amount of \$100,000 were FDIC insured. Accordingly, these deposits are exposed to custodial credit risk. The Fund does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC coverage are uncollateralized.

Compensated Absences

The Fund recognizes expenditures for annual leave and sick leave when leave is actually taken. Accordingly, unused annual leave and sick leave are not included as an obligation within the balance sheet. The estimated accumulated amount of unused annual and sick leave at September 30, 2006 and 2005 is presently not determinable.

Taxes

The Government of RepMar imposes a gross receipts tax of 3% on revenues. The Fund is specifically exempt from this tax.

HEALTH CARE REVENUE FUND

Notes to Financial Statements
September 30, 2006 and 2005

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards

In fiscal year 2006, the Fund implemented the following pronouncements:

GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, which establishes standards for impairment of capital assets when its service utility has declined significantly and unexpectedly.

GASB Statement No. 44, *Economic Condition Reporting: The Statistical Section, an amendment to NCGA Statement 1*, which improves the understandability and usefulness of statistical section information and adds information from the new financial reporting model for state and local governments required by GASB Statement No. 34.

GASB Statement No. 46, *Net Assets Restricted by Enabling Legislation, an amendment of GASB Statement No. 34*, which improves the understandability and comparability of net assets information by making the assessment of legal enforceability more uniform across governments. This Statement requires governments to disclose the portion of total net assets that is restricted by enabling legislation.

GASB Statement No. 47, *Accounting for Termination Benefits*, which requires employees to disclose a description of the termination benefit arrangement, the cost of termination benefits, and significance methods and assumptions used to determine termination benefits liabilities.

GASB Technical Bulletin No. 2004-2, *Recognition of Pension and Other Postemployment Benefit Expenditures/Expense and Liabilities by Cost-Sharing Employers*, which clarifies the requirements of GASB Statement Nos. 27 and 45 for recognition of pension and other postemployment benefit expenditures/expense and liabilities by cost-sharing employers.

Implementation of the above pronouncements had no material impact on the financial statements of the Fund.

In April 2004, GASB issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which establishes uniform financial reporting for other postemployment benefit plans by state and local governments. The provisions of this Statement are effective for periods beginning after December 15, 2007. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Fund.

In June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Post employment Benefits Other Than Pensions*, which establishes standards for the measurement, recognition, and display of other post employment benefits expense/expenditures and related liabilities, note disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employers. The provisions of this Statement are effective for periods beginning after December 15, 2008. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Fund.

HEALTH CARE REVENUE FUND

Notes to Financial Statements
September 30, 2006 and 2005

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In September 2006, GASB issued Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfer of Assets and Future Revenues*. GASB Statement No. 48 establishes criteria that governments will use to ascertain whether certain transactions should be regarded as a sale or a collateralized borrowing. The statement also includes a provision that stipulates that governments should not revalue assets that are transferred between financial reporting entity components. The provisions of this Statement are effective for periods beginning after December 15, 2006. Management does not believe that the implementation of this statement will have a material effect on the financial statements of Fund.

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 liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

(3) Related Party Transactions

The Fund is a special revenue fund of RepMar and is therefore affiliated with all RepMar-owned and affiliated entities. The Marshall Islands Health Fund (the Health Fund) is a governmental fund type - special revenue fund of RepMar established by the Nitijela to provide, pay, or reimburse all or a determined portion of the cost of basic health care obtained at a local health care facility, as an approved off-island medical referral, or as emergency off-island medical care. The Health Fund includes the operations of the Basic Health Benefits Plan, which provides a substantial portion of the funding of the Fund.

Receivables from and payables to affiliates as of September 30, 2006 and 2005, are as follows:

	<u>2006</u>		<u>2005</u>	
	<u>Receivables</u>	<u>Payables</u>	<u>Receivables</u>	<u>Payables</u>
RepMar:				
Health Fund	\$ 1,270,236	\$ 42,409	\$ 1,028,727	\$ 42,409
General Fund	22,300	144,917	3,300	171,292
Federal Grants	-	16,263	-	16,263
Other	-	15,561	20,547	20,655
	<u>\$ 1,292,536</u>	<u>\$ 219,150</u>	<u>\$ 1,052,574</u>	<u>\$ 250,619</u>

Receivable from RepMar's Health Fund represent 45% of contributions to the Basic Health Benefits Plan not transferred by the Health Fund at September 30, 2006 and 2005.

HEALTH CARE REVENUE FUND

Notes to Financial Statements
September 30, 2006 and 2005

(3) Related Party Transactions, Continued

Payables to RepMar's general fund are summarized as follows:

	<u>2006</u>	<u>2005</u>
Asian Development Bank 1316 loan impres balance	\$ 56,936	\$ 56,713
Pacific Health Research Institute deposit	87,817	114,579
Others	<u>164</u>	<u>-</u>
	<u>\$ 144,917</u>	<u>\$ 171,292</u>

Contributions from RepMar during the years ended September 30, 2006 and 2005 are as follows:

	<u>2006</u>	<u>2005</u>
Health Fund	\$ 2,803,160	\$ 2,383,383
Compact (Section 211(a) Health Sector)	<u>-</u>	<u>36,535</u>
	<u>\$ 2,803,160</u>	<u>\$ 2,419,918</u>

Contributions from RepMar's Health Fund during the years ended September 30, 2006 and 2005 represents 45% of collections of the Basic Health Benefits Plan.

Contributions from RepMar through the Health Sector Fund represent Section 211(a) Compact of Free Association, as amended, funding received in a subrecipient capacity.

(4) Risk Management

The Fund is exposed to various risk of loss related to torts; theft of; damage to; and destruction of assets; errors and omissions, injuries to employees; and natural disasters. The Fund has elected to purchase commercial insurance from independent third parties for risks and losses to which is it exposed. Settled claims from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

(5) Contingency

The Fund receives substantially all of its funding from RepMar through collections of the Health Fund's Basic Health Benefits Plan. A significant reduction in the level of this funding, if this were to occur, may have an effect on the Fund's programs and activities.