

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, 2008 AND 2007

INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying statement 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, 2008, and the related statements of revenues, expenses and changes in net assets and of cash flows for the year then ended. We have also audited the accompanying statement of net assets of KAJUR as of September 30, 2007. 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, are recorded in the accompanying statements of net assets at September 30, 2008 and 2007 (stated at \$306,748 and \$320,579, respectively).

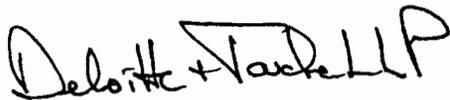
We were engaged to audit KAJUR's financial statements for the year ended September 30, 2006; however, the system of financial accounting and reporting in operation for KAJUR for the year ended September 30, 2006 was inadequate. Because of inadequacies in KAJUR's accounting records and internal control, we were unable to satisfy ourselves about the amounts at which receivables, inventories, plant and equipment, accounts payable, and accrued liabilities were recorded in KAJUR's 2006 financial statements. The 2006 statement of net assets enters into the determination of results of operations of KAJUR for the year ended September 30, 2007.

Because of the significance of the matters discussed in the preceding paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the statements of revenues, expenses and changes in net assets and of cash flows for the year ended September 30, 2007.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had the accounting records been adequate for us to satisfy ourselves about receivables, as discussed in the third paragraph above, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of KAJUR as of September 30, 2008 and 2007, and its changes in net assets and its cash flows for the year ended September 30, 2008, in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 3 through 5 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 August 24, 2009, 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.

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

August 24, 2009

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Management's Discussion and Analysis Year Ended September 30, 2008

This section of the Kwajalein Atoll Joint Utilities Resources, Inc. (KAJUR) annual financial report presents our discussion and analysis of KAJUR's financial performance during the fiscal year ended on September 30, 2008. It must be noted that none of the current senior management and none of the current senior accounting staff were involved with the KAJUR operation prior to the MEC Board taking responsibility for KAJUR's operations in May 2007. Therefore the figures provided as comparatives for the years prior to 2007 in the following discussion and analysis have been taken from the audited figures provided to management by Deloitte Touche and Tohmatsu for those years. The following report is to be read in conjunction with the financial statements, which follow this section.

FINANCIAL HIGHLIGHTS

KAJUR's net assets increased from \$4,194,287 in 2006 to \$4,665,633 in 2007 and increased by a further \$172,009 in 2008 to \$4,837,642. Total operating revenues increased from \$2,561,539 in 2006 to \$2,885,729 in 2007 and further increased to \$3,248,558 in 2008. Operating expenses increased from \$4,544,869 in 2006 to \$5,696,856 and further increased to \$6,341,298 in 2008. These increases were mainly due to increased fuel costs of \$828,151 in 2007 and \$520,121 in 2008, which were substantially passed along to consumers in the form of an increase in tariffs.

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. Conversely, a decrease in net assets indicates deterioration in financial condition.

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

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Current and other assets	\$ 1,506,102	\$ 1,917,468	\$ 262,108
Capital assets	<u>5,060,129</u>	<u>4,690,962</u>	<u>5,874,900</u>
Total assets	<u>6,670,331</u>	<u>6,608,430</u>	<u>6,137,008</u>
Current liabilities	1,015,358	1,093,611	1,903,677
Non-current liabilities	<u>830,197</u>	<u>849,186</u>	<u>39,044</u>
Total liabilities	<u>1,845,555</u>	<u>1,942,797</u>	<u>1,942,721</u>
Net assets:			
Invested in capital assets	5,060,129	4,690,962	5,874,900
Unrestricted	<u>(235,353)</u>	<u>(25,329)</u>	<u>(1,680,613)</u>
Total net assets	\$ <u>4,824,776</u>	\$ <u>4,665,633</u>	\$ <u>4,194,287</u>

As indicated above, total assets have increased from \$6,137,008 in 2006 to \$6,608,430 in 2007 and \$6,670,331 in 2008. Most of the change is explained by an increase in utility receivables of \$997,564 in 2007 and an increase of \$658,288 in 2008, which was due primarily to an increase in tariffs and offset by increases in the allowance for bad debts of \$788,752 in 2007 and \$781,401 in 2008, and an increase in capital assets of \$369,167. Please refer to note 5 to the accompanying financial statements for additional information concerning KAJUR's capital assets. There was a smaller increase in the value of inventory on hand of \$255,374 from 2007 to 2008 primarily due to an increase in fuel supplies on hand at year end.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Management's Discussion and Analysis, Continued Year Ended September 30, 2008

Total liabilities increased marginally from \$1,942,721 in 2006 to \$1,942,797 in 2007 but decreased to \$1,845,555 in 2008 due to increased cash flows for partial payment on accounts payable. Please refer to notes 6 and 7 to the accompanying financial statements for additional information concerning KAJUR's long-term debt.

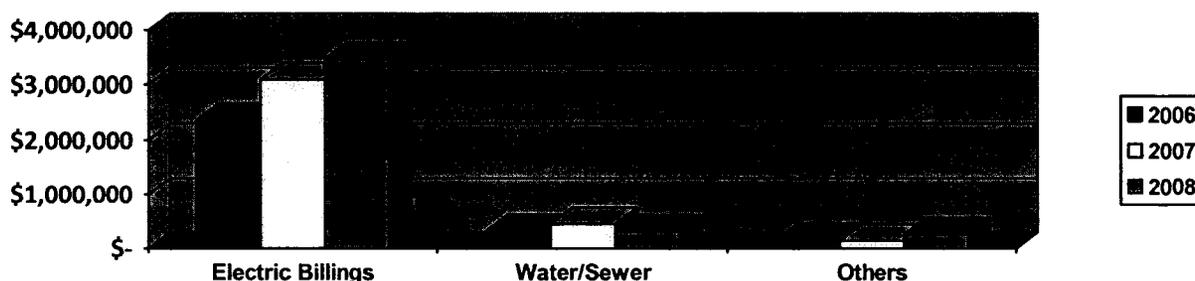
A summary of KAJUR's Statement of Revenues, Expenses and Changes in Net Assets is presented below:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Revenues:			
Net operating revenues	\$ 3,235,692	\$ 2,885,729	\$ 2,561,539
Non-operating revenues	<u>3,005,611</u>	<u>3,779,894</u>	<u>1,352,132</u>
Total revenues	<u>6,241,303</u>	<u>6,665,623</u>	<u>3,913,671</u>
Expenses:			
Operating expenses	6,341,298	5,696,856	4,544,869
Non-operating expenses	<u>491,061</u>	<u>852,225</u>	<u>91,650</u>
Total expenses	<u>6,832,359</u>	<u>6,549,081</u>	<u>4,636,519</u>
Income (loss) before capital contributions	(591,056)	116,542	(722,848)
Capital contributions	<u>750,199</u>	<u>354,804</u>	<u>728,469</u>
Change in net assets	\$ <u>159,143</u>	\$ <u>471,346</u>	\$ <u>5,621</u>

The Statement of Revenues, Expenses and Changes in Net Assets identifies the various revenue and expense items that impacted on the change in net assets. As indicated above, KAJUR's total revenues increased from \$3,913,671 in 2006 to \$6,665,623 in 2007 but fell to \$6,241,303 in 2008. Within the operating revenues, electric billings increased by from \$2,359,260 in 2006 to \$3,090,617 in 2007 and \$3,465,768 in 2008, while water and sewer billings also increased from \$318,435 in 2006 to \$445,524 in 2007 but decreased to \$306,310 in 2008. Other Billings were \$159,588 in 2006 and fell to \$138,390 in 2007 and increased to \$245,015 in 2008.

The graph below shows the major components of operating revenues for 2006, 2007 and 2008.

Major Income Items



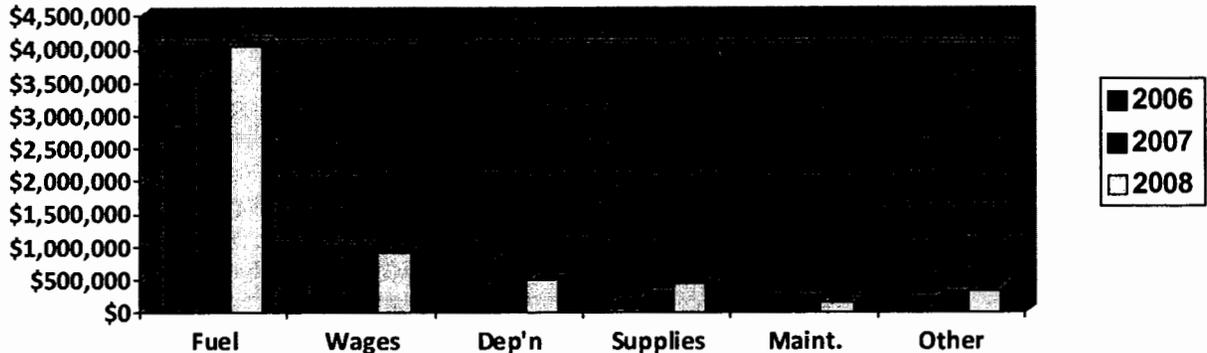
Total expenses have increased from \$4,636,519 in 2006 to \$6,549,081 in 2007 and to \$6,832,359 in 2008. This increase was mainly due to the effect of a loss in plant assets retirement of \$766,180 in 2007 and further retirements of fixed assets in 2008 of \$415,177 calculated between acquisition cost and applied depreciation. Most of the remaining increase in operating costs is explained by the increase in the cost of fuel for generation of \$828,151 in 2007 and \$520,121 in 2008.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Management's Discussion and Analysis, Continued Year Ended September 30, 2008

The graph below shows the major components of operating expenses for 2006, 2007 and 2008.

Major Expense Items



Management's Discussion and Analysis for the year ended September 30, 2007 is set forth in the report on the audit of KAJUR's financial statements, which is dated June 25, 2009. That Discussion and Analysis explains the major factors impacting the 2007 financial statements.

ECONOMIC FACTORS

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 of RepMar in the form of:

- a) Subsidies and grants,
- b) Collection of long outstanding utility receivables, and
- c) Continuing improvements in operations.

ADDITIONAL FINANCIAL INFORMATION

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

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Statements of Net Assets
September 30, 2008 and 2007

<u>ASSETS</u>	<u>2008</u>	<u>2007</u>
Current assets:		
Cash	\$ 172,578	\$ 456,412
Receivables:		
Utility	4,813,862	4,155,574
Affiliate	10,398	10,398
Employees	16,180	12,868
Other	317,363	198,527
	<u>5,157,803</u>	<u>4,377,367</u>
Less allowance for doubtful accounts	<u>(4,838,189)</u>	<u>(4,056,788)</u>
Total receivables, net	<u>319,614</u>	<u>320,579</u>
Prepaid expenses	29,120	398,195
Inventories	997,656	742,282
Total current assets	<u>1,518,968</u>	<u>1,917,468</u>
Long-term prepayment	104,100	-
Capital assets, net	<u>5,060,129</u>	<u>4,690,962</u>
	<u>\$ 6,683,197</u>	<u>\$ 6,608,430</u>

LIABILITIES AND NET ASSETS

Current liabilities:		
Accounts payable	\$ 180,078	\$ 368,593
Social security taxes payable	142,550	136,293
Due to affiliates	446,037	179,049
Accrued liabilities	99,501	281,184
Deferred revenue	147,192	128,492
Total current liabilities	<u>1,015,358</u>	<u>1,093,611</u>
Accrued sick leave - long-term	52,256	45,867
Social security taxes payable	777,941	803,319
	<u>1,845,555</u>	<u>1,942,797</u>
Contingencies		
Net assets:		
Invested in capital assets	5,060,129	4,690,962
Unrestricted	<u>(222,487)</u>	<u>(25,329)</u>
Total net assets	<u>4,837,642</u>	<u>4,665,633</u>
	<u>\$ 6,683,197</u>	<u>\$ 6,608,430</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, 2008 and 2007

	<u>2008</u>	<u>2007</u>
Operating revenues:		
Electric and service billings	\$ 3,465,768	\$ 3,090,617
Water	306,310	445,524
Other	257,881	138,390
Total operating revenues	<u>4,029,959</u>	<u>3,674,531</u>
Less provision for doubtful accounts	<u>(781,401)</u>	<u>(788,802)</u>
Total net operating revenues	<u>3,248,558</u>	<u>2,885,729</u>
Operating expenses:		
Fuel and lubricants	4,043,021	3,522,900
Salaries, wages and benefits	899,268	890,062
Depreciation	481,784	750,765
Supplies and materials	433,801	183,567
Operations and maintenance	145,502	146,555
Contractual services	500	92,364
Travel and transportation	159,732	44,060
Communications	15,460	25,409
Rental	40,607	-
Miscellaneous	121,623	41,174
Total operating expenses	<u>6,341,298</u>	<u>5,696,856</u>
Operating loss	<u>(3,092,740)</u>	<u>(2,811,127)</u>
Nonoperating revenues (expenses):		
Operating subsidies	347,900	562,900
Compact funding	2,487,100	2,902,941
Interest expense	(75,884)	(86,045)
Other income	170,611	314,053
Loss on write-off of fixed assets	(415,177)	(766,180)
Total nonoperating revenues (expenses), net	<u>2,514,550</u>	<u>2,927,669</u>
Capital contributions	<u>750,199</u>	<u>354,804</u>
Change in net assets	172,009	471,346
Net assets at beginning of year	<u>4,665,633</u>	<u>4,194,287</u>
Net assets at end of year	<u>\$ 4,837,642</u>	<u>\$ 4,665,633</u>

See accompanying notes to financial statements.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Statements of Cash Flows
Years Ended September 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
Cash flows from operating activities:		
Cash received from customers	\$ 3,272,225	\$ 2,654,234
Cash payments to suppliers for goods and services	(5,106,609)	(4,320,515)
Cash payments to employees for services	<u>(898,958)</u>	<u>(786,602)</u>
Net cash used for operating activities	<u>(2,733,342)</u>	<u>(2,452,883)</u>
Cash flows from noncapital financing activities:		
Promissory note repayment	(53,630)	-
Interest paid	(50,370)	-
Operating subsidies received from RepMar	<u>2,835,000</u>	<u>3,173,998</u>
Net cash provided by noncapital financing activities	<u>2,731,000</u>	<u>3,173,998</u>
Cash flows from capital and related financing activities:		
Capital contribution	283,780	-
Acquisition and construction of capital assets	<u>(565,272)</u>	<u>(285,047)</u>
Net cash used for capital and related financing activities	<u>(281,492)</u>	<u>(285,047)</u>
Net change in cash	(283,834)	436,068
Cash at beginning of year	<u>456,412</u>	<u>20,344</u>
Cash at end of year	<u>\$ 172,578</u>	<u>\$ 456,412</u>
Reconciliation of operating loss to net cash used for operating activities:		
Operating loss	\$ (3,092,740)	\$ (2,811,127)
Adjustments to reconcile loss from operations to net cash used for operating activities:		
Depreciation	481,784	750,765
Provision for doubtful accounts	781,401	788,802
(Increase) decrease in assets:		
Receivables:		
Utility	(658,288)	(997,614)
Employees	(3,312)	(9,509)
Other	(118,836)	(21,222)
Prepaid expenses	30,538	(44,288)
Inventories	(255,374)	(336,774)
Increase (decrease) in liabilities:		
Accounts payable	(188,515)	94,036
Social security taxes payable	8,995	91,429
Due to affiliates	266,988	23,751
Deferred revenue	18,700	(1,461)
Other current and accrued liabilities	<u>(4,683)</u>	<u>20,329</u>
Net cash used for operating activities	<u>\$ (2,733,342)</u>	<u>\$ (2,452,883)</u>

See accompanying notes to financial statements.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Statements of Cash Flows, Continued
Years Ended September 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
Non-cash investing, capital, and financing activities:		
Compact funding received from RepMar	\$ -	\$ 319,863
Prepaid expenses	-	(17,863)
Inventories	-	(302,000)
	<u>\$ -</u>	<u>\$ -</u>
Capital contributions received from RepMar	\$ 466,419	\$ 354,804
Prepaid expenses	234,437	(306,844)
Acquisition and construction of capital assets	(700,856)	(47,960)
	<u>\$ -</u>	<u>\$ -</u>
Capital assets	\$ 577,803	\$ 1,197,320
Accumulated depreciation	(162,626)	(431,140)
Loss on write-off of capital assets	(415,177)	(766,180)
	<u>\$ -</u>	<u>\$ -</u>
Accrued liabilities	\$ (170,611)	\$ (234,735)
Due to affiliates	-	(79,318)
Other income	170,611	314,053
	<u>\$ -</u>	<u>\$ -</u>

See accompanying notes to financial statements.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Notes to Financial Statements
September 30, 2008 and 2007

(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 October 28, 1999, RepMar and KADA awarded a twenty-four month management contract to the American Samoa Power Authority (ASPA) to assume operational control of KAJUR. The term of the contract was from November 2, 1999 to October 31, 2001 and conditions of the contract were included in the management contract between RepMar, KADA and ASPA. On November 9, 2001, the Cabinet of RepMar approved the extension of the management contract for an additional two years with the same conditions. On April 30, 2003, the ASPA management contract ended and three ASPA employees were retained by KAJUR on a contractual basis to continue the management and operations, however, there was no formal contract approved by the Cabinet of RepMar.

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 issued 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*. These statements 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.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Notes to Financial Statements
September 30, 2008 and 2007

(2) Summary of Significant Accounting Policies, Continued

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.
- 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, 2008 and 2007, the carrying amount of cash was \$172,578 and \$456,412, respectively, and the corresponding bank balances were \$164,523 and \$438,516, respectively. At September 30, 2008 and 2007, 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 collectibility 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, 2008 and 2007

(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, 2008 and 2007. 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, 2008 and 2007, is \$56,706 and \$57,705, 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, 2008 and 2007, is \$75,190 and \$52,256, respectively, and is included within the statements of net assets as accrued liabilities.

New Accounting Standards

During fiscal year 2008, KAJUR implemented GASB Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, GASB Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfer of Assets and Future Revenues*, and GASB Statement No. 50, *Pension Disclosures an amendment of GASB Statements No. 25 and 27*. GASB Statement No. 43 establishes uniform financial reporting for other postemployment benefit plans by state and local governments. 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, and includes a provision that stipulates that governments should not revalue assets that are transferred between financial reporting entity components and GASB Statement No. 50 more closely aligns the financial reporting requirements for pensions with those for other post-employment benefits. The implementation of these pronouncements did not have a material effect on the accompanying financial statements.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Notes to Financial Statements
September 30, 2008 and 2007

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Post employment Benefits Other Than Pensions*. GASB Statement No. 45 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, 2007. Management does not believe that the implementation of this statement will have a material effect on the financial statements of KAJUR.

In December 2006, GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. GASB Statement No. 49 provides guidance and consistency under which a governmental entity would be required to report a liability related to pollution remediation. 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 KAJUR.

In June 2007, GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. GASB Statement No. 51 addresses whether and when intangible assets should be considered capital assets for financial reporting purposes. The provisions of this statement are effective for periods beginning after June 15, 2009. Management does not believe that the implementation of this statement will have a material effect on the financial statements of KAJUR.

In November 2007, GASB issued Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*. GASB Statement No. 52 improves the quality of financial reporting by requiring endowments to report their land and other real estate investments at fair value, creating consistency in reporting among similar entities that exist to invest resources for the purpose of generating income. The provisions of this statement are effective for periods beginning after June 15, 2008. Management does not believe that the implementation of this statement will have a material effect on the financial statements of KAJUR.

In June 2008, GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. GASB Statement No. 53 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. The provisions of this statement are effective for periods beginning after June 15, 2009. Management does not believe that the implementation of this statement will have a material effect on the financial statements of KAJUR.

Reclassification

Certain reclassifications have been made to the 2007 financial statements in order to conform to the 2008 presentation.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Notes to Financial Statements
September 30, 2008 and 2007

(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. No losses as a result of these risks have occurred for the past three years.

(4) Inventories

Inventories at September 30, 2008 and 2007, consist of the following:

	<u>2008</u>	<u>2007</u>
Fuel	\$ 902,439	\$ 606,543
Materials and supplies	76,194	69,163
Lubricants	<u>19,023</u>	<u>66,576</u>
	\$ <u>997,656</u>	\$ <u>742,282</u>

(5) Capital Assets

Capital assets activity for the years ended September 30, 2008 and 2007 is as follows:

	<u>2008</u>			
	<u>October 1, 2007</u>	<u>Additions</u>	<u>Retirements</u>	<u>September 30, 2008</u>
Plant and machinery	\$ 4,673,318	\$ 764,444	\$ (577,803)	\$ 4,859,959
Distribution system	1,954,079	261,246	-	2,215,325
Water system	1,031,015	46,057	-	1,077,072
Other equipment	<u>1,111,035</u>	<u>194,381</u>	-	<u>1,305,416</u>
	8,769,447	1,266,128	(577,803)	9,457,772
Less accumulated depreciation	<u>(4,688,203)</u>	<u>(481,784)</u>	<u>162,626</u>	<u>(5,007,361)</u>
	4,081,244	784,344	(415,177)	4,450,411
Construction work-in-progress	<u>609,718</u>	-	-	<u>609,718</u>
	\$ <u>4,690,962</u>	\$ <u>784,344</u>	\$ <u>(415,177)</u>	\$ <u>5,060,129</u>
	<u>2007</u>			
	<u>October 1, 2006</u>	<u>Additions</u>	<u>Retirements</u>	<u>September 30, 2007</u>
Plant and machinery	\$ 4,488,869	\$ 184,449	\$ -	\$ 4,673,318
Distribution system	1,850,144	103,935	-	1,954,079
Water system	1,031,015	29,739	(29,739)	1,031,015
Other equipment	<u>1,409,901</u>	<u>197,609</u>	<u>(496,475)</u>	<u>1,111,035</u>
	8,779,929	515,732	(526,214)	8,769,447
Less accumulated depreciation	<u>(4,368,578)</u>	<u>(750,765)</u>	<u>431,140</u>	<u>(4,688,203)</u>
	4,411,351	(235,033)	(95,074)	4,081,244
Construction work-in-progress	<u>1,463,549</u>	<u>66,808</u>	<u>(920,639)</u>	<u>609,718</u>
	\$ <u>5,874,900</u>	\$ <u>(168,225)</u>	\$ <u>(1,015,713)</u>	\$ <u>4,690,962</u>

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Notes to Financial Statements
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(5) Capital Assets, Continued

At September 30, 2008 and 2007, management of KAJUR determined that certain capital assets in the amount of \$577,803 and \$1,197,320, respectively, net of \$162,626 and \$431,140, respectively, in accumulated depreciation, no longer existed. Accordingly, these capital assets were written off resulting in a loss of \$415,177 and \$766,180, respectively, for the years ended September 30, 2008 and 2007.

(6) Social Security Taxes Payable

At September 30, 2008 and 2007, 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 \$920,419 and \$939,612, 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, 2008 and 2007, KAJUR incurred penalties and interest relating to these delinquent taxes of \$78,622 and \$86,045, respectively.

During the years ended September 30, 2008 and 2007, employer contributions incurred by KAJUR for MISSA taxes amounted to \$79,941 and \$73,556, respectively.

(7) Changes in Long-term Liabilities

Long-term debt activity during the years ended September 30, 2008 and 2007 were as follows:

	<u>Balance at</u> <u>October 1, 2007</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance at</u> <u>September 30, 2008</u>	<u>Amount due</u> <u>in One Year</u>
MISSA:					
Delinquent taxes	\$ 674,842	\$ -	\$ (53,630)	\$ 621,212	\$ 56,289
Penalties and interest	<u>224,477</u>	<u>78,622</u>	<u>(50,370)</u>	<u>252,729</u>	<u>39,711</u>
Total MISSA	899,319	78,622	(104,000)	873,941	96,000
Accrued sick leave	<u>45,867</u>	<u>6,389</u>	<u>-</u>	<u>52,256</u>	<u>-</u>
Total	\$ <u>945,186</u>	\$ <u>85,011</u>	\$ <u>(104,000)</u>	\$ <u>926,197</u>	\$ <u>96,000</u>
	<u>Balance at</u> <u>October 1, 2006</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance at</u> <u>September 30, 2007</u>	<u>Due within</u> <u>One Year</u>
MISSA:					
Delinquent taxes	\$ -	\$ 674,842	\$ -	\$ 674,842	\$ 56,289
Penalties and interest	<u>-</u>	<u>224,477</u>	<u>-</u>	<u>224,477</u>	<u>39,711</u>
Total MISSA	-	899,319	-	899,319	96,000
Accrued sick leave	<u>39,044</u>	<u>10,399</u>	<u>(3,576)</u>	<u>45,867</u>	<u>-</u>
Total	\$ <u>39,044</u>	\$ <u>909,718</u>	\$ <u>(3,576)</u>	\$ <u>945,186</u>	\$ <u>96,000</u>

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Notes to Financial Statements
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(7) Changes in Long-term Liabilities, Continued

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>
2009	\$ 56,289	\$ 39,711	\$ 96,000
2010	55,122	40,878	96,000
2011	48,519	47,481	96,000
2012	42,692	53,308	96,000
2013	54,473	41,527	96,000
2014 - 2018	206,372	273,628	480,000
2019 - 2023	<u>157,745</u>	<u>247,544</u>	<u>405,289</u>
	<u>\$ 621,212</u>	<u>\$ 744,077</u>	<u>\$ 1,365,289</u>

(8) 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 for the years ended September 30, 2008 and 2007 and the related receivable and payable balances as of September 30, 2008 and 2007, are as follows:

	<u>2008</u>		
	<u>Expenses</u>	<u>Receivable</u>	<u>Payable</u>
American Samoa Power Authority (ASPA)	\$ -	\$ -	\$ 85,459
Marshalls Energy Company, Inc.	3,671,870	-	289,743
Marshall Islands National Telecommunications Authority	15,460	-	-
RepMar	<u>20,613</u>	<u>-</u>	<u>70,835</u>
	<u>\$ 3,707,943</u>	<u>\$ -</u>	<u>\$ 446,037</u>
	<u>2007</u>		
	<u>Expenses</u>	<u>Receivable</u>	<u>Payable</u>
American Samoa Power Authority (ASPA)	\$ -	\$ -	\$ 85,459
Marshalls Energy Company, Inc.	2,840,602	-	22,755
Marshall Islands National Telecommunications Authority	25,409	-	-
RepMar	<u>-</u>	<u>-</u>	<u>70,835</u>
	<u>\$ 2,866,011</u>	<u>\$ -</u>	<u>\$ 179,049</u>

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Notes to Financial Statements
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(8) Related Party Transactions, Continued

During the years ended September 30, 2008 and 2007, the operations of KAJUR were funded by appropriations from RepMar in the amounts of \$2,835,000 and \$3,465,841, respectively, of which \$10,398 was due and receivable from RepMar at September 30, 2008 and 2007, respectively. Of these appropriations from RepMar for the years ended September 30, 2008 and 2007, \$0 and \$319,863, respectively, were paid directly by RepMar to vendors for the purchase of fuel and lubricants.

In addition, during the years ended September 30, 2008 and 2007, KAJUR was the recipient of capital grants from RepMar in the amounts of \$750,199 and \$354,804, respectively, of which \$466,419 and \$354,804, respectively, was paid directly by RepMar to vendors for the acquisition and construction of capital assets.

As of September 30, 2008 and 2007, KAJUR maintained demand deposit accounts with a related financial institution in the amount of \$164,523 and \$456,412, respectively.

KAJUR received additional capital grants from ASPA through grant awards from the U.S. Department of the Interior (DOI). As of September 30, 2008 and 2007, KAJUR recorded deferred revenue of \$112,800, representing unexpended capital grants.

(9) 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 have provided funding in the past, no formal agreement exists to provide funds in the future, except as described in note 5. 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 2007 have been set forth in KAJUR's Single Audit Report for the year ended September 30, 2008. 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.