

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, 2011 AND 2010

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, 2011 and 2010, 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.

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.

In our opinion, such financial statements present fairly, in all material respects, the financial position of KAJUR as of September 30, 2011 and 2010, 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 8, 2012, 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.

The Management's Discussion and Analysis on pages 3 through 10 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.

Deloitte & Touche LLC

August 8, 2012



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, 2011

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 September 30, 2011, with selected comparative information for the fiscal years ended September 30, 2010 and 2009. It is to be read in conjunction with the financial statements, which follow this section.

FINANCIAL HIGHLIGHTS

KAJUR's operational data show that KAJUR continues to face many challenges in providing services to the communities of Ebeye and Gugeegue. The greatest challenges are deteriorated infrastructure and the cost of transporting fuel from Majuro to Ebeye. These challenges have a direct impact on KAJUR's revenue collection efforts and impede KAJUR's ability to recover costs for services it provides to the communities. However, several initiatives have evolved during the period which is beginning to shape a more positive outlook for KAJUR. These initiatives include the implementation of KAJUR's five-year reform strategy, the infusion of funds for capital improvement projects, and the granting of technical assistance from donor countries to help with KAJUR's system upgrades and reform strategy.

For the past three years KAJUR's net assets have decreased. KAJUR's net assets decreased by \$370,057 in 2011 from 2010 and by \$1,043,791 in 2010 from 2009. Hopefully, this trend will change in 2012 with the infusion of approximately \$3 million in infrastructure improvement funds allocated for KAJUR in fiscal year 2011.

The expanded use of prepaid meters positively contributed to KAJUR's overall operations as evidenced by the increase in net operating revenues. Where possible, KAJUR converted postpaid electric meters to prepaid electric meters for private residences and business operators throughout Ebeye and Gugeegue. Consequently, KAJUR's total net operating revenues increased by \$596,054 in 2011 from 2010 and by \$525,174 in 2010 from 2009, while total operating expenses decreased by \$64,148 in 2011 from 2010 and by \$27,540 in 2010 from 2009. Electric and service billings, water and other revenues increased by \$808,764 in 2011 from 2010 and by \$406,628 in 2010 from 2009, which is in direct correlation with the continuing increase in fuel prices and related increase in tariff. Unfortunately KAJUR's allowance for doubtful accounts reflect continuing challenges in its collection efforts of past due receivables. Some of the contributing factors include KAJUR's inability to make rate adjustments in its FoxPro billing system, the lack of a three-phase debit metering system and a fresh and a salt water distribution system that provides inconsistent services to the community hindering KAJUR's ability to charge flat rates to the community in the absence of water meters.

KAJUR's total operating expenses decreased from \$6,093,950 in 2010 to \$6,029,802 in 2011 and from \$6,121,490 in 2009 to \$6,093,950 in 2010. Fuel and lubricant expense increased substantially by \$443,281 in 2011 from 2010 and slightly by \$1,351 in 2010 from 2009 as volatile world market fuel prices fluctuated upward during the period. Overall, total operating expenses for KAJUR in fiscal year 2011 decreased by \$64,148 compared to fiscal year 2010 and by \$27,540 in fiscal year 2010 compared to fiscal year 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>2011</u>	<u>2010</u>	<u>2009</u>
Current and other assets	\$ 1,427,350	\$ 1,577,532	\$ 2,235,598
Capital assets	<u>3,526,918</u>	<u>3,487,583</u>	<u>4,241,345</u>
Total assets	<u>4,954,268</u>	<u>5,065,115</u>	<u>6,476,943</u>
Current liabilities	917,005	389,032	682,506
Noncurrent liabilities	<u>538,507</u>	<u>807,270</u>	<u>881,833</u>
Total liabilities	<u>1,455,512</u>	<u>1,196,302</u>	<u>1,564,339</u>
Net assets:			
Invested in capital assets	3,526,918	3,487,583	4,241,345
Unrestricted	<u>(28,162)</u>	<u>381,230</u>	<u>671,259</u>
Total net assets	<u>\$ 3,498,756</u>	<u>\$ 3,868,813</u>	<u>\$ 4,912,604</u>

As indicated above, KAJUR's capital assets increased slightly by \$39,335 in fiscal year 2011 from fiscal year 2010 and decreased significantly by \$753,762 in fiscal year 2010 from fiscal year 2009. Current and other assets decreased by \$150,182 for an overall decrease of \$110,847 in KAJUR's total assets for fiscal year 2011 and decreased significantly by \$658,066 for an overall decrease of \$1,411,828 in total assets for fiscal year 2010.

KAJUR sustained a significant increase in liabilities in fiscal year 2011 due in part to diesel fuel it received on credit from the Marshalls Energy Company, Inc. throughout the year. Compared to fiscal year 2010, KAJUR's current liabilities increased significantly by \$527,973 in fiscal year 2011 from fiscal year 2010 and decreased by \$293,474 in fiscal year 2010 from fiscal year 2009. KAJUR's total liabilities increased by \$259,210 in fiscal year 2011 compared to that of the previous year and decreased by \$368,037 in fiscal year 2010 compared to fiscal year 2009. For the foreseeable future, KAJUR, as a state-owned enterprise, will continue to rely heavily on the Republic of the Marshall Islands (RepMar) government for funding support to subsidize services to the Ebeye and Gugegue communities in order to maintain the tariff at a level that is affordable to these communities.

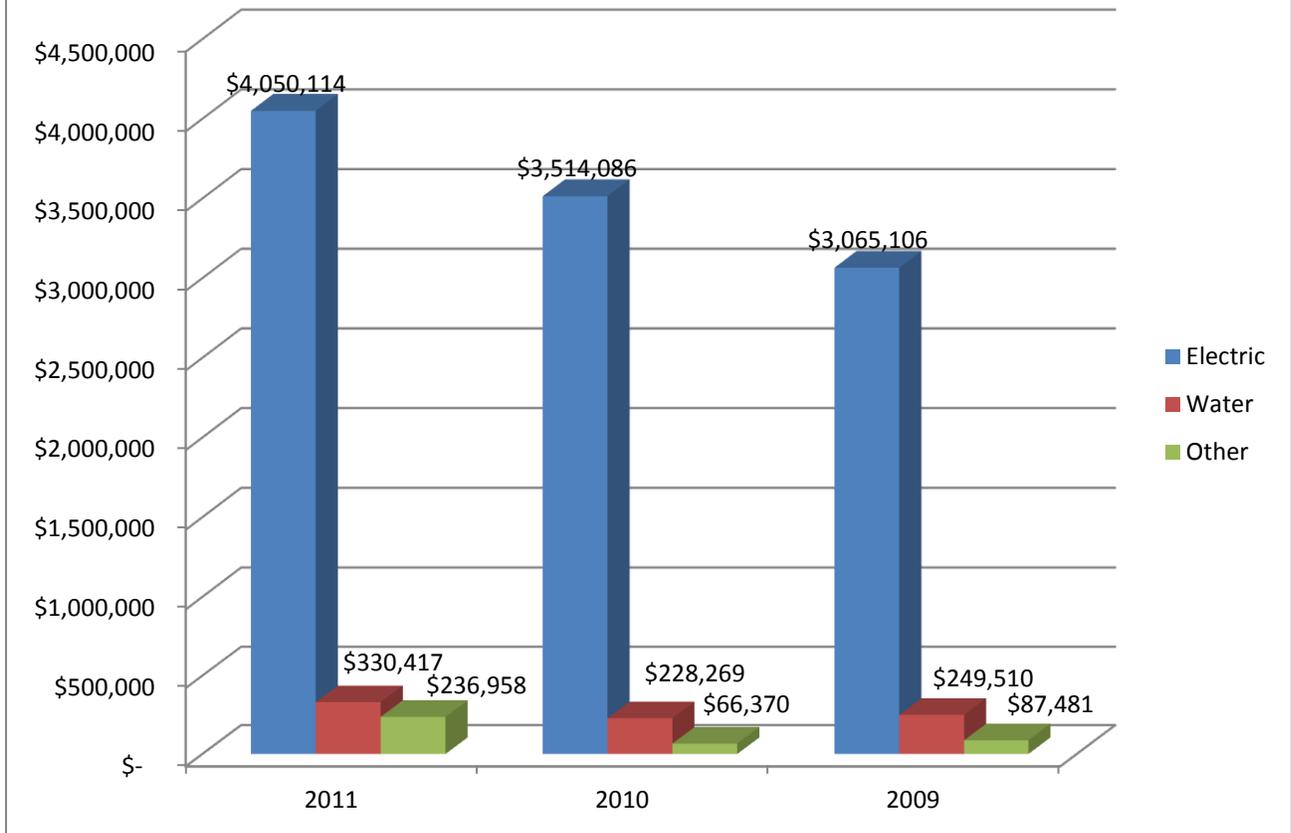
A comparative summary of KAJUR's Statements of Revenues, Expenses and Changes in Net Assets is presented below:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Revenues:			
Net operating revenues	\$ 4,165,024	\$ 3,568,970	\$ 3,043,796
Nonoperating revenues	<u>1,100,000</u>	<u>1,548,782</u>	<u>3,431,612</u>
Total revenues	<u>5,265,024</u>	<u>5,117,752</u>	<u>6,475,408</u>
Expenses:			
Operating expenses	6,029,802	6,093,950	6,121,490
Nonoperating expenses	<u>105,279</u>	<u>67,593</u>	<u>528,253</u>
Total expenses	<u>6,135,081</u>	<u>6,161,543</u>	<u>6,649,743</u>
Loss before capital contributions	(870,057)	(1,043,791)	(174,335)
Capital contributions	<u>500,000</u>	<u>-</u>	<u>-</u>
Change in net assets	\$ <u>(370,057)</u>	\$ <u>(1,043,791)</u>	\$ <u>(174,335)</u>

The Statement of Revenues, Expenses and Changes in Net Assets identifies the various revenue and expense items that impacted the change in net assets. As indicated above, KAJUR's total revenues increased from \$5,117,752 in 2010 to \$5,265,024 in 2011 and decreased from \$6,475,408 in 2009 to \$5,117,752 in 2010. Within operating revenues, electric and service billings increased from \$3,514,086 in 2010 to \$4,050,114 in 2011 and from \$3,065,106 in 2009 to \$3,514,086 in 2010. This increase in electric and service billings is primarily attributed to a six-cent increase in the tariff driven by the rise in fuel prices during the year. Continuing efforts by KAJUR to convert a few remaining postpaid meters to debit meters also contributed to this increase. Unfortunately, revenues from freshwater and saltwater services continue to be a challenge for KAJUR as potentially higher revenue can be collected from these two revenue sources. Inconsistent freshwater and saltwater services to the community has prompted KAJUR to postpone its intended application of flat rate fees to consumers until existing pipeline issues are repaired. In spite of these challenges, freshwater and saltwater revenues increased slightly from \$228,269 in 2010 to \$330,417 in 2011 and decreased from \$249,510 in 2009 to \$228,269 in 2010. A significant increase in other revenues from \$66,370 in 2010 to \$236,958 in 2011 can be attributed to fuel sales that KAJUR earned during periods when ALRO, the only fuel retailer in Ebeye, exhausted its fuel supply allowing KAJUR to temporarily step in to provide fuel to government agencies and business operators. Other revenues decreased from \$87,481 in 2009 to \$66,370 in 2010.

The graph below shows the major components of operating revenues for 2011, 2010 and 2009.

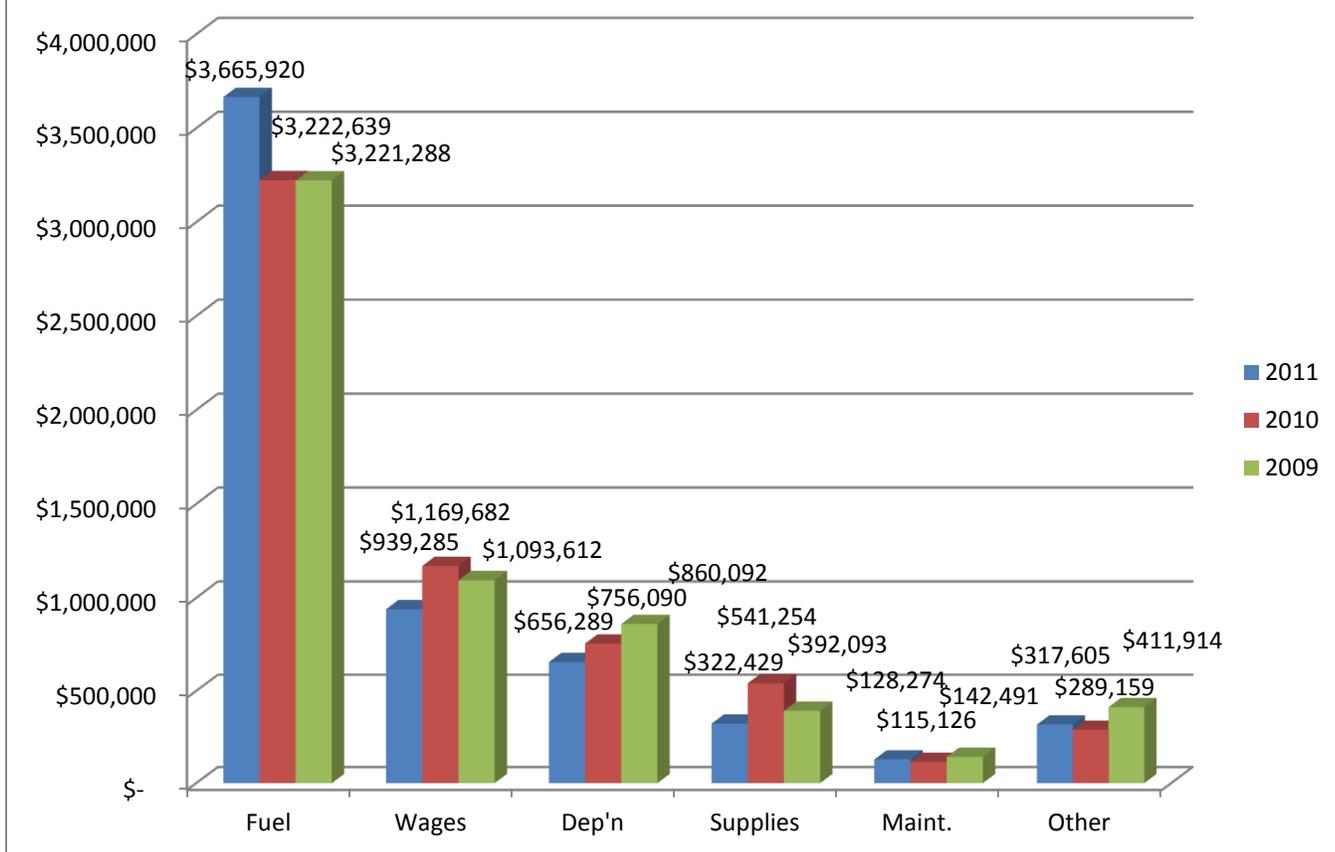
Major Operating Revenues



Fuel and lubricant expenses accounted for approximately 61% and 53% of KAJUR's operating expenses in fiscal years 2011 and 2010, respectively. Salaries and wages decreased from \$1,169,682 in fiscal year 2010 to \$939,285 in fiscal year 2011 and represented approximately 16% of KAJUR's operating expenses. Salaries and wages increased from \$1,093,612 in fiscal year 2009 to \$1,169,682 in fiscal year 2010 and represented approximately 19% of KAJUR's operating expenses. Other major expenses decreased significantly including supplies and materials (by \$218,825) and depreciation (by \$99,801) in fiscal year 2011 compared to the previous year. Supplies and materials increased by \$149,161 in 2010 from 2009 and depreciation decreased by \$104,002 in 2010 from 2009. Overall, KAJUR's total operating expenses decreased by \$64,148 in fiscal year 2011 from 2010 and by \$27,540 in 2010 from 2009, continuing KAJUR's positive trend of decreased operating expenses and increased revenues for three consecutive years.

The graph below shows the major components of operating expenses for 2011, 2010 and 2009.

Major Operating Expenses



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

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Cash flows from operating activities	\$ (948,635)	\$ (1,123,102)	\$ (2,872,493)
Cash flows from noncapital financing activities	859,952	1,388,782	3,303,612
Cash flows from capital and related financing activities	<u>(248,833)</u>	<u>(2,328)</u>	<u>(368,296)</u>
Net change in cash	(337,516)	263,352	62,823
Cash as beginning of year	<u>498,753</u>	<u>235,401</u>	<u>172,578</u>
Cash at end of year	\$ <u>161,237</u>	\$ <u>498,753</u>	\$ <u>235,401</u>

CAPITAL ASSETS

Over the past four years, KAJUR made very little investment in capital assets as KAJUR struggled with the high cost of fuel for power generation. In fiscal year 2011, two brand new generators (less alternators) were acquired at highly reduced prices. This acquisition will help secure uninterrupted power for the communities of Ebeye and Gugeegue for the next four to five years. Due to inadequate funds, KAJUR put off planned upgrades of its power distribution system as well as its water production and sewer systems; however, with an anticipated infusion of \$3 million in capital improvement funds approved for fiscal year 2012, overdue system upgrades along with the acquisition of additional capital assets will hopefully improve the quality of KAJUR's service delivery.

A summary of KAJUR's capital assets for fiscal years 2011, 2010 and 2009 is presented below:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Plant and machinery	\$ 5,604,266	\$ 5,047,589	\$ 5,038,589
Distribution system	2,215,325	2,215,325	2,215,325
Water system	1,192,532	1,192,532	1,181,172
Other equipment	<u>1,741,419</u>	<u>1,655,680</u>	<u>1,491,952</u>
	10,753,542	10,111,126	9,927,038
Less accumulated depreciation	<u>(7,226,624)</u>	<u>(6,623,543)</u>	<u>(5,867,453)</u>
	3,526,918	3,487,583	4,059,585
Construction work-in-progress/ equipment in transit	<u>-</u>	<u>-</u>	<u>181,760</u>
	<u>\$ 3,526,918</u>	<u>\$ 3,487,583</u>	<u>\$ 4,241,345</u>

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

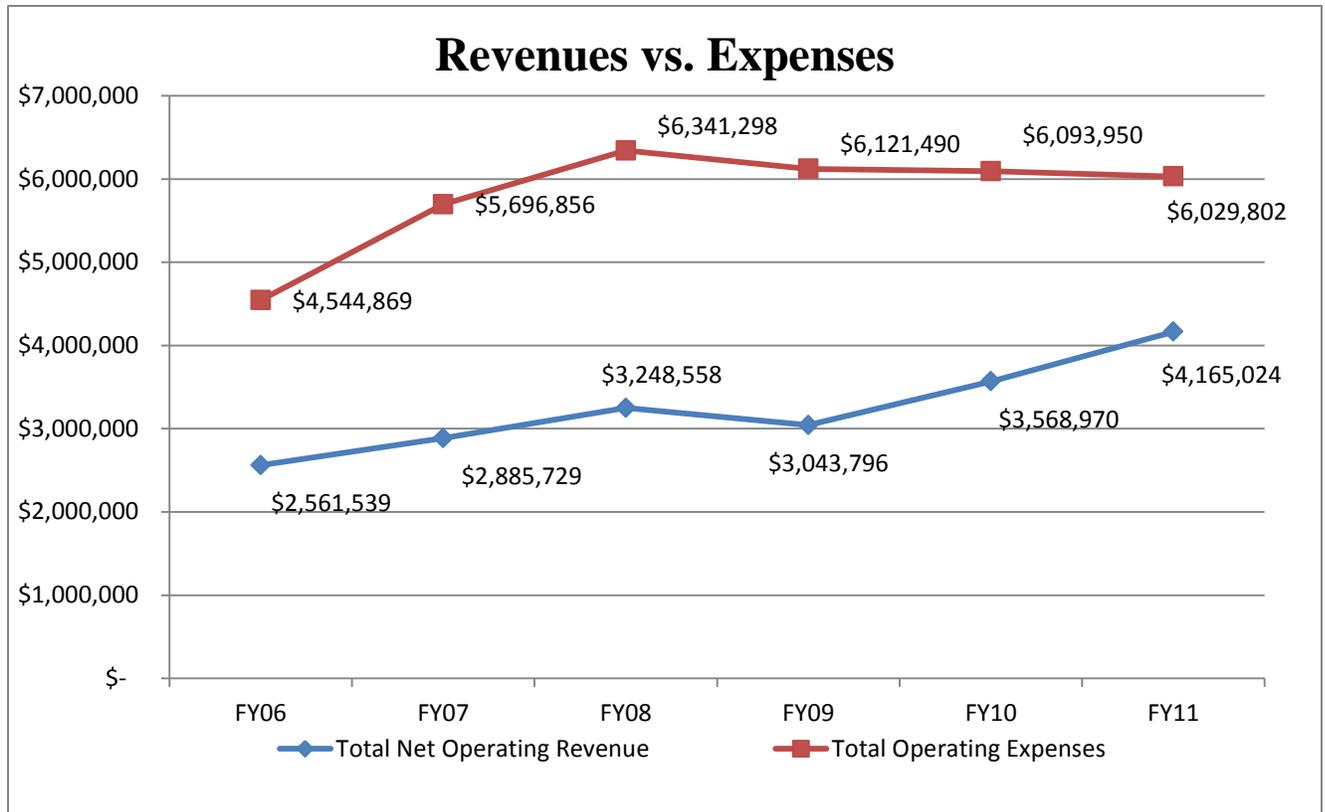
LONG-TERM DEBT

At September 30, 2011, 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 amount of \$594,201, \$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, 2011, 2010 and 2009, KAJUR incurred interest relating to these delinquent taxes of \$52,070 and \$67,593 and \$94,304, respectively. Please refer to note 6 to the financial statements for more information on KAJUR's long-term debt.

FUTURE OUTLOOK ON SUSTAINABILITY

As indicated in the financial data provided earlier in this report, KAJUR's operating expenses continue to decline while its revenues continue to increase; however, the data also indicates that there continues to be a substantial gap between revenues that KAJUR generates and the expenses it incurs. For the foreseeable future, KAJUR will continue to look to the RepMar government for funding support in order to supplement operations. Unfortunately, this dependency on government support will continue until such time the RepMar government will allow KAJUR to raise its tariff to a level which will enable KAJUR to recover the true cost of its services.

The chart below reflects this gap between KAJUR's revenues and expenses over a span of six years:



KAJUR recognizes that establishing an inexpensive means of transporting fuel from Majuro to Ebeye will help narrow the gap between revenues and expenses and has set this as one of its primary focus areas for fiscal year 2012.

KAJUR'S FOCUS IN THE COMING FISCAL YEAR

KAJUR's goals for fiscal year 2012 include, but are not limited to, the following:

- 1) Complete transition from the old FoxPro billing system to the new Utility Star billing system and initiate transition from the MAS90 accounting system to the new MIP accounting system.
- 2) Initiate system upgrades for freshwater and saltwater systems and implement flat rate fees for service users once deficiencies in the freshwater/saltwater distribution systems have been addressed.
- 3) Complete review of all personnel files and ensure all job descriptions are complete and that all supervisors have completed training sessions on how to perform employee performance evaluations.
- 4) Continue to monitor KAJUR's performance against its five-year reform strategy.
- 5) Develop plan and cost estimates for upgrading the Reverse Osmosis Water Production System.
- 6) Complete the acquisition of all capital improvement assets approved in the fiscal year 2012 budget.

- 7) Work with the Board of Directors of the Kwajalein Atoll Development Authority and the Kwajalein land owners on a plan to build fuel pipelines from the dock to the KAJUR fuel farm and seek possible funding sources once the plan is accepted.

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, 2010 is set forth in the report on the audit of KAJUR's financial statements which is dated May 18, 2011. That Discussion and Analysis explains the major factors impacting the 2010 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. General Manager at P.O. Box 5819, Ebeye, MH 96970 or call (692) 329-3799 or email romeo.alfred@yahoo.com.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Statements of Net Assets
September 30, 2011 and 2010

	<u>ASSETS</u>	<u>2011</u>	<u>2010</u>
Current assets:			
Cash		\$ 161,237	\$ 498,753
Receivables:			
Utility		1,490,352	950,898
Affiliate		587,130	448,133
Employees		8,102	10,028
Other		134,206	100,177
		<u>2,219,790</u>	<u>1,509,236</u>
Less allowance for doubtful accounts		<u>(1,661,997)</u>	<u>(1,209,532)</u>
Total receivables, net		<u>557,793</u>	<u>299,704</u>
Prepaid expenses		<u>12,158</u>	<u>274,034</u>
Inventories		<u>696,162</u>	<u>505,041</u>
Total current assets		<u>1,427,350</u>	<u>1,577,532</u>
Capital assets, net		<u>3,526,918</u>	<u>3,487,583</u>
		<u>\$ 4,954,268</u>	<u>\$ 5,065,115</u>
 <u>LIABILITIES AND NET ASSETS</u> 			
Current liabilities:			
Note payable, current portion		\$ 55,694	\$ 39,742
Accounts payable		51,969	110,459
Due to affiliates		665,463	15,974
Accrued liabilities		91,044	182,789
Deferred revenue		52,835	40,068
Total current liabilities		<u>917,005</u>	<u>389,032</u>
Accrued sick leave - long-term		-	64,833
Note payable, net of current portion		<u>538,507</u>	<u>742,437</u>
Total liabilities		<u>1,455,512</u>	<u>1,196,302</u>
Contingencies			
Net assets:			
Invested in capital assets		3,526,918	3,487,583
Unrestricted		<u>(28,162)</u>	<u>381,230</u>
Total net assets		<u>3,498,756</u>	<u>3,868,813</u>
		<u>\$ 4,954,268</u>	<u>\$ 5,065,115</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, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Operating revenues:		
Electric and service billings	\$ 4,050,114	\$ 3,514,086
Water	330,417	228,269
Other	<u>236,958</u>	<u>66,370</u>
Total operating revenues	4,617,489	3,808,725
Less provision for doubtful accounts	<u>(452,465)</u>	<u>(239,755)</u>
Total net operating revenues	<u>4,165,024</u>	<u>3,568,970</u>
Operating expenses:		
Fuel and lubricants	3,665,920	3,222,639
Salaries, wages and benefits	939,285	1,169,682
Depreciation	656,289	756,090
Supplies and materials	322,429	541,254
Operations and maintenance	128,274	115,126
Travel and transportation	122,109	125,400
Communications	53,296	6,900
Rental	33,268	17,453
Contractual services	19,120	20,244
Miscellaneous	<u>89,812</u>	<u>119,162</u>
Total operating expenses	<u>6,029,802</u>	<u>6,093,950</u>
Operating loss	<u>(1,864,778)</u>	<u>(2,524,980)</u>
Nonoperating revenues (expenses):		
Compact funding	1,100,000	1,548,782
Interest expense	(52,070)	(67,593)
Loss on write-off of fixed assets	<u>(53,209)</u>	<u>-</u>
Total nonoperating revenues (expenses), net	<u>994,721</u>	<u>1,481,189</u>
Capital contributions - Compact funding	<u>500,000</u>	<u>-</u>
Change in net assets	(370,057)	(1,043,791)
Net assets at beginning of year	<u>3,868,813</u>	<u>4,912,604</u>
Net assets at end of year	<u>\$ 3,498,756</u>	<u>\$ 3,868,813</u>

See accompanying notes to financial statements.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Statements of Cash Flows
Years Ended September 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Cash flows from operating activities:		
Cash received from customers	\$ 3,917,776	\$ 3,753,064
Cash payments to suppliers for goods and services	(3,727,583)	(3,825,259)
Cash payments to employees for services	<u>(1,138,828)</u>	<u>(1,050,907)</u>
Net cash used for operating activities	<u>(948,635)</u>	<u>(1,123,102)</u>
Cash flows from noncapital financing activities:		
Promissory note repayment	(187,978)	(92,407)
Interest paid	(52,070)	(67,593)
Operating subsidies received from RepMar	<u>1,100,000</u>	<u>1,548,782</u>
Net cash provided by noncapital financing activities	<u>859,952</u>	<u>1,388,782</u>
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets	<u>(248,833)</u>	<u>(2,328)</u>
Net cash used for capital and related financing activities	<u>(248,833)</u>	<u>(2,328)</u>
Net change in cash	(337,516)	263,352
Cash at beginning of year	<u>498,753</u>	<u>235,401</u>
Cash at end of year	<u>\$ 161,237</u>	<u>\$ 498,753</u>
Reconciliation of operating loss to net cash used for operating activities:		
Operating loss	\$ (1,864,778)	\$ (2,524,980)
Adjustments to reconcile operating loss to net cash used for operating activities:		
Depreciation	656,289	756,090
Provision for doubtful accounts	452,465	239,755
(Increase) decrease in assets:		
Receivables:		
Utility	(539,454)	(381,246)
Affiliate	(138,997)	190,601
Employees	1,926	10,483
Other	(34,029)	142,626
Prepaid expenses	261,876	918,592
Inventories	(191,121)	(199,393)
Increase (decrease) in liabilities:		
Accounts payable	(58,490)	(145,253)
Due to affiliates	649,489	(173,187)
Deferred revenue	12,767	(7,642)
Other current and accrued liabilities	(91,745)	50,452
Accrued sick leave - long-term	<u>(64,833)</u>	<u>-</u>
Net cash used for operating activities	<u>\$ (948,635)</u>	<u>\$ (1,123,102)</u>

See accompanying notes to financial statements.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Statements of Cash Flows, Continued
 Years Ended September 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Noncash capital and related financing activities:		
Acquisition of capital assets	\$ 500,000	\$ -
Capital contributions received from RepMar	<u>(500,000)</u>	<u>-</u>
	<u>\$ -</u>	<u>\$ -</u>
Capital assets	\$ (53,209)	\$ -
Loss on write-off of capital assets	<u>53,209</u>	<u>-</u>
	<u>\$ -</u>	<u>\$ -</u>

See accompanying notes to financial statements.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Notes to Financial Statements
September 30, 2011 and 2010

(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, fund equity is 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, 2011 and 2010

(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, 2011 and 2010, the carrying amount of cash was \$161,237 and \$498,753, respectively, and the corresponding bank balances were \$185,617 and \$564,605, respectively. At September 30, 2011 and 2010, 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, 2011 and 2010

(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, 2011 and 2010. 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, 2011 and 2010, is \$-0- and \$73,420, 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, 2011 and 2010, is \$-0- and \$129,667, respectively, and is included within the statements of net assets as accrued liabilities and accrued sick leave - long-term. Effective October 1, 2010, vacation and sick leave credits not utilized at the end of the year will not be paid out in the following year.

New Accounting Standards

During fiscal year 2011, KAJUR implemented the following pronouncements:

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Notes to Financial Statements
September 30, 2011 and 2010

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

- GASB 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.
- GASB Statement No. 59, *Financial Instruments Omnibus*, which updates and improves existing standards regarding financial reporting of certain financial instruments and external investment pools.

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

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 December 2010, GASB issued Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, which addresses how to account for and report service concession arrangements (SCAs), a type of public-private or public-public partnership that state and local governments are increasingly entering into. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of KAJUR.

In December 2010, GASB issued Statement No. 61, *The Financial Reporting Entity: Omnibus*, which is designed to improve financial reporting for governmental entities by amending the requirements of Statements No. 14, *The Financial Reporting Entity*, and No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, to better meet user needs and address reporting entity issues that have come to light since those Statements were issued in 1991 and 1999, respectively. The provisions of this statement are effective for periods beginning after June 15, 2012. Management does not believe that the implementation of this statement will have a material effect on the financial statements of KAJUR.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Notes to Financial Statements
September 30, 2011 and 2010

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In December 2010, GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which is intended to enhance the usefulness of its Codification by incorporating guidance that previously could only be found in certain Financial Accounting Standards Board (FASB) and American Institute of Certified Public Accountants (AICPA) pronouncements. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of KAJUR.

In July 2011, GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which establishes guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of KAJUR.

In July 2011, GASB issued Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions* (an amendment of GASB Statement No. 53), which will improve financial reporting by state and local governments by clarifying the circumstances in which hedge accounting continues to be applied when a swap counterparty, or a swap counterparty's credit support provider, is replaced. The provisions of this statement are effective 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.

(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, 2011 and 2010, consist of the following:

	<u>2011</u>	<u>2010</u>
Materials and supplies	\$ 439,367	\$ 334,625
Fuel	221,299	148,576
Lubricants	<u>35,496</u>	<u>21,840</u>
	<u>\$ 696,162</u>	<u>\$ 505,041</u>

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Notes to Financial Statements
September 30, 2011 and 2010

(5) Capital Assets

Capital assets activity for the years ended September 30, 2011 and 2010 is as follows:

	2011			
	<u>October 1, 2010</u>	<u>Additions and Transfers</u>	<u>Retirements</u>	<u>September 30, 2011</u>
Plant and machinery	\$ 5,047,589	\$ 663,094	\$ (106,417)	\$ 5,604,266
Distribution system	2,215,325	-	-	2,215,325
Water system	1,192,532	-	-	1,192,532
Other equipment	<u>1,655,680</u>	<u>85,739</u>	<u>-</u>	<u>1,741,419</u>
	10,111,126	748,833	(106,417)	10,753,542
Less accumulated depreciation	<u>(6,623,543)</u>	<u>(656,289)</u>	<u>53,208</u>	<u>(7,226,624)</u>
	<u>\$ 3,487,583</u>	<u>\$ 92,544</u>	<u>\$ (53,209)</u>	<u>\$ 3,526,918</u>
	2010			
	<u>October 1, 2009</u>	<u>Additions and Transfers</u>	<u>Retirements</u>	<u>September 30, 2010</u>
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>

At September 30, 2011 and 2010, management of KAJUR determined that certain capital assets in the amount of \$106,417 and \$-0-, respectively, no longer existed. Accordingly, these capital assets were written-off resulting in a loss of \$53,209 and \$-0-, respectively, for the years ended September 30, 2011 and 2010.

(6) MISSA Note Payable

At September 30, 2011 and 2010, KAJUR was liable for taxes, including certain delinquent taxes, interest and penalties, payable to the Marshall Islands Social Security Administration (MISSA) in the amount of \$594,201 and \$782,179, 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, 2011 and 2010, KAJUR incurred interest relating to these delinquent taxes of \$52,070 and \$67,593, respectively.

During the years ended September 30, 2011 and 2010, employer contributions incurred by KAJUR for MISSA taxes amounted to \$103,919 and \$97,337, respectively.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Notes to Financial Statements
September 30, 2011 and 2010

(6) MISSA Note Payable, 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>
2012	\$ 55,694	\$ 40,306	\$ 96,000
2013	61,674	34,326	96,000
2014	67,404	28,596	96,000
2015	72,999	23,001	96,000
2016	78,468	17,532	96,000
2017 - 2019	<u>257,962</u>	<u>22,579</u>	<u>280,541</u>
	<u>\$ 594,201</u>	<u>\$ 166,340</u>	<u>\$ 760,541</u>

Long-term debt activity during the years ended September 30, 2011 and 2010 were as follows:

	<u>Balance at October 1, 2010</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance at September 30, 2011</u>	<u>Amount due in One Year</u>
MISSA note payable	\$ 782,179	\$ -	\$ (187,978)	\$ 594,201	\$ 55,694
Compensated absences	<u>203,087</u>	<u>-</u>	<u>(203,087)</u>	<u>-</u>	<u>-</u>
Total	<u>\$ 985,266</u>	<u>\$ -</u>	<u>\$ (391,065)</u>	<u>\$ 594,201</u>	<u>\$ 55,694</u>
	<u>Balance at October 1, 2009</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance at September 30, 2010</u>	<u>Amount due in One Year</u>
MISSA note payable	\$ 874,586	\$ -	\$ (92,407)	\$ 782,179	\$ 39,742
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>

(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, 2011 and 2010 and the related receivable and payable balances as of September 30, 2011 and 2010, are as follows:

	<u>Expenses</u>	<u>2011 Receivable</u>	<u>Payable</u>
Marshall's Energy Company, Inc.	\$ 3,750,272	\$ -	\$ 620,573
Marshall Islands National Telecommunications Authority	53,296	14,971	44,890
RepMar	<u>-</u>	<u>572,159</u>	<u>-</u>
	<u>\$ 3,803,568</u>	<u>\$ 587,130</u>	<u>\$ 665,463</u>

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Notes to Financial Statements
September 30, 2011 and 2010

(7) Related Party Transactions, Continued

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

During the years ended September 30, 2011 and 2010, KAJUR received appropriations from RepMar in the amounts of \$1,600,000 and \$1,548,782, respectively, which were paid by RepMar directly to vendors for the purchase of fuel and lubricants and generators.

(8) Contingencies

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, 2011. 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.