

**KWAJALEIN ATOLL JOINT UTILITIES RESOURCES,  
INC.**

**(A COMPONENT UNIT OF THE  
REPUBLIC OF THE MARSHALL ISLANDS)**

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**FINANCIAL STATEMENTS  
AND  
INDEPENDENT AUDITORS' REPORT**

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**YEARS ENDED SEPTEMBER 30, 2012 AND 2011**

## INDEPENDENT AUDITORS' REPORT

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

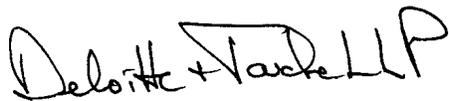
We have audited the accompanying statements of net assets of the Kwajalein Atoll Joint Utilities Resources, Inc. (KAJUR), a component unit of the Republic of the Marshall Islands, as of September 30, 2012 and 2011, and the related statements of revenues, expenses and changes in net assets and of cash 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, 2012 and 2011, 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 May 10, 2013, 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 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.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 3 through 9 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

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

May 10, 2013

## **KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.**

### **Management's Discussion and Analysis Years Ended September 30, 2012 and 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, 2012, with selected comparative information for the fiscal years ended September 30, 2011 and 2010. It is to be read in conjunction with the financial with the financial statements, which follow this section.

#### **FINANCIAL HIGHLIGHTS**

KAJUR's operational data show that this State Owned Enterprise is continually facing many challenges in its provision of services to the communities of Ebeye and Gugeegue. Deteriorated infrastructures and costly transportation mode used in provisioning fuel for the power plant continue to impede service improvement efforts. Despite some improvement in KAJUR's operations since 2010, the financial and operational integrity of the company remains at risk and requires improvement to continue its services and adapt in the future.

With continuing support from the central government and donor countries such as U.S., Japan and Australia, KAJUR was able to maintain utility services to the two communities and avert any major breakdown to its already deteriorated water and sanitation distribution systems. Additionally, in anticipation of a major support grant from the Australian government, KAJUR had scaled down its 2012 Kwajalein Development Fund (KDF) spending plan in order to expend its limited financial resources only on equipment and supplies that are necessary to maintain and keep existing systems operational until major long-term system upgrades commence under the Australian grant support scheme.

As indicated, KAJUR's financial integrity remains at risk. However, some investment was directed toward mitigating these risks while KAJUR continues to strive toward meeting its strategic objectives as outlined under its Five-Year Strategic Reform Plan. As such, information and accounting system upgrades were acquired which will allow KAJUR to improve its data collection, accounting, billing, and report generation capabilities. Consequently, system generated reports have now made it possible for KAJUR to analyze customers' power usage trends and identify possible meter tampering activities by customers.

For the past three consecutive years, KAJUR's net assets have continued to decrease. In 2012, KAJUR's net assets decreased by \$482,205. Some improvement in capital assets is anticipated with approximately \$1.2 million of capital improvements for KAJUR remaining unspent as KAJUR has developed a scaled down spending plan for its Kwajalein Development Fund. Pending DOI and Combined Utility Board approval, KAJUR plans to use the remaining funds from the scaled down spending plan to support KAJUR's fuel requirements; acquisition of three-phase pre-paid meters; and to support an energy efficiency program that is aimed to reduce KAJUR's overall fuel consumption.

A sustained increase in KAJUR's net operating revenue is attributed to a slight increase in its electric tariff during this period; KAJUR's continued use of the cash power system to collect outstanding debts from customers who are on the cash power system; as well as positive use of an opportunity to raise fuel revenue by selling fuel during the early parts of this period when no fuel was available for sale on Ebeye. Despite these positive trends, KAJUR's Allowance for Doubtful Accounts also reflects continuing challenges in KAJUR's collection efforts on long standing, past due arrears.

#### **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.

**KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.**

Management's Discussion and Analysis, Continued  
Years Ended September 30, 2012 and 2011

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

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Current and other assets	\$ 1,432,326	\$ 1,427,350	\$ 1,577,532
Capital assets	<u>2,681,991</u>	<u>3,526,918</u>	<u>3,487,583</u>
Total assets	<u>4,114,317</u>	<u>4,954,268</u>	<u>5,065,115</u>
Current liabilities	779,058	917,005	389,032
Non-current liabilities	<u>318,708</u>	<u>538,507</u>	<u>807,270</u>
Total liabilities	<u>1,097,766</u>	<u>1,455,512</u>	<u>1,196,302</u>
Net assets:			
Invested in capital assets	2,681,991	3,526,918	3,487,583
Unrestricted	<u>334,560</u>	<u>(28,162)</u>	<u>381,230</u>
Total net assets	\$ <u>3,016,551</u>	\$ <u>3,498,756</u>	\$ <u>3,868,813</u>

As indicated above, KAJUR's capital assets decreased slightly by \$844,927 in FY 2012. Other assets increased slightly by \$4,976 for an overall decrease of \$839,951 in KAJUR's total assets for FY2012.

By the closing of FY2012, KAJUR's current liabilities stood at \$779,058 due in great part to diesel fuel it received on credit from the Marshalls Energy Company (MEC) throughout that period. Its non-current liabilities for that same period stood at \$318,708; mostly attributed to its existing payable balance with the Marshall Islands Social Security Administration (MISSA). While KAJUR's promissory note on balance due with MISSA established several years back was for a monthly payment of \$8,000, since October 2012, KAJUR increased this monthly payment to \$20,000 a month. Consequently, KAJUR's total liabilities for this period decreased by \$357,746 compared to that of the previous year. For the foreseeable future, KAJUR, as a State Owned Enterprise, will continue to rely heavily on the RMI government for funding support to subsidize services to the Ebeye and Gugegue communities in order to maintain tariffs at a level that is affordable for these two communities.

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

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Net operating revenues	\$ 4,349,098	\$ 4,165,024	\$ 3,568,970
Non-operating revenues	<u>2,852,455</u>	<u>1,100,000</u>	<u>1,548,782</u>
Total revenues	7,201,553	5,265,024	5,117,752
Expenses:			
Operating expenses	7,592,057	6,029,802	6,093,950
Non-operating expenses	<u>91,701</u>	<u>105,279</u>	<u>67,593</u>
Total expenses	7,683,758	6,135,081	6,161,543
Loss before capital contributions	(482,205)	(870,057)	(1,043,791)
Capital contributions	<u>-</u>	<u>500,000</u>	<u>-</u>
Change in net assets	\$ <u>(482,205)</u>	\$ <u>(370,057)</u>	\$ <u>(1,043,791)</u>

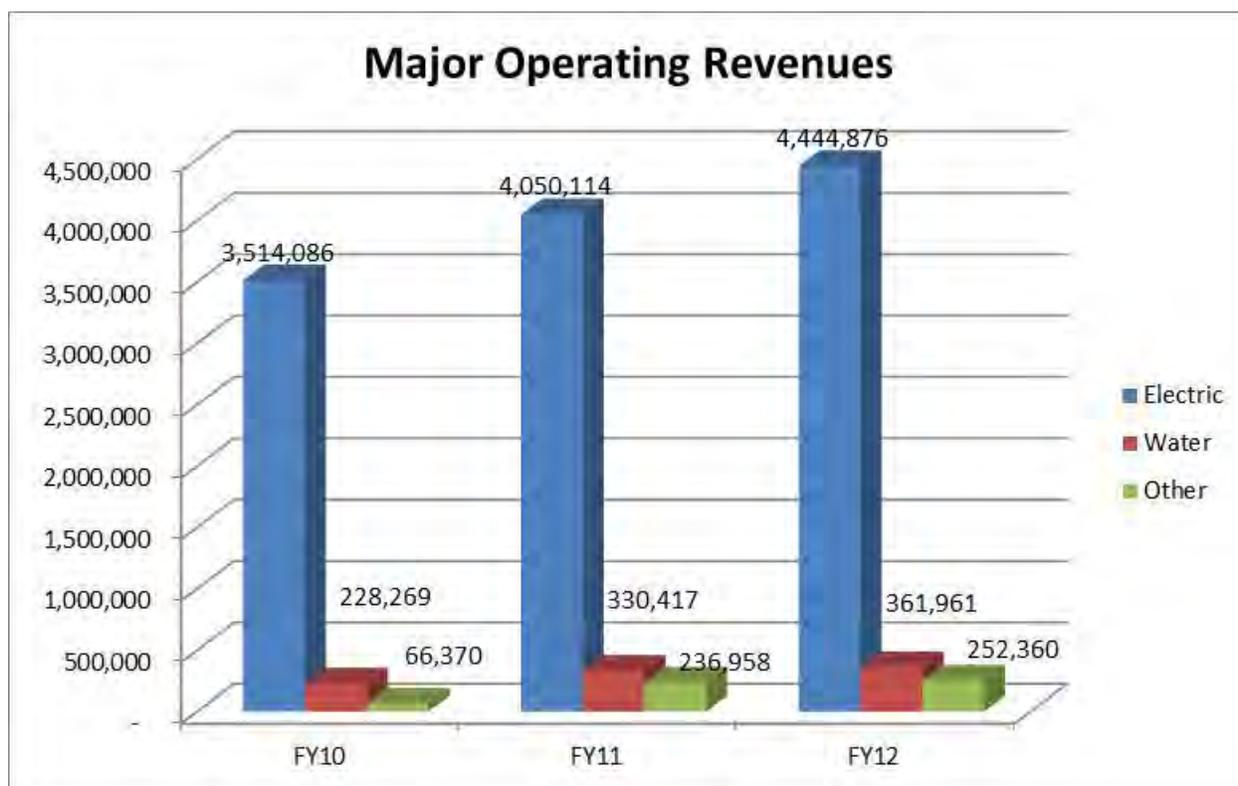
## KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

### Management's Discussion and Analysis, Continued Years Ended September 30, 2012 and 2011

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 \$5,265,024 in 2011 to \$7,201,553 in 2012. Within the operating revenues, electric revenue increased from \$4,050,114 in 2011 to \$4,444,876 in 2012. This increase in electric revenue is primarily attributed to a 2.5% (1.2 cents) increase in tariff driven by rise in fuel prices during that period. Despite freshwater and sewer services being provided to the public free of charge, there were slight increases in revenue collections for fresh water and sewer services mostly from government facilities and revenues that were generated from personal (truck) deliveries of freshwater. As such, freshwater revenues increased from \$330,417 in 2011 to \$361,961 in 2012. A significant increase in other revenues from \$236,958 in 2011 to \$252,360 in 2012 can be attributed mostly to fuel sales collected during periods when ALRO, the only fuel retailer in Ebeye, exhausted its fuel supply thereby allowing KAJUR to temporarily step in to provide fuel to government agencies, business operators and to the general public.

Management's Discussion and Analysis for the year ended September 30, 2011 is set forth in the report on the audit of KAJUR's financial statements dated August 8, 2012. That Discussion and Analysis explains the major factors impacting the 2011 financial statements and may be obtained from the contact information below.

The graph below comparatively illustrates the major components of operating revenues for FY10, FY11 and FY12.

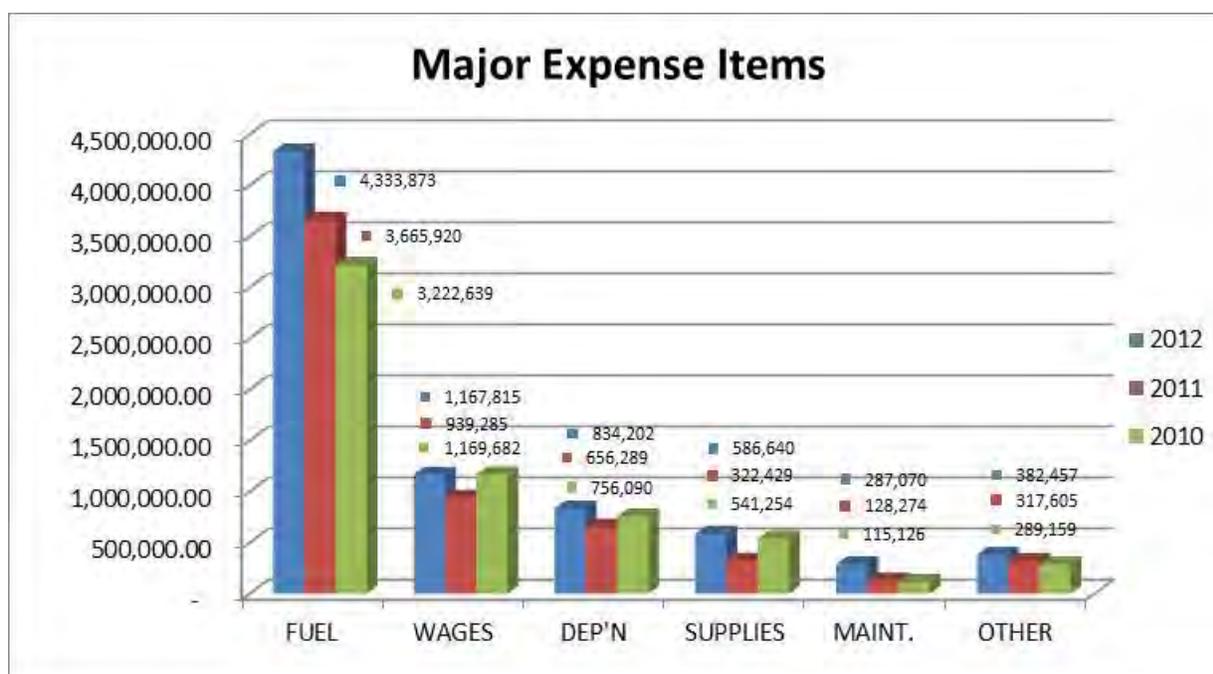


## KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

### Management's Discussion and Analysis, Continued Years Ended September 30, 2012 and 2011

As expected, Fuel and Lubricants Expense remained by far the highest expense item for KAJUR in FY2012. It represents approximately fifty-seven percent (57%) of KAJUR's overall operating expenses. At \$4,333,873 in FY2012, this figure represents an increase of \$667,953 or 18% increase compared to that of the previous year. This increase in fuel and lubricant expense fairly represents the volatile nature of world market fuel prices throughout this period. Salaries and wages, which came in second, increased slightly by \$228,530 from \$939,285 in FY2011 to \$1,167,815 in 2012. In FY12, KAJUR spent \$1,167,815 in Salaries and Wages. This amount represents approximately fifteen percent (15%) of KAJUR's operating expenses over that period. While no annual pay increment for employees was awarded during this period, there was an increase of \$228,530 in Salaries and Wages. This can be attributed to three new hires and one job promotion that was awarded in FY12. Employees overtime is also a major contributor to this increase in Salaries and Wages as monthly fuel transports from Majuro to Ebeye required around-the-clock manpower. Additionally, KAJUR's failing water and sewer systems also require around-the-clock monitoring. KAJUR also experienced some slight increases in Supplies and Maintenance Expenses during this period as some minor investments in equipment and system upgrades were purchased. On paper, KAJUR's total Operating Expense increased substantially by \$1,562,255 in FY2012; unfortunately, breaking the organization's positive trend of decreased operating expense and increased revenue over the past three consecutive years. However, it should also be noted that the upward spike in operational expense was primarily caused by a sudden increase in plant fuel usage. An investigation done by plant technicians and auditors confirmed that the fuel metering systems used by the power plant are not properly calibrated and that complex fuel piping layout as well as lack of fuel transfer procedures are all contributing factors to possible misstatement in plant fuel usage.

The graph below shows a comparative analysis of major operating expenses components for FY2012 and the preceding two years.



## KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Management's Discussion and Analysis, Continued  
Years Ended September 30, 2012 and 2011

### CAPITAL ASSETS

KAJUR made no significant investment in capital assets during this period as the organization continued to struggle with the high cost of fuel for power generation. As clearly shown in its summary of capital assets, the only major change in KAJUR's capital assets is one influenced by assets' depreciation. With the anticipated support grant for water and sanitation system upgrade from the Australian government, KAJUR's immediate plan is to use limited KDF funds to keep existing systems running and to make minor investments to expand the life of KAJUR's existing water and sewer systems until the support grant from AusAid/ADB gets underway.

A summary of KAJUR's capital assets for the past three years is presented below:

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Plant and machinery	\$ 5,519,679	\$ 5,604,266	\$ 5,047,589
Distribution system	1,954,168	2,215,325	2,215,325
Water System	1,186,932	1,192,532	1,192,532
Other equipment	<u>1,769,637</u>	<u>1,741,419</u>	<u>1,655,680</u>
	10,430,416	10,753,542	10,111,126
Less accumulated depreciation	<u>(7,748,425)</u>	<u>(7,226,624)</u>	<u>(6,623,543)</u>
	\$ <u>2,681,991</u>	\$ <u>3,526,918</u>	\$ <u>3,487,583</u>

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

### LONG-TERM DEBT

At September 30, 2012, 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 \$390,218, \$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, 2012, 2011 and 2010, KAJUR incurred interest relating to these delinquent taxes of \$36,171, \$52,070 and \$67,593, respectively. Please refer to note 6 to the financial statements for more information on KAJUR's long-term debt.

### FUTURE OUTLOOK ON SUSTAINABILITY

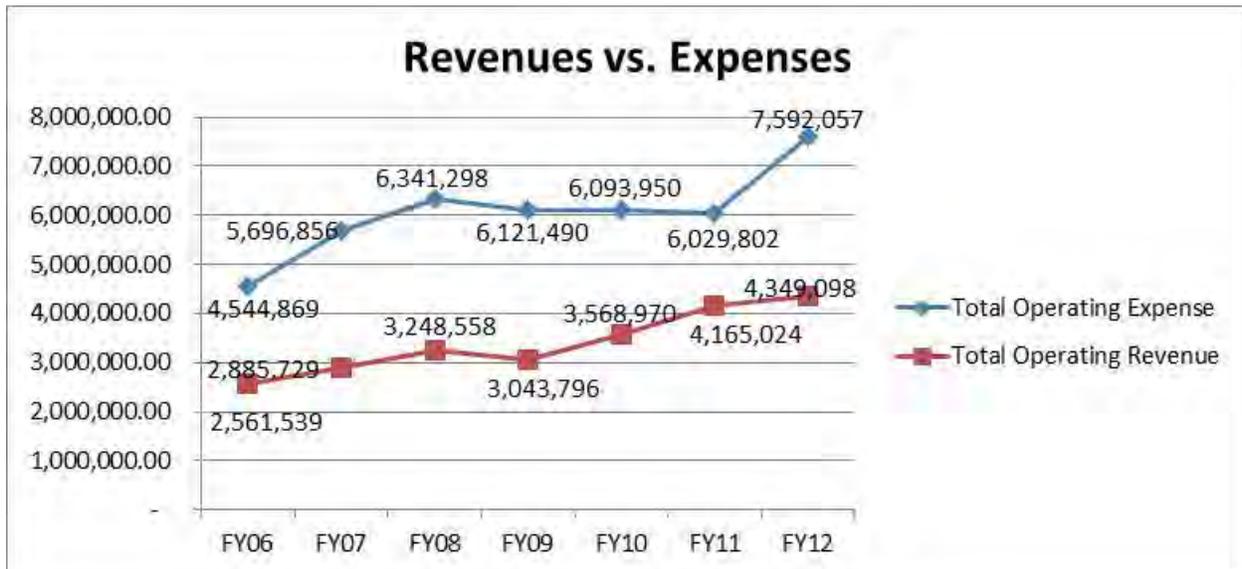
KAJUR's operational data clearly shows that there continued to be a substantial gap between revenue that KAJUR generated and its operational expenses - a clear indication that KAJUR continues to operate at a loss. For the foreseeable future, KAJUR will continue to look to the RMI government for funding support in order to make up for the difference in operational loss. Unfortunately, this dependency on RMI government support will continue until such time the RMI government will allow KAJUR to raise its tariff to a level which will enable the company to recover the true cost of its services to the community.

## KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

### Management's Discussion and Analysis, Continued Years Ended September 30, 2012 and 2011

Like other power companies in the region, the cost of fuel continues to be the primary determining factor relative to KAJUR's power generation affordability and sustainability. While long term planning continues to shape KAJUR's future outlook, management has taken some steps outlined under its strategic plan toward reducing its operational cost. During this period, a key energy efficiency program which focuses on introducing energy efficient appliances to the community was developed. Under this program, air conditioner (highest energy consuming appliance) is being targeted. Energy audit training for KAJUR employees was conducted during this period, followed by an island-wide household survey to determine the number of households that use air conditioners and the types of air conditioners that are currently being used. These data are now being analyzed to determine potential energy savings and how its impact may affect fuel consumption at the power generation plant. With DOI and Board's approval, KAJUR intends to use KDF funds to purchase energy efficient air conditioners and issue them out on credit to customers. Payment for air conditioners will then be collected using the Cash Power system. That is, each time a customer purchases pre-paid electricity, a small portion of that payment will be deducted to pay off air conditioners issued out on credit. A revolving "energy efficient fund" will be created from this set-up and used to purchase more air conditioners until all air conditioners being used in Ebeye are energy efficient. Other appliances may also be targeted based on successful implementation of this program. KAJUR continues to engage the local government and business operators on this initiative.

The chart below shows a clear representation of this gap between KAJUR's revenue and expense over a span of seven years:



## **KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.**

Management's Discussion and Analysis, Continued  
Years Ended September 30, 2012 and 2011

KAJUR recognizes that establishing a cheaper means of transporting fuel from Majuro to Ebeye will further narrow the gap between its revenues and expenses. As long term planning relative to fuel provisioning continues to evolve, KAJUR will remain vigilant in exploring shorter term methods it can employ to reduce costs associated with power generation and distribution.

### **KAJUR'S FOCUS IN THE COMING FISCAL YEAR**

The following are KAJUR's goals for the coming fiscal year 2013:

- 1) Position KAJUR so it can absorb additional strain on its resources with the initiation of the multi-million dollar support project from AusAid/ADB.
- 2) Continue to work with Board and Kwajalein Leadership to identify cheaper means of transporting fuel for the power plant.
- 3) Reconfigure complex fuel pipeline layout and replace or recalibrate fuel metering systems at the power plant.
- 4) Complete minor system upgrades for freshwater and saltwater and implement flat rate fees for service users.
- 5) Continue to strengthen benchmarking efforts to better monitor KAJUR's performance against its Five Year Reform Strategy.
- 6) Develop an Emergency Response Plan for KAJUR.
- 7) Complete acquisition of all assets approved in the FY13 KDF budget allocation.
- 8) Continue to work with the Board and Kwajalein Leadership on a plan to build fuel pipelines from dock to the KAJUR fuel farm and seek possible funding sources once plan is accepted.
- 9) Complete plan for maintenance of power distribution lines from Ebeye to Gugeegue and seek funding support in FY14 budget.

### **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, 2012 and 2011

	<u>ASSETS</u>	<u>2012</u>	<u>2011</u>
Current assets:			
Cash		\$ 320,316	\$ 161,237
Receivables:			
Utility		1,973,570	1,490,352
Affiliate		593,259	587,130
Employees		8,421	8,102
Other		88,068	134,206
		<u>2,663,318</u>	<u>2,219,790</u>
Less allowance for doubtful accounts		<u>(2,355,204)</u>	<u>(1,661,997)</u>
Total receivables, net		<u>308,114</u>	<u>557,793</u>
Prepaid expenses		<u>86,604</u>	<u>12,158</u>
Inventories		<u>717,292</u>	<u>696,162</u>
Total current assets		<u>1,432,326</u>	<u>1,427,350</u>
Capital assets, net		<u>2,681,991</u>	<u>3,526,918</u>
		<u>\$ 4,114,317</u>	<u>\$ 4,954,268</u>
 <u>LIABILITIES AND NET ASSETS</u>			
Current liabilities:			
Note payable, current portion		\$ 71,510	\$ 55,694
Accounts payable		18,938	51,969
Due to affiliates		539,552	665,463
Accrued liabilities		103,776	91,044
Deferred revenue		45,282	52,835
Total current liabilities		<u>779,058</u>	<u>917,005</u>
Note payable, net of current portion		<u>318,708</u>	<u>538,507</u>
Total liabilities		<u>1,097,766</u>	<u>1,455,512</u>
Contingencies			
Net assets:			
Invested in capital assets		2,681,991	3,526,918
Unrestricted		334,560	(28,162)
Total net assets		<u>3,016,551</u>	<u>3,498,756</u>
		<u>\$ 4,114,317</u>	<u>\$ 4,954,268</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, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Operating revenues:		
Electric and service billings	\$ 4,444,876	\$ 4,050,114
Water	361,961	330,417
Other	<u>252,360</u>	<u>236,958</u>
Total operating revenues	5,059,197	4,617,489
Less provision for doubtful accounts	<u>(710,099)</u>	<u>(452,465)</u>
Total net operating revenues	<u>4,349,098</u>	<u>4,165,024</u>
Operating expenses:		
Fuel and lubricants	4,333,873	3,665,920
Salaries, wages and benefits	1,167,815	939,285
Depreciation	834,202	656,289
Supplies and materials	586,640	322,429
Operations and maintenance	287,070	128,274
Water purchases	160,074	-
Travel and transportation	78,677	122,109
Communications	34,756	53,296
Contractual services	30,279	19,120
Rental	24,079	33,268
Miscellaneous	<u>54,592</u>	<u>89,812</u>
Total operating expenses	<u>7,592,057</u>	<u>6,029,802</u>
Operating loss	<u>(3,242,959)</u>	<u>(1,864,778)</u>
Nonoperating revenues (expenses):		
Compact funding	2,025,000	1,100,000
Government of Japan grant	827,455	-
Interest expense	(36,171)	(52,070)
Loss on write-off of fixed assets	<u>(55,530)</u>	<u>(53,209)</u>
Total nonoperating revenues (expenses), net	<u>2,760,754</u>	<u>994,721</u>
Capital contributions - Compact funding	<u>-</u>	<u>500,000</u>
Change in net assets	(482,205)	(370,057)
Net assets at beginning of year	<u>3,498,756</u>	<u>3,868,813</u>
Net assets at end of year	<u>\$ 3,016,551</u>	<u>\$ 3,498,756</u>

See accompanying notes to financial statements.

**KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.**

Statements of Cash Flows  
Years Ended September 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Cash flows from operating activities:		
Cash received from customers	\$ 4,591,543	\$ 3,917,776
Cash payments to suppliers for goods and services	(5,844,558)	(3,864,219)
Cash payments to employees for services	<u>(1,155,402)</u>	<u>(1,002,192)</u>
Net cash used for operating activities	<u>(2,408,417)</u>	<u>(948,635)</u>
Cash flows from noncapital financing activities:		
Promissory note repayment	(203,983)	(187,978)
Interest paid	(36,171)	(52,070)
Operating subsidies received from RepMar	2,025,000	1,100,000
Government of Japan grant	<u>827,455</u>	<u>-</u>
Net cash provided by noncapital financing activities	<u>2,612,301</u>	<u>859,952</u>
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets	<u>(44,805)</u>	<u>(248,833)</u>
Net change in cash	159,079	(337,516)
Cash at beginning of year	<u>161,237</u>	<u>498,753</u>
Cash at end of year	<u>\$ 320,316</u>	<u>\$ 161,237</u>
Reconciliation of operating loss to net cash used for operating activities:		
Operating loss	\$ (3,242,959)	\$ (1,864,778)
Adjustments to reconcile operating loss to net cash used for operating activities:		
Depreciation	834,202	656,289
Provision for doubtful accounts	710,099	452,465
(Increase) decrease in assets:		
Receivables:		
Utility	(500,110)	(539,454)
Affiliate	(6,129)	(138,997)
Employees	(319)	1,926
Other	46,138	(34,029)
Prepaid expenses	(74,446)	261,876
Inventories	(21,130)	(191,121)
Increase (decrease) in liabilities:		
Accounts payable	(33,031)	(58,490)
Due to affiliates	(125,911)	649,489
Deferred revenue	(7,553)	12,767
Other current and accrued liabilities	12,732	(91,745)
Accrued sick leave - long-term	<u>-</u>	<u>(64,833)</u>
Net cash used for operating activities	<u>\$ (2,408,417)</u>	<u>\$ (948,635)</u>

See accompanying notes to financial statements.

**KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.**

Statements of Cash Flows, Continued  
Years Ended September 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Noncash capital and related financing activities:		
Acquisition of capital assets	\$ -	\$ 500,000
Capital contributions received from RepMar	<u>-</u>	<u>(500,000)</u>
	<u>\$ -</u>	<u>\$ -</u>
Capital assets	\$ (367,931)	\$ (106,417)
Accumulated depreciation	312,401	53,208
Loss on write-off of capital assets	<u>55,530</u>	<u>53,209</u>
	<u>\$ -</u>	<u>\$ -</u>

See accompanying notes to financial statements.

## KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Notes to Financial Statements  
September 30, 2012 and 2011

### (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.
- 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.

# KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Notes to Financial Statements  
September 30, 2012 and 2011

## (2) Summary of Significant Accounting Policies, Continued

### 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, 2012 and 2011, the carrying amount of cash was \$320,316 and \$161,237, respectively, and the corresponding bank balances were \$324,038 and \$185,617, respectively. At September 30, 2012 and 2011, \$11,064 and \$0, respectively, were subject to Federal Deposit Insurance Corporation (FDIC) insurance. KAJUR does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk.

### 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.

### 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, 2012 and 2011. Bulk fuel inventories are held for power plant use.

# KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Notes to Financial Statements  
September 30, 2012 and 2011

## (2) Summary of Significant Accounting Policies, Continued

### 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.

### New Accounting Standards

During fiscal year 2012, KAJUR implemented the following pronouncements:

- GASB 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 the frequency and timing of measurements for actuarial valuations first used to report funded status information in OPEB plan financial statements. The implementation of this pronouncement did not have a material effect on the accompanying financial statements.
- GASB 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 implementation of this pronouncement did not have a material effect on the accompanying financial statements.

## KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Notes to Financial Statements  
September 30, 2012 and 2011

### (2) Summary of Significant Accounting Policies, Continued

#### New Accounting Standards, Continued

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.

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 has not yet determined the effect of implementation of this statement on the financial statements of KAJUR.

In April 2012, GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*, which clarifies the appropriate reporting of deferred outflows of resources and deferred inflows of resources to ensure consistency in financial reporting. The provisions of this statement are effective for periods beginning after December 15, 2012. Management has not yet determined the effect of implementation of this statement on the financial statements of KAJUR.

In April 2012, GASB issued Statement No. 66, *Technical Corrections - 2012*, which enhances the usefulness of financial reports by resolving conflicting accounting and financial reporting guidance that could diminish the consistency of financial reporting. The provisions of this statement are effective for periods beginning after December 15, 2012. Management has not yet determined the effect of implementation of this statement on the financial statements of KAJUR.

**KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.**

Notes to Financial Statements  
September 30, 2012 and 2011

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In June 2012, GASB issued Statement No. 67, *Financial Reporting for Pension Plans*, which revises existing guidance for the financial reports of most pension plans, and Statement No. 68, *Accounting and Financial Reporting for Pensions*, which revises and establishes new financial reporting requirements for most governments that provide their employees with pension benefits. The provisions in Statement 67 are effective for financial statements for periods beginning after June 15, 2013. The provisions in Statement 68 are effective for fiscal years beginning after June 15, 2014. Management has not yet determined the effect of implementation of these statements 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, 2012 and 2011, consist of the following:

	<u>2012</u>	<u>2011</u>
Materials and supplies	\$ 425,982	\$ 439,367
Fuel	233,369	221,299
Lubricants	<u>57,941</u>	<u>35,496</u>
	<u>\$ 717,292</u>	<u>\$ 696,162</u>

(5) Capital Assets

Capital assets activity for the years ended September 30, 2012 and 2011 is as follows:

	2012			September <u>30, 2012</u>
	<u>October 1, 2011</u>	<u>Additions and Transfers</u>	<u>Retirements</u>	
Plant and machinery	\$ 5,604,266	\$ 4,000	\$ (88,587)	\$ 5,519,679
Distribution system	2,215,325	-	(261,157)	1,954,168
Water system	1,192,532	-	(5,600)	1,186,932
Other equipment	<u>1,741,419</u>	<u>40,805</u>	<u>(12,587)</u>	<u>1,769,637</u>
	10,753,542	44,805	(367,931)	10,430,416
Less accumulated depreciation	<u>(7,226,624)</u>	<u>(834,202)</u>	<u>312,401</u>	<u>(7,748,425)</u>
	<u>\$ 3,526,918</u>	<u>\$ (789,397)</u>	<u>\$ (55,530)</u>	<u>\$ 2,681,991</u>

**KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.**

Notes to Financial Statements  
September 30, 2012 and 2011

(5) Capital Assets, Continued

	2011			
	October 1, 2010	Additions and Transfers	Retirements	September 30, 2011
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>

At September 30, 2012 and 2011, management of KAJUR determined that certain capital assets in the amount of \$367,931 and \$106,417, respectively, no longer existed. Accordingly, these capital assets were written-off resulting in a loss of \$55,530 and \$53,209, respectively, for the years ended September 30, 2012 and 2011.

(6) MISSA Note Payable

At September 30, 2012 and 2011, 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 \$390,218 and \$594,201, 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, 2012 and 2011, KAJUR incurred interest relating to these delinquent taxes of \$36,171 and \$52,070, respectively.

During the years ended September 30, 2012 and 2011, employer contributions incurred by KAJUR for MISSA taxes amounted to \$97,566 and \$103,919, respectively.

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

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2013	\$ 71,510	\$ 24,490	\$ 96,000
2014	77,366	18,634	96,000
2015	83,228	12,772	96,000
2016	88,769	7,231	96,000
2017	<u>69,345</u>	<u>2,024</u>	<u>71,369</u>
	<u>\$ 390,218</u>	<u>\$ 65,151</u>	<u>\$ 455,369</u>

**KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.**

Notes to Financial Statements  
September 30, 2012 and 2011

(6) MISSA Note Payable, Continued

Long-term debt activity during the years ended September 30, 2012 and 2011 were as follows:

	Balance at October <u>1, 2011</u>	<u>Additions</u>	<u>Reductions</u>	Balance at September <u>30, 2012</u>	Amount due <u>in One Year</u>
MISSA note payable	\$ <u>594,201</u>	\$ <u>-</u>	\$ <u>(203,983)</u>	\$ <u>390,218</u>	\$ <u>71,510</u>
	Balance at October <u>1, 2010</u>	<u>Additions</u>	<u>Reductions</u>	Balance at September <u>30, 2011</u>	Amount due <u>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>

(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, 2012 and 2011 and the related receivable and payable balances as of September 30, 2012 and 2011, are as follows:

	<u>2012</u>		
	<u>Expenses</u>	<u>Receivable</u>	<u>Payable</u>
Marshalls Energy Company, Inc.	\$ 4,379,509	\$ 3,125	\$ 539,552
Marshall Islands National Telecommunications Authority	34,756	29,341	-
RepMar	<u>-</u>	<u>560,793</u>	<u>-</u>
	\$ <u>4,414,265</u>	\$ <u>593,259</u>	\$ <u>539,552</u>
	<u>2011</u>		
	<u>Expenses</u>	<u>Receivable</u>	<u>Payable</u>
Marshalls 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>

During the years ended September 30, 2012 and 2011, KAJUR received appropriations from RepMar in the amounts of \$2,025,000 and \$1,600,000, respectively, which were paid by RepMar directly to vendors for the purchase of fuel and lubricants and generators.

## KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Notes to Financial Statements  
September 30, 2012 and 2011

### (7) Related Party Transactions, Continued

On January 19, 2009, RepMar received certain grant aid from the Government of Japan to secure fuel for power generation by the Marshalls Energy Company, Inc. (MEC). The grant required MEC to repay 50% of the grant to RepMar, which requirement was fulfilled during the year ended September 30, 2012. On July 31, 2012, KAJUR applied for and received approval from the Government of Japan to utilize \$827,455 in grant funds for the purpose of providing stabilization of utility tariffs through the use of grant funds for fuel purchases from MEC.

### (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, 2012. 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.