

UTRŌK ATOLL LOCAL GOVERNMENT

**FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT**

YEAR ENDED SEPTEMBER 30, 2008

UTRÖK ATOLL LOCAL GOVERNMENT

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INDEPENDENT AUDITORS' REPORT

Mayor John Kaiko
Utrök Atoll Local Government
Republic of the Marshall Islands:

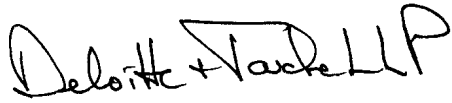
We have audited the accompanying financial statements of the governmental activities and each major fund of the Utrök Atoll Local Government (UALGOV) as of and for the year ended September 30, 2008, which collectively comprise UALGOV's basic financial statements as set forth in Section II of the foregoing table of contents. These financial statements are the responsibility of the management of UALGOV. Our responsibility is to express an opinion on the respective financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 UALGOV'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 audit provides a reasonable basis for our opinions.

In our opinion, such financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and each major fund of the Utrök Atoll Local Government as of September 30, 2008, and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis, on pages 3 through 7, as well as the Schedule of Revenues, Expenditures, and Changes in Fund Balance - Budget and Actual - General Fund and notes thereto, as set forth in Section III of the foregoing table of contents, are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the management of UALGOV. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 18, 2009, on our consideration of the UALGOV's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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

August 18, 2009

UTRÖK ATOLL LOCAL GOVERNMENT

Management's Discussion and Analysis September 30, 2008

This Management's Discussion and Analysis (MD&A) is provided by the Finance Department of the Utrök Atoll Local Government (UALGOV) as an overview to the financial statements for fiscal year 2008 in compliance with Governmental Accounting Standards Board (GASB). This analysis is a required supplementary information (RSI) to the accompanying financial statements and notes to financial statements. It is intended to present the result of activities and changes from October 1, 2007 through September 30, 2008 and future financial plans and outlook for the following year.

UALGOV'S FINANCIAL STATEMENTS

UALGOV's basic financial statements comprise three components 1) Government-wide financial statements, 2) Fund financial statements, and 3) Notes to financial statements. The report also contains additional required supplementary information in the form of budgetary schedules that is prepared on the budgetary basis of accounting in addition to basic financial statements themselves.

UALGOV'S FUNDS AND ITS SOURCES

The following are the three Funds maintained by the local government to account for the activities per category:

- Utrök Claims Trust Fund (CTF). This fund is awarded to Utrök Local Distribution Authority (LDA) through the Nuclear Claims Tribunal for the purpose of compensating the people of Utrök who are listed in LDA. The corpus of this trust is not expendable. The income generated by the trust fund may be used for distribution to the people; however, only 70% of such income is allowed to be disbursed as stated in the Claims Trust Fund.
- Distribution Fund. This fund obtains funding from the income of CTF. This is used for distribution of payments to the quarterly and land compensation LDA recipients.
- General Fund. This fund sources its money from income of CTF. This is used for operations of the local government and local distribution authority.

FINANCIAL HIGHLIGHTS

- UALGOV total net assets decreased by \$3,310,098 or 19% as compared to FY2007 balances.
- Revenues for the current fiscal year reduced by \$3,662,767 or 142% from the previous fiscal year. Investment losses contributed mainly to the decrease in as much as \$1,646,722 for the fiscal year which is a complete turnaround from FY2007 of \$2,057,347 increase in market value of investments. Expenses for the current year increased by \$133,866 or 6% from the previous year's expenses. Fund transfers from CTF to Distribution and General Fund increased by \$75,250 or 4 % as compared to last year.

UTRŌK ATOLL LOCAL GOVERNMENT

Management's Discussion and Analysis
September 30, 2008

GOVERNMENT-WIDE FINANCIAL STATEMENTS

UALGOV's financial statements report information about UALGOV as a whole using accounting methods similar to those used by private sector companies. The statement of net assets includes all of the local government's assets and liabilities. The statement of activities accounts for the current year's revenues and expenses regardless of when cash is received or paid. These two statements reporting UALGOV's net assets and liabilities, is one way to measure UALGOV's financial position. Over time, increases or decreases in UALGOV's net assets are indicators of whether its financial condition is improving or deteriorating.

FUND FINANCIAL STATEMENTS

The fund financial statements provide more detailed information about UALGOV's most significant funds. Funds are accounting devices that UALGOV uses to keep track of specific sources of funding and spending for particular purposes.

- Some funds are required by agreements.
- UALGOV establishes other funds to control and manage money for particular purposes

FINANCIAL ANALYSIS OF UALGOV

In reference to the Summary Statements of Net Assets and Summary Statements of Revenues, Expenses and Net Assets for FY2008 and FY2007 shown below, the following are presented to provide an overview to UALGOV's basic financial statements and to give the readers a better understanding of the financial condition and activities of UALGOV.

Net assets may serve over time as a useful indicator of a government's financial position. At the end of fiscal year 2008, UALGOV's assets exceeded liabilities by \$14,068,306; however, it should be noted that \$13,878,556 is restricted for nuclear claims related distribution payments and is not available to fund UALGOV's operations or capital projects. The summary of UALGOV's net assets for 2008 as compared with 2007 follows:

		<u>Statements of Net Assets</u>	
		<u>2008</u>	<u>2007</u>
Assets	Current assets	\$ 221,339	\$ 211,969
	Noncurrent assets:	136,718	13,025
	Investments	13,903,556	17,156,831
	Capital assets, net	101,289	106,059
	Total Assets	<u>14,226,184</u>	<u>17,474,859</u>
Liabilities	Current Liabilities	157,878	96,455
Net Assets	Invested in capital assets	101,289	106,059
	Restricted	13,878,556	17,156,831
	Unrestricted	88,461	115,514
	Total Net Assets	<u>\$ 14,068,306</u>	<u>\$ 17,378,404</u>

UTRÖK ATOLL LOCAL GOVERNMENT

Management's Discussion and Analysis September 30, 2008

Governmental activities for the year ended September 30, 2008 decreased UALGOV's net assets by \$3,310,098. A key element of the decrease was the global financial meltdown impacting UALGOV's trust fund that commenced in the last quarter of 2007. The summary of UALGOV's changes in net assets for 2008 as compared with 2007 follows:

Statements of Revenues, Expenses and Changes in Net Assets

	<u>2008</u>	<u>2007</u>
Revenues:		
Grants	\$ 148,920	\$ 128,356
Dividends and interest	391,699	392,819
Net change in fair value of investments	(1,646,722)	2,057,347
Others	23,459	1,601
Total revenues	<u>(1,082,644)</u>	<u>2,580,123</u>
Less expenses:		
Distributions and Nuclear claims related	1,387,042	1,359,988
Mayor and council	326,314	308,421
Investment management activities	155,642	141,832
Administration and finance	213,302	166,892
Food program	122,091	101,769
Public safety	23,063	14,686
Total expenses	<u>2,227,454</u>	<u>2,093,588</u>
Change in net assets	(3,310,098)	486,535
Net assets at the beginning of the year	<u>17,378,404</u>	<u>16,891,869</u>
Net assets at the end of the year	<u>\$ 14,068,306</u>	<u>\$ 17,378,404</u>

Fiscal year 2008 had been a challenging year for UALGOV as the global economic crisis unfavorably affected the CTF. Along with other investors that reported losses during the year, UALGOV was not spared as its CTF posted a decrease in fair market value of \$3,253,275 or 19% as compared to FY2007 value. This resulted to a net loss of \$1,646,722 which is a complete reverse from the net income of \$2,057,347 in FY2007. As the main source of funding, the net decrease and net loss in CTF are reflected as well to the decrease in total net assets of \$3,310,098 or 19% from previous year's balances.

Of the cash balances, \$49,346 or 58% of the total cash amount pertains to a savings account with Marshall Islands Development Bank. This account was created in January 2003 for the purpose of securing the bank loans made by the people of Utrök with the bank. For FY2008, it earned an interest of 4% per annum or \$1,842 for FY2008.

The decrease in cash balances of \$114,323 or 57% and the significant increase in receivables of \$123,693 or 949% as compared to last year are due mainly to uncollected USDA Food Program grant and Auditor General Grant amounting to \$83,387 and \$39,000, respectively, as of year-end. For the whole fiscal year, UALGOV has no collection of reimbursement of expenses from the food program. As of to date, \$23,991 or 28% of the balance remains uncollected. As for the Auditor General grant, these were audit fees relating to partial billings for audit of FY2004-2007. All were subsequently collected in FY2009.

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Management's Discussion and Analysis September 30, 2008

Current payables increased by \$61,423 or 39% compared to previous year due to non-payment of some operation expenses before the year ended. However, all were subsequently paid the following year.

Grants recorded this year are as follows:

- The Local Government Fund grant from Ministry of Internal Affairs had been recorded as additional source of fund for the fiscal year amounting to \$14,388. Fifty percent (50%) of this amount was collected during the year and 50% was subsequently collected the following year.
- The proceeds from sale of the NOAA boat amounted to \$59,375 had been recorded as deferred income in FY2007. For FY2008, this fund was used to purchase a new company vehicle in the amount of \$22,350 and to purchase fuel for the said vehicle in the amount of \$4,479. The total amount of \$26,829 was recorded as grant this year.
- Total USDA Food Program grant recorded this year amounted to \$122,091.

The increase in expenses of \$133,866 or 6% as compared to previous year is due to the following:

- As part of the new management's effort to improve service to the people of Utrök, additional employees were hired during the year. A secretary, clerk of council, driver and administration clerk were made part of the administration office to manage the day-to-day activities of the local government. Also, at the beginning of the year, three additional policemen were hired to better secure the people in Utrök Atoll.
- Part of the FY2003 audit fee was expensed this year due to expiration of the grant from Auditor General.
- As mentioned above, a new company vehicle was purchased this year for the day-to-day operations of UALGOV.
- Council meeting expenses increased this year due to the council meeting held in January 2008 to elect the new Mayor for Utrök Atoll.
- Payments for the quarterly and land distribution are basically the same with an exception to advance payments made to some recipients. These were recorded as part of the expense for the year.

Refer to note 4 to the accompanying financial statements for additional information concerning capital assets.

UALGOV did not enter into any debt arrangements during FY 2008 nor was any long-term outstanding at the end of the fiscal year.

FINANCIAL ANALYSIS OF UALGOV'S FUNDS

As noted earlier, UALGOV uses fund accounting to ensure and demonstrate compliance with finance related legal requirements. As of the end of fiscal year 2008, UALGOV's governmental funds reported a combined fund balance of \$13,967,017, a decrease of \$3,305,328 or 19.1% from the \$17,272,345 fund balance at the beginning of fiscal year. The decrease is primarily due to the 2008 global financial crisis that swept the world towards recession.

UTRŌK ATOLL LOCAL GOVERNMENT

Management's Discussion and Analysis
September 30, 2008

GENERAL FUND BUDGET ANALYSIS

For fiscal year 2008, the budget for the General Fund was \$482,610 to be funded by drawdowns from the CTF. The final budget for FY2008 increased by \$39,388 or 8% of the original budget which was sourced from the \$25,000 supplemental budget in FY2009 and \$14,388 RepMar Local Government Fund awarded this year. During the year ended September 30, 2008, the deficiency of revenues under expenditures for the General Fund was \$509,664, which was primarily offset by transfers in from the CTF of \$507,610, resulting in a \$2,504 or 0.4% over spending in FY2008.

FINANCIAL PLAN AND OUTLOOK

With the global economic crisis still looming over the US stock market, the future does not promise a better year for the CTF. In an effort to buy time for CTF, the Utrōk Council approved to get a bank loan from UBS Bank that would fund future expenditures of the local government for the next two years. Please refer to Note 8 for the details of this bank loan. This loan is set to help CTF grow back in two years without any drawdown for distributions.

In order to lessen the impact of the financial crisis, the CTF's investments in bonds were increased to 32% as of August 14, 2009 from only 24% in FY2008.

In September 2008, US DOI awarded UALGOV the Fiscal Management Improvement Project Grant that will provide an amount of \$77,000 per year in two years (FY2009-FY2010) to the operations fund budget. This amount is allotted to subsidize the salaries of employees in the finance department, purchase of computers and equipment, and pay for office rent. Please note that the last grant of this kind received by UALGOV was in FY2007.

The management is gearing up for various projects lined up for FY2009. These projects are expected to contribute to a better living condition for people of Utrōk. The financial impact of this is the flow of additional grants that would support each project. One of it is the grant awarded by Embassy of Japan in March 2009 to UALGOV amounting to \$85,995 to support the construction of a community center in Utrōk Atoll. The management has submitted grant proposals to various entities and constantly followed up the progress of each.

FY2009 budget is slightly higher than FY2008 Final budget by \$42,192 or 8%. The main reasons are the budget to purchase motor vehicles that would come out of the remaining proceeds from sale of NOAA boat and the additional budget for salaries of hired employees in FY2008.

CONTACTING UALGOV's MANAGEMENT

This financial report is designed to provide our constituents, donors and customers with a general overview of UALGOV's finances and to demonstrate transparency and accountability for the money it is entrusted to manage. If you have any questions about this report or need additional information, contact the Mayor at P.O. Box 1499, Majuro, Marshall Islands, MH 96960, telephone number (692) 625-3749.

UTRŌK ATOLL LOCAL GOVERNMENT

Statement of Net Assets September 30, 2008

ASSETS

Current assets:

Cash and cash equivalents	\$ 84,621
Receivables	<u>136,718</u>
Total current assets	<u>221,339</u>

Noncurrent assets:

Restricted assets:

Investments	13,903,556
Capital assets, net of accumulated depreciation	<u>101,289</u>

Total noncurrent assets 14,004,845

Total assets \$ 14,226,184

LIABILITIES

Current liabilities:

Accounts payable	\$ 109,305
Distribution payable	1,883
Other liabilities and accruals	<u>46,690</u>

Total liabilities 157,878

Contingencies

NET ASSETS

Invested in capital assets	101,289
Restricted for:	
Nonexpendable	13,878,556
Unrestricted	<u>88,461</u>
Total net assets	<u>14,068,306</u>
Total liabilities and net assets	<u>\$ 14,226,184</u>

See accompanying notes to basic financial statements.

UTRÖK ATOLL LOCAL GOVERNMENT

Statement of Activities
Year Ended September 30, 2008

		Program Revenues		Net (Expenses)
		Operating Grants and Contributions	Capital Grants and Contributions	Revenues and Changes in Net Assets
<u>Functions/Programs</u>				
Governmental activities:				
Mayor and council	\$ 326,314	\$ 26,829	\$ -	\$ (299,485)
Administration and finance	213,302	-	-	(213,302)
Public safety	23,063	-	-	(23,063)
Food Program	122,091	122,091	-	-
Nuclear claims related	1,387,042	(1,255,023)	-	(2,642,065)
Investment management activities	155,642	-	-	(155,642)
	<u>\$ 2,227,454</u>	<u>\$ (1,106,103)</u>	<u>\$ -</u>	<u>(3,333,557)</u>
General revenues:				
Other				23,459
Total general revenues				23,459
Change in net assets				(3,310,098)
Net assets at beginning of the year				17,378,404
Net assets at end of the year				\$ 14,068,306

See accompanying notes to basic financial statements.

UTRŌK ATOLL LOCAL GOVERNMENT

Balance Sheet Governmental Funds September 30, 2008

<u>ASSETS</u>	<u>General</u>	<u>Special Revenue Local Distribution Authority</u>	<u>Permanent Claims Trust</u>	<u>Total</u>
Cash and cash equivalents	\$ 56,545	\$ 28,076	\$ -	\$ 84,621
Receivables	132,718	4,000	-	136,718
Due from other funds	169,181	-	-	169,181
Restricted assets:				
Investments	-	-	13,903,556	13,903,556
	<u>\$ 358,444</u>	<u>\$ 32,076</u>	<u>\$ 13,903,556</u>	<u>\$ 14,294,076</u>
 <u>LIABILITIES AND FUND BALANCES</u>				
Liabilities:				
Accounts payable	\$ 109,305	\$ -	\$ -	\$ 109,305
Distribution payable	-	1,883	-	1,883
Other liabilities and accruals	46,690	-	-	46,690
Due to other funds	-	144,181	25,000	169,181
Total liabilities	<u>155,995</u>	<u>146,064</u>	<u>25,000</u>	<u>327,059</u>
Fund balances (deficit):				
Reserved for:				
Claims	-	-	13,878,556	13,878,556
Unreserved (deficit)	<u>202,449</u>	<u>(113,988)</u>	<u>-</u>	<u>88,461</u>
Total fund balances (deficit)	<u>202,449</u>	<u>(113,988)</u>	<u>13,878,556</u>	<u>13,967,017</u>
Total liabilities and fund balances	<u>\$ 358,444</u>	<u>\$ 32,076</u>	<u>\$ 13,903,556</u>	

Amounts reported for governmental activities in the statement of net assets are different because:

Capital assets used in governmental activities are financial resources and, therefore, are not reported in the funds	<u>101,289</u>
Net assets of governmental activities	<u>\$ 14,068,306</u>

See accompanying notes to basic financial statements.

UTRŌK ATOLL LOCAL GOVERNMENT

Statement of Revenues, Expenditures and Changes in Fund Balances (Deficit)
Governmental Funds
Year Ended September 30, 2008

	General	Special Revenue Local Distribution Authority	Permanent Claims Trust	Total
Revenues:				
Federal grants	\$ 148,920	\$ -	\$ -	\$ 148,920
RepMar local government fund	14,388	-	-	14,388
Net change in the fair value of investments	-	-	(1,646,722)	(1,646,722)
Dividends and interest	-	-	391,699	391,699
Other	<u>7,028</u>	<u>2,043</u>	<u>-</u>	<u>9,071</u>
Total revenues	<u>170,336</u>	<u>2,043</u>	<u>(1,255,023)</u>	<u>(1,082,644)</u>
Expenditures:				
Current:				
Mayor and council	299,194	-	-	299,194
Administration and finance	213,302	-	-	213,302
Public safety	23,063	-	-	23,063
Food program	122,091	-	-	122,091
Nuclear claims related	-	1,247,042	140,000	1,387,042
Investment management	-	-	155,642	155,642
Capital outlay	<u>22,350</u>	<u>-</u>	<u>-</u>	<u>22,350</u>
Total expenditures	<u>680,000</u>	<u>1,247,042</u>	<u>295,642</u>	<u>2,222,684</u>
Deficiency of revenues under expenditures	<u>(509,664)</u>	<u>(1,244,999)</u>	<u>(1,550,665)</u>	<u>(3,305,328)</u>
Other financing sources (uses):				
Operating transfers in	507,610	1,220,000	-	1,727,610
Operating transfers out	<u>-</u>	<u>-</u>	<u>(1,727,610)</u>	<u>(1,727,610)</u>
Total other financing sources (uses), net	<u>507,610</u>	<u>1,220,000</u>	<u>(1,727,610)</u>	<u>-</u>
Net change in fund balances (deficit)	<u>(2,054)</u>	<u>(24,999)</u>	<u>(3,278,275)</u>	<u>(3,305,328)</u>
Fund balances (deficit) at beginning of year	<u>204,503</u>	<u>(88,989)</u>	<u>17,156,831</u>	<u>17,272,345</u>
Fund balances (deficit) at end of year	<u>\$ 202,449</u>	<u>\$ (113,988)</u>	<u>\$ 13,878,556</u>	<u>\$ 13,967,017</u>

See accompanying notes to basic financial statements.

UTRŌK ATOLL LOCAL GOVERNMENT

Reconciliation of the Statement of Revenues, Expenditures,
and Changes in Fund Balances (Deficit) of Governmental Funds
to the Statement of Activities
Year Ended September 30, 2008

Net change in fund balances (deficit) - total governmental funds from page 11 \$ (3,305,328)

Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which depreciation expense exceeded capital outlays in the current period.

(4,770)

Change in net assets of governmental activities as presented on page 9

\$ (3,310,098)

See accompanying notes to basic financial statements.

UTRŌK ATOLL LOCAL GOVERNMENT

Notes to Financial Statements
September 30, 2008

(1) Organization

The Utrŏk Atoll Local Government (UALGOV) was established pursuant to Public Law 1981-2, the Local Government Act of the Republic of the Marshall Islands and operates under the Constitution of the Utrŏk Atoll Local Government. UALGOV is governed by an elected mayor and a twenty nine-member council.

(2) Summary of Significant Accounting Policies

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

A. Government-Wide Financial Statements

The Statement of Net Assets and the Statement of Activities report financial information on all of the non-fiduciary activities of UALGOV. For the most part, the effect of interfund activity has been eliminated from these statements. UALGOV's activities are defined as governmental activities, which are supported by intergovernmental revenues and other non-exchange revenues.

The Statement of Net Assets presents all of UALGOV's non-fiduciary assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories:

- Invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation and reduced by outstanding balances for bonds, notes and other debt that are attributed to the acquisition, construction or improvement of those assets.
- Restricted net assets – nonexpendable consists of permanent funds in which donors or other outside sources have stipulated that the principal is to be maintained inviolate and in perpetuity, and invested for the purpose of producing present and future income, which may either be expended or added to the principal.
- Restricted net assets – expendable consists of resources in which UALGOV is legally or contractually obligated to spend resources in accordance with restrictions either externally imposed by creditors, grantors, contributors, and the like, or imposed by law.
- Unrestricted net assets consist of net assets, which do not meet the definition of the two preceding categories. Unrestricted net assets often are designated, (for example, internally restricted), to indicate that management does not consider them to be available for general operations.

The Statement of Activities demonstrates the degree to which the direct expenses of given functions or segments are offset by program revenues. Direct expenses are those that are clearly identifiable within a specific function or segment. Program revenues include charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges that are restricted to meeting the operational or capital requirements of a particular function. Taxes and other items not meeting the definition of program revenues are, instead, reported as general revenue.

UTRŌK ATOLL LOCAL GOVERNMENT

Notes to Financial Statements
September 30, 2008

(2) Summary of Significant Accounting Policies, Continued

B. Fund Financial Statements

The fund financial statements present a balance sheet and a statement of revenues, expenditures, and changes in fund balances for UALGOV's major funds. Major individual governmental funds are reported as separate columns in the fund financial statements pursuant to GASB reporting standards.

UALGOV reports its financial position and results of operations in funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues and expenditures/expenses. Transactions between funds within a fund type, if any, have not been eliminated.

C. Measurement Focus and Basis of Accounting

The government-wide financial statements are reported using the economic resources management focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements account for the general governmental activities of UALGOV and are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as they become susceptible to accrual; generally when they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, UALGOV considers revenues to be available if they are collected within 90 days of the end of the current fiscal period.

Significant revenues susceptible to accrual include federal grants. Miscellaneous revenues from other financing sources are recognized when received in cash because they are generally not measurable until actually received. Investment earnings are recorded as earned, since they are both measurable and available. Investments and related investment earnings are recorded at fair value. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Expenditures generally are recorded in the period in which the related fund liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

Amounts reported as program revenue include 1) charges to customers or applicants for goods, services, or privileges provided, 2) operating grants and contributions, and 3) capital grants and contributions. Internally dedicated resources are reported as general revenues rather than as program revenues. General revenue is derived from taxation, investment income and other fees that are not allocated to specific programs.

UTRŌK ATOLL LOCAL GOVERNMENT

Notes to Financial Statements
September 30, 2008

(2) Summary of Significant Accounting Policies, Continued

C. Measurement Focus and Basis of Accounting, Continued

UALGOV reports the following governmental fund types:

i. General Fund

This fund is the primary operating fund of UALGOV. It is used to account for all governmental transactions, except those required to be accounted for in another fund.

ii. Special Revenue Fund

This fund accounts for specific revenue resources that have been aggregated according to enabling legislation to support specific governmental activities.

The special revenue fund of UALGOV (the Local Authority Distribution Fund) accounts for funds received under the Utrōk Claims Trust Fund. These funds are distributed by UALGOV to the people of Utrōk based on an approved distribution scheme.

iii. Permanent Fund

This fund accounts for resources that are legally restricted to the extent that only earnings, and not principal, may be used to support programs for the benefit of the government.

UALGOV's permanent fund (the Claims Trust Fund) accounts for funds received under Article II, Section 4, of the agreement between the Government of the United States and the Government of the Republic of the Marshall Islands for the implementation of Section 177 of the Compact of Free Association (the Compact). In accordance with Article II, Section 8, of the Compact, UALGOV executed the Utrōk Claims Trust Agreement and established the Claims Trust Fund. Pursuant to Section 4.2 of the trust agreement, after the final payment was received on October, 2001, the Claim Trust Fund was required to distribute annually to the people of Utrōk between 15% and 70% of its net income. In addition, pursuant to Section 5.1 of the trust agreement, UALGOV may also invade up to 3% of the corpus of the Claims Trust Fund. Such invasion may occur in the event of an unforeseen natural disaster or other similar circumstance, as determined by the sole discretion of UALGOV Council, in order to prevent hardship to the people of Utrōk. An invasion of the corpus shall not occur more frequently than once every three years.

GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - For State and Local Governments*, as amended by GASB Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - For State and Local Governments: Omnibus*, sets forth minimum criteria (percentage of the assets, liabilities, revenues or expenditures/expenses for either fund category or the governmental and enterprise funds combined) for the determination of major funds. Major individual governmental funds are reported as separate columns in the fund financial statements.

UTRŌK ATOLL LOCAL GOVERNMENT

Notes to Financial Statements
September 30, 2008

(2) Summary of Significant Accounting Policies, Continued

D. Cash and Cash Equivalents

Cash and cash equivalents include cash held in demand accounts.

E. Investments

Investments and related investment earnings are recorded at fair value. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

F. Receivables

Receivables consist of amounts advanced to individuals, on an unsecured basis, substantially all of whom are situated in the Republic of the Marshall Islands. Receivables are stated net of estimated allowances for uncollectable accounts, which is determined based upon past collection experience and aging of the accounts. Reimbursements due to UALGOV for expenditures on federally funded reimbursement and grant programs are included as receivables on the governmental fund balance sheet.

Receivables as of September 30, 2008, for the primary government's individual major governmental funds, including applicable allowance for uncollectible accounts, are as follows:

	<u>General</u>	<u>Local Distribution Authority</u>	<u>Total</u>
Receivables:			
Federal agencies	\$ 83,386	\$ -	\$ 83,386
Receivable from RepMar	46,111	-	46,111
Other	<u>3,221</u>	<u>4,000</u>	<u>7,221</u>
	\$ <u>132,718</u>	\$ <u>4,000</u>	\$ <u>136,718</u>

G. Interfund Receivables/Payables

During the course of its operations, UALGOV records transactions between individual funds for goods provided or services rendered. Receivables and payables resulting from transactions between funds are classified as "due from other funds" or "due to other funds" on the governmental funds balance sheet.

Interfund receivables and payables have been eliminated from the statement of net assets.

H. Restricted Assets

Certain assets of UALGOV are classified as restricted assets because their use is completely restricted by trust agreements or enabling legislation. Specifically, investments of \$13,903,556 recorded in the Claims Trust Fund are restricted in that they are not available to be used in current operations.

UTRŌK ATOLL LOCAL GOVERNMENT

Notes to Financial Statements
September 30, 2008

(2) Summary of Significant Accounting Policies, Continued

I. Capital Assets

Capital assets, which include property, plant and equipment and infrastructure assets (e.g. roads, docks, airports, water catchments, and other similar items), whether purchased or constructed, are recorded at historical cost. UALGOV capitalizes all capital assets that exceed \$5,000 and have a useful life greater than one year. Depreciation is provided over the estimated useful lives of the assets through use of the straight-line method. The estimated useful lives of these assets are as follows:

Airport terminal	25 years
Motor vehicles	3 years

J. Interfund/Intrafund Transactions

As a general rule, the effect of interfund activity has been eliminated in the government-wide statements. Exceptions to this rule are: 1) activities between funds reported as governmental activities and funds reported as business-type activities and 2) activities between funds that are reported in different functional categories in either the governmental or business-type activities column. Elimination of these activities would distort the direct costs and program revenues for the functions concerned.

K. Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the general purpose financial statements and the reported amounts of revenues and expenditures/expenses during the reporting period. Actual results could differ from those estimates.

L. Compensated Absences

UALGOV recognizes expenditures for annual leave and sick leave when leave is actually taken. Accordingly, unused annual leave and sick leave are not included as an obligation within the governmental funds balance sheet. The estimated accumulated amounts of unused sick leave at September 30, 2008 is presently not determinable.

M. Total Columns

Total columns are presented primarily to facilitate financial analysis. The Management's Discussion and Analysis includes certain prior year summarized comparative information in total. Such information does not include sufficient detail to constitute a full comparative presentation. Accordingly, such information should be read in conjunction with UALGOV's financial statements for the year ended September 30, 2007 from which summarized information was derived.

UTRŌK ATOLL LOCAL GOVERNMENT

Notes to Financial Statements
September 30, 2008

(2) Summary of Significant Accounting Policies, Continued

N. New Accounting Standards

During fiscal year 2008, UALGOV implemented GASB Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfer of Assets and Future Revenues*, and GASB Statement No. 50, *Pension Disclosures an amendment of GASB Statements No. 25 and 27*. GASB Statement No. 48 establishes criteria that governments will use to ascertain whether certain transactions should be regarded as a sale or a collateralized borrowing, and includes a provision that stipulates that governments should not revalue assets that are transferred between financial reporting entity components. GASB Statement No. 50 more closely aligns the financial reporting requirements for pensions with those for other post-employment benefits.

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

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

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

In December 2006, GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. GASB Statement No. 49 provides guidance and consistency under which a governmental entity would be required to report a liability related to pollution remediation. The provisions of this statement are effective for periods beginning after December 15, 2007. Management does not believe that the implementation of this statement will have a material effect on the financial statements of UALGOV.

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

UTRŌK ATOLL LOCAL GOVERNMENT

Notes to Financial Statements
September 30, 2008

(2) Summary of Significant Accounting Policies, Continued

N. New Accounting Standards, Continued

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

In June 2008, GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. GASB Statement No. 53 is intended to improve how state and local governments report information about derivative instruments - financial arrangements used by governments to manage specific risks or make investments - in their financial statements. The provisions of this statement are effective for periods beginning after June 15, 2009. Management does not believe that the implementation of this statement will have a material effect on the financial statements of UALGOV.

(3) Deposits and Investments

GASB Statement No. 40 addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk and foreign currency risk. As an element of interest rate risk, disclosure is required of investments that have fair values that are highly sensitive to changes in interest rates. GASB Statement No. 40 also requires disclosure of formal policies related to deposit and investment risks.

UALGOV does not have formal deposit and investment policies. Investments in the Claims Trust Fund are governed by a trust agreement.

A. Deposits

GASB Statement No. 3 previously required government entities to present deposit risks in terms of whether the deposits fell into the following categories:

- Category 1 Deposits that are federally insured or collateralized with securities held by UALGOV or its agent in UALGOV's name;
- Category 2 Deposits that are uninsured but fully collateralized with securities held by the pledging financial institution's trust department or agent in UALGOV's name; or
- Category 3 Deposits that are collateralized with securities held by the pledging financial institution's trust department or agent but not in UALGOV's name and non-collateralized deposits.

UTRŌK ATOLL LOCAL GOVERNMENT

Notes to Financial Statements
September 30, 2008

(3) Deposits and Investments, Continued

A. Deposits, Continued

GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for deposits falling into categories 1 and 2 but retained disclosures for deposits falling under category 3. Category 3 deposits are those deposits that have exposure to custodial credit risk. Custodial credit risk is the risk that in the event of a bank failure, UALGOV'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. UALGOV does not have a deposit policy for custodial credit risk.

As of September 30, 2008, the carrying amount of the UALGOV's total cash and cash equivalents was \$84,621 and the corresponding bank balance was \$88,463. Of the bank balance amount, \$39,827 is maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2008, bank deposits in the amount of \$39,827 were FDIC insured. UALGOV 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.

B. Investments

GASB Statement No. 3 previously required government entities to present investment risks in terms of whether the investments fell into the following categories:

- Category 1 Investments that are insured or registered, or securities held by UALGOV or its agent in UALGOV's name;
- Category 2 Investments that are uninsured and unregistered for which the securities are held by the counterparty's trust department or agent in UALGOV's name; or
- Category 3 Investments that are uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent but not in UALGOV's name.

GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for investments falling into categories 1 and 2, and provided for disclosure requirements addressing other common risks of investments such as credit risk, interest rate risk, concentration of credit risk, and foreign currency risk. GASB Statement No. 40 did retain and expand the element of custodial credit risk in GASB Statement No. 3.

Permanent Fund:

As of September 30, 2008, investments at fair value are as follows:

Claims Trust Fund:

Cash management	\$ 1,220,843
Future managed assets	1,484,675
Domestic equities	7,805,501
U.S. Government notes and bonds	2,230,088
Corporate notes and bonds	975,677
International developed bonds and debentures	<u>186,772</u>
	<u>\$ 13,903,556</u>

UTRŌK ATOLL LOCAL GOVERNMENT

Notes to Financial Statements
September 30, 2008

(3) Deposits and Investments, Continued

B. Investments, Continued

Custodial credit risk for investments is the risk that in the event of the failure of the counterparty to the transaction, UALGOV will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. UALGOV's investments are held and administered by trustees in accordance with various trustee agreements. Based on negotiated trust and custody contracts, all of these investments were held in UALGOV's name by UALGOV's custodial financial institutions at September 30, 2008.

Credit risk for investments is the risk that an issuer or other counterparty to an investment will not fulfill its obligations.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of debt instruments. UALGOV does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Concentration of credit risk for investments is the risk of loss attributed to the magnitude of an entity's investment in a single issuer. GASB Statement No. 40 requires disclosure by issuer and amount of investments in any one issuer that represents five percent (5%) or more of total investments for UALGOV. As of September 30, 2008, there were no investments in any one issuer that exceeded 5% of total investments.

As of September 30, 2008 investments in debt securities were as follows:

	Moody's Rating	<u>Investment Maturities (In years)</u>				Total
		<u>Less than 1</u>	<u>1 to 5</u>	<u>6 to 10</u>	<u>Greater than 10</u>	
U.S. Treasury Obligations	AAA	\$ -	\$ 1,446,913	\$ -	\$ -	\$ 1,446,913
U.S. Government agencies	AAA	-	186,677	224,366	372,132	783,175
Corporate bonds	AAA	-	-	165,234	-	165,234
Corporate bonds	A1	-	52,884	183,189	-	236,073
Corporate bonds	AA2	-	214,482	-	-	214,482
Corporate bonds	A2	-	151,153	-	-	151,153
Corporate bonds	AA3	-	66,186	-	-	66,186
Corporate bonds	BAA1	-	87,241	-	-	87,241
Corporate bonds	BAA3	-	55,308	-	-	55,308
International bonds and debentures	AAA	-	113,090	-	-	113,090
International bonds and debentures	BAA1	-	73,682	-	-	73,682
		<u>\$ -</u>	<u>\$ 2,447,616</u>	<u>\$ 572,789</u>	<u>\$ 372,132</u>	<u>\$ 3,392,537</u>

UTRÖK ATOLL LOCAL GOVERNMENT

Notes to Financial Statements September 30, 2008

(4) Capital Assets

Capital asset activities for the year ended September 30, 2008, is as follows:

	Balance October <u>1, 2007</u>	<u>Additions</u>	<u>Retirements</u>	Balance September 30, 2008
Airport terminal	\$ 90,310	\$ -	\$ -	\$ 90,310
Motor vehicles	<u>58,595</u>	<u>22,350</u>	<u>(41,450)</u>	<u>39,495</u>
	148,905	22,350	(41,450)	129,805
Less accumulated depreciation	<u>(42,846)</u>	<u>(13,756)</u>	<u>28,086</u>	<u>(28,516)</u>
	\$ <u>106,059</u>	\$ <u>8,594</u>	\$ <u>(13,364)</u>	\$ <u>101,289</u>

Depreciation expense of \$13,756 was charged to the office of the Mayor and Council. Furthermore, UALGOV disposed of various motor vehicles, which resulted in a loss on disposal of \$13,364 and which was also charged to the office of the Mayor and Council.

(5) Transfers In/Out

Operating transfers in/out for all fund types, for the year ended September 30, 2008, are as follows:

<u>Source</u>	<u>Recipient</u>	<u>Transfer Out</u>	<u>Transfer In</u>
Claims Trust Fund	General Fund	\$ 507,610	\$ 507,160
Claims Trust Fund	Local Distribution Authority Fund	<u>1,220,000</u>	<u>1,220,000</u>
		<u>\$ 1,727,610</u>	<u>\$ 1,727,610</u>

(6) Contingencies

Settlement Agreement

On May 9, 1997, UALGOV entered into a Settlement Agreement with the Bank of New York, the former trustee for the Utrök Claims Trust Fund. During fiscal year 1996, the Bank transferred \$390,000 of funds to the Utrök Local Distribution Authority (LDA) Fund, which should have been transferred to the Utrök Claims Trust Fund. These funds were subsequently loaned out or were otherwise disbursed by the LDA. Under the terms of the Settlement Agreement, the Bank agreed to reimburse the Utrök Claims Trust Fund the money erroneously transferred and UALGOV agreed to repay \$180,000 to the Bank plus any additional amounts that are subsequently identified and collected. As of September 30, 2008, UALGOV repaid \$180,000 under this agreement. Repayment of the remaining \$210,000 is contingent upon future collection of amounts previously loaned or disbursed by the LDA. UALGOV elected to not record the receivable for the loans amount and the related liability in the accompanying financial statements.

Section 177 Compact Funding

UALGOV received its final compensatory payment under the terms of the Compact on October 22, 2001. Management believes that investment income is sufficient to cover future cost of operations and distributions of the General Fund and the Local Distribution Authority Fund, respectively. However, in the event of a decline in future investment income, UALGOV will need to obtain revenue from other sources to be able to support its cost of operations and distributions.

UTRÖK ATOLL LOCAL GOVERNMENT

Notes to Financial Statements
September 30, 2008

(7) Risk Management

UALGOV 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. UALGOV has elected to purchase commercial automobile insurance from independent third parties for the risks of loss to which it is exposed to with respect to the use of motor vehicles. Settled claims have not exceeded this commercial coverage in any of the past three years. For other risks of loss to which it is exposed, UALGOV has elected not to purchase commercial insurance. Instead, UALGOV management believes it is more economical to manage its risks internally. In the event of claim settlements and judgments, UALGOV reports all of its risk management activities in its General Fund.

Claims expenditures and liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. These losses include an estimate of claims that have been incurred but not reported. No material losses have resulted from UALGOV's risk management activities during the years ended September 30, 2008, 2007 and 2006.

(8) Subsequent Events

On December 8, 2008, UALGOV obtained a \$2,440,000, 2-year maturity, fixed rate loan with a commercial bank. The loan proceeds will be used in lieu of liquidation of securities for the purpose of meeting the obligations of the Utrök Local Distribution Authority. The loan is fully collateralized with the securities held by the bank in UALGOV's name.

UTRŌK ATOLL LOCAL GOVERNMENT
REQUIRED SUPPLEMENTARY INFORMATION
- BUDGETARY REPORTING
YEAR ENDED SEPTEMBER 30, 2008

UTRŌK ATOLL LOCAL GOVERNMENT

Schedule of Revenues, Expenditures and Changes in Fund Balance (Deficit) - Budget and Actual - General Fund Year Ended September 30, 2008

	Budgeted Amounts		Actual	Variance with
	Original	Final		Final Budget - Positive (Negative)
Revenues:				
RepMar local government fund	\$ -	\$ 14,388	\$ 14,388	\$ -
Federal and other grants	-	-	148,920	148,920
Other	-	-	7,028	7,028
Total revenues	<u>-</u>	<u>14,388</u>	<u>170,336</u>	<u>155,948</u>
Expenditures:				
Salaries, wages and benefits	136,000	162,060	162,060	-
Honorarium and sitting fees	105,000	131,250	141,902	(10,652)
Travel and stipends	92,500	74,700	59,017	15,683
Food program	-	-	122,091	(122,091)
Professional services	66,000	66,000	73,216	(7,216)
Contractual services	7,000	8,454	8,432	22
Contributions	5,000	6,250	10,222	(3,972)
Representation	2,000	1,959	1,875	84
Rental	21,000	20,250	19,068	1,182
Communications	9,000	11,000	10,386	614
Office equipment and supplies	15,000	16,600	13,333	3,267
Motor vehicle	-	-	22,350	(22,350)
Miscellaneous	24,110	23,475	36,048	(12,573)
Total expenditures	<u>482,610</u>	<u>521,998</u>	<u>680,000</u>	<u>(158,002)</u>
Deficiency of revenues under expenditures	<u>(482,610)</u>	<u>(507,610)</u>	<u>(509,664)</u>	<u>(2,054)</u>
Other financing sources:				
Operating transfers in	<u>482,610</u>	<u>507,610</u>	<u>507,610</u>	<u>-</u>
Excess of revenues and other financing sources over expenditures	-	-	(2,054)	(2,054)
Unreserved fund balance at the beginning of year	<u>204,503</u>	<u>204,503</u>	<u>204,503</u>	<u>-</u>
Unreserved fund balance at the end of year	<u>\$ 204,503</u>	<u>\$ 204,503</u>	<u>\$ 202,449</u>	<u>\$ (2,054)</u>

See Accompanying Independent Auditors' Report.

UTRŌK ATOLL LOCAL GOVERNMENT

Notes to Required Supplementary Information - Budgetary Reporting
September 30, 2008

Budgetary Information

The UALGOV constitution provides for the Executive Committee to introduce into the Council the proposed budget for the Fiscal Year effective October 1. The budget includes estimates of the proposed expenditures for all the funds and the sources of funds. The Executive members of the UALGOV Council review and recommend changes to the proposed budget during the budget deliberation prior to presentation to the Council. UALGOV council meeting holds public hearing/s during which the council presents to the constituents the proposed budget for the coming fiscal year. After all of the feedbacks are heard, the council en banc amends if necessary, and then approves the budget through an ordinance duly enacted by the Local Government Council.

Formal budget integration is employed as a management control device during the year for all funds. The Executive Council has the authority to reprogram budgeted estimates in accordance with the UALGOV Constitution. All annual appropriations lapse at fiscal year end unless otherwise specified in the Ordinance. Supplemental appropriations may occur throughout the year. Unexpended encumbrances at each fiscal year end are carried forward until they are expended or canceled without further ordinance for the matter.

Accounting principles used in developing data on a budgetary basis differ from those used in preparing the financial statements in conformity with GAAP. Amounts included on the Statement of Revenues, Expenditures, and Changes in Fund Balance - Budget and Actual - General Fund (which are presented on a non-GAAP budgetary basis) are reconciled to unreserved deficit of the Governmental Fund Balance Sheet within the other changes in unreserved deficit section of that statement.

Encumbrance accounting has not been utilized by the General Fund.