

KWAJALEIN ATOLL LOCAL GOVERNMENT

BASIC FINANCIAL STATEMENTS,
ADDITIONAL INFORMATION
AND
INDEPENDENT AUDITORS' REPORT

YEAR ENDED SEPTEMBER 30, 2007

INDEPENDENT AUDITORS' REPORT

The Honorable Interim Mayor Card Subillie
Kwajalein Atoll Local Government:

We were engaged to audit the accompanying financial statements of the governmental activities and the general fund of the Kwajalein Atoll Local Government (KALGOV) as of and for the year ended September 30, 2007, which collectively comprise the basic financial statements of KALGOV's primary government. These financial statements are the responsibility of the management of KALGOV.

Because of inadequacies in the accounting records, detailed records regarding receivables and liabilities of the governmental activities and the general fund, and underlying supporting documentation evidencing the validity of revenues and expenditures/expenses, have not been maintained and certain supporting data were not made available for our engagement. Therefore, we were not able to satisfy ourselves about the amount at which receivables, liabilities, revenues and expenditures/expenses are recorded for the governmental activities and the general fund as of and for the year ended September 30, 2007.

While detailed property records exist for items obtained during the year ended September 30, 2007, prior-year records and supporting data were not made available for our engagement concerning the underlying costs for capital assets recorded by the governmental activities or the bases supporting such costs. Therefore, we are not able to satisfy ourselves about the amounts at which capital assets and related accumulated depreciation are recorded for the governmental activities in the accompanying statement of net assets at September 30, 2007, and the amount of depreciation expense for the year then ended.

Because of the significance of the matters discussed in the second and third paragraphs above, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the respective financial statements of the governmental activities and the general fund.

As discussed in note 11 to the financial statements, the beginning net assets of the governmental activities have been restated for the correction of an error.

The Management's Discussion and Analysis, on pages 3 through 5, as well as the Schedule of Revenues, Expenditures, and Changes in Deficit - Budget and Actual - General Fund and notes thereto, on pages 18 and 19, are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board (GASB). This information is the responsibility of the management of KALGOV. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit such information and we do not express an opinion on it. As a result of these limited procedures, we believe that the Management's Discussion and Analysis is not in conformity with guidelines established by GASB because it does not discuss significant events, current year results in comparison with prior year, an analysis of the overall financial position and results of operations or a budgetary discussion.

The Other Supplementary Information, on pages 20 through 24, which is also the responsibility of the management of KALGOV, is presented for the purpose of additional analysis and is not a required part of the basic financial statements of KALGOV. Because of the significance of the matters discussed in the second paragraph above, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the supplementary information in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated July 6, 2015, on our consideration of KALGOV's internal control over financial reporting and 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 engagement to audit.

Deloitte & Touche LLC

July 6, 2015



Kwajalein Atoll Local Government
OFFICE OF THE MAYOR

P.O. Box 5220
Ebeye, Marshall Islands MH 96970
Tel (692) 329-8008 • Cel (692) 235-1207 • Fax (692) 329-3711
Email: kwajgov@yahoo.com

MANAGEMENT'S DISCUSSION AND ANALYSIS
Year Ended September 30, 2007

This section presents the Management's Discussion and Analysis (MD&A) of the Kwajalein Atoll Local Government's (KALGOV) financial status and performance encompassing the fiscal year ended September 30, 2007. Please read it in conjunction with KALGOV's financial statements, which follows this section. Fiscal year 2006 comparative information has been included where appropriate for comparative purposes. The accounting firm of Deloitte & Touche was engaged to audit KALGOV's financial statements in accordance with *Government Auditing Standards*.

Introductory Section

KALGOV 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 Kwajalein Atoll Local Government.

Overview of the Financial Statements

KALGOV's financial transactions and subsequent statements are prepared in accordance with accounting principles generally accepted in the United States of America and standards mandated by the Governmental Accounting Standards Board, as applicable to governmental entities.

KALGOV operates on an accrual basis wherein revenues are recognized when earned, not when received and expenses are recorded when incurred, not when paid. Grants and similar items are recognized as revenues as soon as all eligibility requirements imposed by the provider have been met. Capital assets are recorded at historical cost or estimated historical cost and are depreciated using the straight-line method. Contributed capital assets are recorded at estimated fair market value at the date of donation. Further information is provided in the footnotes of the accompanying financial statements.

The financial statements of this report consist of the MD&A, the basic financial statements, and notes to the financial statements. The basic financial statements consist of the Governmental Funds Balance Sheet/Statement of Net Assets and the Statement of Governmental Fund Revenues, Expenditures and Changes in Fund Balance/Statement of Activities.

KALGOV uses one governmental fund to report on its financial position and results of operations. KALGOV presents a balance sheet and a statement of revenues, expenditures and changes in fund balances for its governmental fund.

The Statement of Net Assets and the Statement of Activities report information on all nonfiduciary activities of KALGOV.

A condensed Governmental Funds Balance Sheet/Statement of Net Assets as of September 30, 2007 follows with comparative information as of September 30, 2006:

Governmental Funds Balance Sheets/Statements of Net Assets

	2007		2006	
	General Fund	Statement of Net Assets	General Fund	Statement of Net Assets
Current and other assets	\$ 32,276	\$ 32,276	\$ 56,887	\$ 56,887
Capital assets	-	27,986	-	51,011
Total assets	\$ <u>32,276</u>	\$ <u>60,262</u>	\$ <u>56,887</u>	\$ <u>107,898</u>
Long-term liabilities	\$ -	\$ 269,657	\$ -	\$ 153,318
Other liabilities	69,060	8,345,847	3,667,883	3,667,883
Total liabilities	69,060	8,615,504	3,667,883	3,821,201
Fund deficit:				
Unreserved	(36,784)		(3,610,996)	
Total liabilities and fund deficit	\$ <u>32,276</u>		\$ <u>56,887</u>	
Net assets:				
Invested in capital assets		27,986		51,011
Unrestricted		(8,583,228)		(3,764,314)
Total net assets		\$ <u>(8,555,242)</u>		\$ <u>(3,713,303)</u>

A condensed Statement of Governmental Fund Revenues, Expenditures and Changes in Fund Balance/Statement of Activities for the year ended September 30, 2007 follows with comparative information for the year ended September 30, 2006:

Statements of Governmental Fund Revenues, Expenditures and Changes in Fund Balance/Statements of Activities

	2007		2006	
	General Fund	Statement of Net Assets	General Fund	Statement of Net Assets
Revenues:				
Taxes	\$ 996,996	\$ 996,996	\$ 986,222	\$ 986,222
Grants and contributions	22,059	22,059	277,005	277,005
Other	136,235	136,235	116,731	116,731
Total revenues	<u>1,155,290</u>	<u>1,155,290</u>	<u>1,379,958</u>	<u>1,379,958</u>
Expenditures:				
General government	411,043	430,294	562,011	546,516
Public safety	382,129	388,381	404,964	401,818
Public works	489,683	491,548	725,755	730,114
Culture and recreation	46,077	48,437	43,594	44,065
Penalties and interest	-	2,223,709	-	-
Contributions to component unit	53,331	53,331	-	-
Community development	-	-	2,500	2,500
Total expenditures/expenses	<u>1,382,263</u>	<u>3,635,700</u>	<u>1,738,824</u>	<u>1,725,013</u>
Deficiency of revenues under expenditures	(226,973)	-	(358,866)	-
Extraordinary item:				
RMI and MISSA obligations under MOU	3,801,185		-	
Change in net assets	-	(2,480,410)	-	(345,055)
Fund deficit/net assets:				
Beginning of the year, as previously reported	(3,610,996)	(3,713,303)	(3,252,130)	(3,368,248)
Prior-period adjustment	-	(2,361,529)	-	-
Beginning of year, as restated	<u>(3,610,996)</u>	<u>(6,074,832)</u>	<u>(3,252,130)</u>	<u>(3,368,248)</u>
End of year	\$ <u>(36,784)</u>	\$ <u>(8,555,242)</u>	\$ <u>(3,610,996)</u>	\$ <u>(3,713,303)</u>

Budget

The Constitution of KALGOV provides for the Executive Committee to introduce to the Kwajalein Atoll Local Council (the Council) at least one set of budget estimates of revenues and expenditures and at least one appropriation ordinance for each fiscal year. In addition, actual revenues were less than final estimates by \$1,461,331 or 56%, while actual expenditures were less than final estimates by \$1,234,358 or 47%.

Capital Assets

At September 30, 2007, KALGOV had \$27,986 invested in capital assets, net of depreciation where applicable, including equipment, furniture and fixtures and transportation equipment. See note 3 to the financial statements for more information on KALGOV's capital assets.

Economic Outlook

The economic outlook of KALGOV will improve as revenue amounts go up.

Contacting KALGOV's Financial Management

This financial report is designed to provide a general overview of KALGOV's finances and to demonstrate KALGOV's accountability for the money it receives. If you have questions about this report, or need additional information, please contact the Kwajalein Atoll Local Government, P.O. Box 5220, Ebeye, Marshall Islands MH 96970, or e-mail kwajgov@yahoo.com or call (692) 329-8008.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Governmental Funds Balance Sheet/Statement of Net Assets
September 30, 2007

	General Fund	Adjustments (Note 2)	Statement of Net Assets
<u>ASSETS</u>			
Cash and cash equivalents	\$ 16,671	\$ -	\$ 16,671
Other receivables, net	15,605	-	15,605
Capital assets, net of accumulated depreciation	-	27,986	27,986
Total assets	\$ 32,276	27,986	60,262
<u>LIABILITIES</u>			
Accounts payable	\$ 29,471	-	29,471
Other liabilities and accruals	39,589	-	39,589
Withholding taxes payable	-	2,740,509	2,740,509
Social security taxes payable	-	5,536,278	5,536,278
Long-term liabilities:			
Compensated absences payable	-	269,657	269,657
Total liabilities	69,060	8,546,444	8,615,504
Contingencies			
<u>FUND DEFICIT/NET ASSETS</u>			
Fund deficit:			
Unreserved	(36,784)	36,784	-
Total fund deficit	(36,784)	36,784	-
Total liabilities and fund deficit	\$ 32,276		
Net assets:			
Invested in capital assets		27,986	27,986
Unrestricted		(8,583,228)	(8,583,228)
Total net assets		\$ (8,555,242)	\$ (8,555,242)

See accompanying notes to financial statements.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Statement of Governmental Fund Revenues, Expenditures and
Changes in Fund Deficit/Statement of Activities
Year Ended September 30, 2007

	General Fund	Adjustments (Note 2)	Statement of Activities
Revenues:			
Taxes:			
Property	\$ 633,874	\$ -	\$ 633,874
Excise	363,122	-	363,122
Grants and contributions:			
Operating	22,059	-	22,059
Fees and other	90,757	-	90,757
Other	45,478	-	45,478
	<u>1,155,290</u>	<u>-</u>	<u>1,155,290</u>
Total revenues			
Expenditures/expenses:			
General government	411,043	19,251	430,294
Public works	489,683	1,865	491,548
Public safety	382,129	6,252	388,381
Culture and recreation	46,077	2,360	48,437
Contributions to component unit	53,331	-	53,331
RMI penalties and interest	-	50,762	50,762
MISSA penalties and interest	-	2,172,947	2,172,947
	<u>1,382,263</u>	<u>2,253,437</u>	<u>3,635,700</u>
Total expenditures/expenses			
Deficiency of revenues under expenditures	<u>(226,973)</u>	<u>226,973</u>	
Extraordinary item:			
RMI and MISSA obligations under MOU	<u>3,801,185</u>		
Changes in net assets		<u>(2,480,410)</u>	<u>(2,480,410)</u>
Fund deficit/net assets:			
Beginning of the year, as previously reported	(3,610,996)	-	(3,713,303)
Prior-period adjustment	-	-	(2,361,529)
	<u>(3,610,996)</u>	<u>-</u>	<u>(6,074,832)</u>
Beginning of the year, as restated			
End of the year	<u>\$ (36,784)</u>	<u>\$ -</u>	<u>\$ (8,555,242)</u>

See accompanying notes to financial statements.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Notes to Financial Statements
September 30, 2007

(1) Reporting Entity

The Kwajalein Atoll Local Government (KALGOV) 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 Kwajalein Atoll Local Government.

(2) Summary of Significant Accounting Policies

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

Government-Wide Financial Statements

The Statement of Net Assets and the Statement of Activities report information on all nonfiduciary activities of KALGOV.

Primary government activities are defined as either governmental or business-type activities. Governmental activities, which normally are supported by taxes, intergovernmental revenues and other non-exchange revenues, are reported separately from business-type activities, which rely to a significant extent on fees charged to external parties for goods or services.

The Statement of Net Assets presents KALGOV's nonfiduciary assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories:

- Invested in capital assets consists of capital assets, net of accumulated depreciation plus construction or improvement of those assets.
- Restricted net assets result when constraints placed on net asset use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through enabling legislation. KALGOV has no restricted net assets at September 30, 2007.
- 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. They often have resources that are imposed by management, but can be removed or modified.

The degrees to which direct expenses of given functions or segments are offset by program revenues are described as follows:

<u>Functions/Programs</u>	<u>Expenses</u>	<u>Charges for Services</u>	<u>Operating Grants and Contributions</u>	<u>Capital Grants and Contributions</u>	<u>Net Expenses Primary Government</u>
Governmental activities:					
General government	\$ 430,294	\$ 76,324	\$ 22,059	\$ -	\$ (331,911)
Public safety	388,381	-	-	-	(388,381)
Public works	491,548	14,433	-	-	(477,115)
Community development	48,437	-	-	-	(48,437)
Contribution to component unit	53,331	-	-	-	(53,331)
RMI penalties and interest	50,762	-	-	-	(50,762)
MISSA penalties and interest	<u>2,172,947</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(2,172,947)</u>
	<u>\$ 3,635,700</u>	<u>\$ 90,757</u>	<u>\$ 22,059</u>	<u>\$ -</u>	<u>\$ (3,522,884)</u>

KWAJALEIN ATOLL LOCAL GOVERNMENT

Notes to Financial Statements
September 30, 2007

(2) Summary of Significant Accounting Policies, Continued

Government-Wide Financial Statements, Continued

Direct expenses are those that are clearly identifiable within a specific function. 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 do not meet the definition of program revenues.

Fund Financial Statements

KALGOV uses one governmental fund to report on its financial position and results of operations. The operations of this fund are accounted for with a set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues and expenditures.

Separate financial statements are provided for governmental funds. KALGOV presents a balance sheet and a statement of revenues, expenditures and changes in fund deficit for its governmental fund. The ending fund deficit on the balance sheet is then reconciled to the ending governmental activities net assets.

Adjustments required to reconcile total governmental fund deficit to net assets of governmental activities in the Statement of Net Assets are as follows:

Total fund deficit - governmental funds		\$ (36,784)
Add:		
Capital assets	156,409	
Accumulated depreciation	<u>(128,423)</u>	27,986
Less:		
Compensated absences payable	(269,657)	
Social security taxes payable	(5,536,278)	
Withholding taxes payable	<u>(2,740,509)</u>	<u>(8,546,444)</u>
Total net assets - governmental activities		\$ <u>(8,555,242)</u>

Adjustments required to reconcile net change in total governmental fund deficit to change in net assets of governmental activities in the Statement of Activities are as follows:

Net change in fund deficit - governmental funds		\$ (226,973)
---	--	--------------

Capital outlays are reported as expenditures in governmental funds. However, in the statement of activities, the cost of capital assets is allocated over their estimated useful lives as depreciation expense. For the current year, these amounts consist of:

Capital outlays		3,143
Depreciation expense	<u>(26,168)</u>	(23,025)

KWAJALEIN ATOLL LOCAL GOVERNMENT

Notes to Financial Statements
September 30, 2007

(2) Summary of Significant Accounting Policies, Continued

Fund Financial Statements, Continued

Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds. For the current year, these activities consist of:

Increase in RMI penalties and interest	(50,762)	
Increase in MISSA penalties and interest	(2,172,947)	
Increase in compensated absences payable	<u>(6,703)</u>	<u>(2,230,412)</u>
Change in net assets - governmental activities		\$ <u>(2,480,410)</u>

Measurement Focus and Basis of Accounting

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

Governmental fund financial statements account for the general governmental activities of KALGOV 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, KALGOV considers revenues to be available if they are collected within 60 days of the end of the current fiscal period.

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 and other items that are not allocated to specific programs.

Unrestricted contributions and grants are recorded as revenue in the statement of revenues, expenditures, and changes in fund deficit when received (in the case of contributions) or when approved by the grantor agency (in the case of grants).

Cash and Cash Equivalents

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

KWAJALEIN ATOLL LOCAL GOVERNMENT

Notes to Financial Statements
September 30, 2007

(2) Summary of Significant Accounting Policies, Continued

Cash and Cash Equivalents, Continued

For purposes of the balance sheet/statement of net assets, cash and cash equivalents is defined as cash on hand, and cash held in demand accounts. As of September 30, 2007, the carrying amount of the primary government's total cash and cash equivalents was \$16,671 and the corresponding bank balance was \$23,544. Of the bank balance amount, \$51 is maintained in a financial institution subject to Federal Deposit Insurance Corporation (FDIC) insurance. KALGOV 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

In general, tax revenue is recognized on the government-wide financial statements, when assessed or levied and on the governmental fund financial statements to the extent that it is both measurable and available. Receivables are primarily due from businesses and individuals residing on islands within the Kwajalein Atoll. The allowance for doubtful accounts is stated at an amount that 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 an allowance for doubtful accounts charged to bad debts expense. KALGOV believes the allowance amounting to \$68,099 at September 30, 2007, is adequate to absorb currently estimated bad debts in the account balance.

Capital Assets

Capital assets, which consist of equipment, are reported in the government-wide financial statements. Such assets, whether purchased or constructed, are recorded at historical cost or estimated historical cost. Contributed capital assets are recorded at estimated fair market value at the date of donation.

Title to the land on which KALGOV's facilities are located is held in the name of the landowner. Fair market rental value related to this property has not been assessed or recorded.

Title to the building where the Mayor's Office, the Department of Administration, the Department of Revenue and Finance and the Legal Administration are located has not been perfected in the name of KALGOV and is still held in the name of the Kwajalein Atoll Development Authority. Fair market rental value related to the building has not been assessed or recorded.

KALGOV has not developed a capitalization policy. The costs of normal maintenance and repairs that do not add to the value of assets or materially extend assets lives are not capitalized. Capital assets are depreciated using the straight-line method. When capital assets are disposed, the cost and applicable accumulated depreciation are removed from the respective accounts, and the resulting gain or loss is recorded in the statement of activities.

KALGOV has not accounted for its general fixed assets acquired before FY 2004. Management has taken the position that general fixed assets acquired before FY 2004 have a net book value of zero.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Notes to Financial Statements
September 30, 2007

(2) Summary of Significant Accounting Policies, Continued

Compensated Absences

It is KALGOV's policy to permit employees to accumulate earned but unused vacation and sick pay benefits. All vacation leave benefits and a portion of sick leave benefits is accrued when incurred in the government-wide financial statements. A liability for these amounts is reported in governmental funds only if they have matured, for example, as a result of employee resignations and retirements.

Per Rule XVIII of KALGOV's personnel policy, employee vacation rates are credited at either 104, 156 or 208 hours per year, depending upon their length of service.

1. One-half day (4 hours) for each full bi-weekly pay period in the case of employees with less than three (3) years of service.
2. Three-fourths day (6) hours for each full bi-weekly pay period in the case of employees with more than three (3) years of service but less than five (5) years of service.
3. One (1) day (8 hours) for each full bi-weekly pay period in the case of employees with more than five (5) years of service.

The policy further sets maximum accumulation of such vacation credits at 240 hours. Thereafter, any excess shall be forfeited unless taken before the end of the calendar year in which such excess was accumulated. Upon termination, unused vacation leave will be paid to the employee.

The policy allows employees to receive a lump sum payment of one-half of their accumulated sick leave benefits upon retirement. KALGOV has accrued an estimated liability of \$160,021 at September 30, 2007, for potential future sick leave payments as a result of this policy. However, this amount is an estimate and actual payout may be materially different than estimated.

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 financial statements and the reported amounts of revenues and expenditures/expenses during the reporting period. Actual results may differ from those estimates.

New Accounting Standards

During fiscal year 2007, KALGOV implemented GASB Statement No. 44, *Economic Condition Reporting: The Statistical Section, an amendment to NCGA Statement 1*. GASB Statement No. 44 improves the understandability and usefulness of statistical section information and adds information from the new financial reporting model for state and local governments required by GASB Statement No. 34. The implementation of this pronouncement did not have a material impact on the accompanying 2007 financial statements.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Notes to Financial Statements
September 30, 2007

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

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 KALGOV.

In July 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 KALGOV.

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

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 KALGOV.

In May 2007, GASB issued Statement No. 50, *Pension Disclosures an amendment of GASB Statements No. 25 and 27*. GASB Statement No. 50 more closely aligns the financial reporting requirements for pensions with those for other post-employment benefits. The provisions of this statement are effective for periods beginning after June 15, 2007. Management does not believe the implementation of this statement will have a material effect on the financial statements of KALGOV.

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 KALGOV.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Notes to Financial Statements
September 30, 2007

(2) Summary of Significant Accounting Policies, Continued

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 KALGOV's financial statements for the year ended September 30, 2006 from which summarized information was derived.

(3) Capital Assets

Capital asset activity for the year ended September 30, 2007, was as follows:

	<u>Estimated Useful Lives</u>	<u>October 1, 2006</u>	<u>Additions</u>	<u>Deletions</u>	<u>September 30, 2007</u>
Depreciable capital assets:					
Equipment	1 - 3 years	\$ 69,881	\$ 2,185	\$ -	\$ 72,066
Furniture and fixtures	1 - 2 years	2,639	958	-	3,597
Transportation equipment	1 - 4 years	<u>80,746</u>	<u>-</u>	<u>-</u>	<u>80,746</u>
		153,266	3,143	-	156,409
Less accumulated depreciation		<u>(102,255)</u>	<u>(26,168)</u>	<u>-</u>	<u>(128,423)</u>
		<u>\$ 51,011</u>	<u>\$ (23,025)</u>	<u>\$ -</u>	<u>\$ 27,986</u>

Depreciation expense was charged to functions/programs of KALGOV's governmental activities as follows:

General government	\$ 20,811
Public safety	4,715
Public works	192
Culture and recreation	<u>450</u>
	<u>\$ 26,168</u>

(4) Social Security Taxes Payable

At September 30, 2007, KALGOV was liable for taxes payable to the Marshall Islands Social Security Administration (MISSA) in the amount of \$5,536,278. In 2003, the Court ordered KALGOV to pay MISSA \$2.8 million for unpaid contributions from 1996 to 2000. However, in a post judgment agreement, all penalty charges were waived with the condition that KALGOV pay a fixed amount monthly to cover the delinquent amounts and keep current on its quarterly obligations. KALGOV has been unable to keep current on its quarterly obligations and thus the entire \$5,536,278 has been reflected as current in the accompanying financial statements. KALGOV has not recorded any additional penalties and interest.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Notes to Financial Statements
September 30, 2007

(5) Withholding Taxes Payable

At September 30, 2007, KALGOV was liable for withholding taxes payable to the Republic of the Marshall Islands (RepMar) in the amount of \$2,740,509. No repayment schedule with RepMar exists and thus the entire \$2,740,509 has been reflected as a current liability in the accompanying financial statements.

(6) Long-Term Obligations

Long-term liabilities will be liquidated in the future from governmental funds. During the year ended September 30, 2007, the following changes occurred in liabilities reported as part of KALGOV's long-term liabilities in the statement of net assets:

	<u>October 1, 2006</u>	<u>Additions</u>	<u>Deletions</u>	<u>September 30, 2007</u>	<u>Due Within One Year</u>
Compensated absences	\$ <u>248,084</u>	\$ <u>21,573</u>	\$ <u>-</u>	\$ <u>269,657</u>	\$ <u>-</u>

(7) Contingencies

Sick Leave

It is the policy of KALGOV to record expenditures for sick leave when leave is actually taken. Sick leave is compensated time for absence during working hours arising from employee illness or injury. The estimated accumulated amount of unused sick leave as of September 30, 2007, is \$320,042. KALGOV has accrued an estimated liability of \$160,021 at September 30, 2007, for potential future sick leave payments in accordance with the compensated absences policy.

Insurance Coverage

KALGOV does not maintain insurance coverage for a significant amount of fixed assets. In the event of a catastrophe, KALGOV may be self-insured to a material extent.

(8) Related Party Transactions

KALGOV processes payroll for employees of the Kwajalein Atoll Port Authority (KAPA) on a reimbursable basis. Total related gross salaries and wages and related employer MISSA share for the year ended September 30, 2007 amounted to \$26,319. As of September 30, 2007, related receivables of \$53,331 are included within other receivables in the accompanying financial statements. During the year ended September 30, 2007, KALGOV recorded a corresponding allowance for doubtful accounts of \$53,331, which has been presented as a contribution to component unit in the accompanying financial statements.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Notes to Financial Statements September 30, 2007

(9) Risk Management

KALGOV 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. KALGOV has elected to purchase commercial insurance coverage from independent third parties for the risks of loss to which it is exposed. Settled claims from these risks have not exceeded commercial insurance coverage for the past three years.

(10) Going Concern

As a result of recurring operating deficits and a significant unreserved fund deficit in the General Fund, there is substantial doubt about KALGOV's ability to continue as a going concern. Management's plans to address KALGOV's financial situation include:

- Reducing certain controllable expenses.
- Minimizing capital acquisitions.
- Reducing regular working hours for employees.
- Implementing a comp time system for overtime hours worked.
- Negotiating amounts due from RepMar for past appropriations not honored in accordance with the Memorandum of Understanding dated March 29, 1987 for the assumption of the Department of Public Works.
- Negotiating with RepMar for the return of the Department of Public Works back to RepMar.

Management believes that actions presently being taken to revise KALGOV operating requirements, as outlined above, provide the opportunity for KALGOV to continue as a going concern and to commence the process of reducing the abovementioned General Fund deficit position (see note 12).

(11) Restatement

Subsequent to the issuance of KALGOV's 2006 financial statements, it was determined that penalties and interest payable to RepMar related to unpaid withholding taxes were understated by \$2,251,893 and that accrued compensated balances were understated by \$109,636.

(12) Subsequent Event

In January 2010, KALGOV entered into a memorandum of understanding (MOU) with RepMar and MISSA to address taxes payable. The MOU assigned 40% of KALGOV's share of all immovable property tax collected from Kwajalein land-use payments to MISSA and RepMar with 60% and 40% issued directly to MISSA and RepMar, respectively. As a result of the MOU the nature of the tax payable liabilities to MISSA and RepMar have changed in that the total amounts are not due within one year. As a result of the MOU, \$3,801,185 was recorded as an extraordinary item of the General Fund. Accordingly, MISSA and RepMar taxes payable are not recorded within the General Fund in the accompanying financial statements.

KWAJALEIN ATOLL LOCAL GOVERNMENT
REQUIRED SUPPLEMENTARY INFORMATION
YEAR ENDED SEPTEMBER 30, 2007

KWAJALEIN ATOLL LOCAL GOVERNMENT

Schedule of Revenues, Expenditures and Changes in Unreserved
Fund Deficit - Budget and Actual - General Fund
Year Ended September 30, 2007

	Budgeted Amounts		Actual	Variance Positive (Negative)
	Original	Final		
Revenues:				
Taxes:				
Property	\$ 670,000	\$ 670,000	\$ 633,874	\$ (36,126)
Excise	366,500	366,500	363,122	(3,378)
Grants and contributions:				
Operating	863,000	863,000	22,059	(840,941)
Fees and other	571,150	571,150	90,757	(480,393)
Other	145,971	145,971	45,478	(100,493)
Total revenues	<u>2,616,621</u>	<u>2,616,621</u>	<u>1,155,290</u>	<u>(1,461,331)</u>
Expenditures:				
General government	874,255	874,255	411,043	463,212
Public works	1,126,662	1,126,662	489,683	636,979
Public safety	554,914	554,914	382,129	172,785
Culture and recreation	60,790	60,790	46,077	14,713
Contributions to component unit	-	-	53,331	(53,331)
Total expenditures	<u>2,616,621</u>	<u>2,616,621</u>	<u>1,382,263</u>	<u>1,234,358</u>
Extraordinary item:				
RMI and MISSA obligations under MOU	-	-	3,801,185	3,801,185
Net change in unreserved fund deficit	-	-	3,574,212	3,574,212
Unreserved fund deficit at beginning of year	<u>(3,610,996)</u>	<u>(3,610,996)</u>	<u>(3,610,996)</u>	<u>-</u>
Unreserved fund deficit at end of year	<u>\$ (3,610,996)</u>	<u>\$ (3,610,996)</u>	<u>\$ (36,784)</u>	<u>\$ 3,574,212</u>

See accompanying notes to required supplementary information - budgetary reporting.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Notes to Required Supplementary Information - Budgetary Reporting
September 30, 2007

(1) Budgetary Information

The Constitution of KALGOV provides for the Executive Committee to introduce to the Kwajalein Atoll Local Council (the Council) at least one set of budget estimates of revenues and expenditures and at least one appropriation ordinance for each fiscal year. No monies shall be expended unless appropriated by ordinance for the purpose for which it is to be expended.

Accounting principles used in developing data on a budgetary basis do not differ from those used in preparing the basic financial statements in conformity with GAAP.

Encumbrance accounting for budgetary control purposes is not followed by KALGOV; however, management has determined that no material encumbrances exist at year end.

KWAJALEIN ATOLL LOCAL GOVERNMENT

OTHER SUPPLEMENTARY INFORMATION

YEAR ENDED SEPTEMBER 30, 2007

KWAJALEIN ATOLL LOCAL GOVERNMENT
GENERAL FUND

September 30, 2007

The General Fund is used to account for resources traditionally associated with government which are not required legally or by sound financial management to be accounted for in another fund. The following are combined and included in the General Fund as of September 30, 2007:

Operating Fund

This fund accounts for all governmental transactions, except those activities of the Department of Public Works and Public Safety.

Public Services Fund

This fund accounts for the activities of the Department of Public Works and Public Safety.

See Accompanying Independent Auditors' Report.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Combining Balance Sheet
General Fund
September 30, 2007

<u>ASSETS</u>	<u>Operating</u>	<u>Public Service</u>	<u>Eliminations</u>	<u>Total</u>
Cash and cash equivalents	\$ 16,671	\$ -	\$ -	\$ 16,671
Other receivables, net	15,605	-	-	15,605
Due from other funds	<u>1,142,175</u>	<u>-</u>	<u>(1,142,175)</u>	<u>-</u>
	<u>\$ 1,174,451</u>	<u>\$ -</u>	<u>\$ (1,142,175)</u>	<u>\$ 32,276</u>
 <u>LIABILITIES AND FUND BALANCES (DEFICITS)</u> 				
Liabilities:				
Accounts payable	\$ 29,471	\$ -	\$ -	\$ 29,471
Other liabilities and accruals	39,589	-	-	39,589
Due to other funds	<u>-</u>	<u>1,142,175</u>	<u>(1,142,175)</u>	<u>-</u>
Total liabilities	<u>69,060</u>	<u>1,142,175</u>	<u>(1,142,175)</u>	<u>69,060</u>
Contingencies				
Fund balances (deficits):				
Unreserved	<u>1,105,391</u>	<u>(1,142,175)</u>	<u>-</u>	<u>(36,784)</u>
Total fund balances (deficits)	<u>1,105,391</u>	<u>(1,142,175)</u>	<u>-</u>	<u>(36,784)</u>
	<u>\$ 1,174,451</u>	<u>\$ -</u>	<u>\$ (1,142,175)</u>	<u>\$ 32,276</u>

See accompanying Independent Auditors' Report.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Combining Statement of Revenues, Expenditures by Function,
and Changes in Fund Balances (Deficits)

General Fund

Year Ended September 30, 2007

	<u>Operating</u>	<u>Public Service</u>	<u>Eliminations</u>	<u>Total</u>
Revenues:				
Taxes:				
Property	\$ 633,874	\$ -	\$ -	\$ 633,874
Excise	363,122	-	-	363,122
Grants and contributions:				
Operating	22,059	-	-	22,059
Fees and other	76,324	14,433	-	90,757
Other	45,478	-	-	45,478
Total revenues	<u>1,140,857</u>	<u>14,433</u>	<u>-</u>	<u>1,155,290</u>
Expenditures:				
General government	411,043	-	-	411,043
Public works	-	489,683	-	489,683
Public safety	-	382,129	-	382,129
Culture and recreation	-	46,077	-	46,077
Contributions to component unit	53,331	-	-	53,331
Total expenditures	<u>464,374</u>	<u>917,889</u>	<u>-</u>	<u>1,382,263</u>
Excess (deficiency) of revenues over (under) expenditures	<u>676,483</u>	<u>(903,456)</u>	<u>-</u>	<u>(226,973)</u>
Other financing sources (uses):				
Operating transfers in	-	425,216	(425,216)	-
Operating transfers out	(425,216)	-	425,216	-
Total other financing sources (uses), net	<u>(425,216)</u>	<u>425,216</u>	<u>-</u>	<u>-</u>
Extraordinary item:				
RMI and MISSA obligations under MOU	<u>3,801,185</u>	<u>-</u>	<u>-</u>	<u>3,801,185</u>
Change in fund balances (deficits)	4,052,452	(478,240)	-	3,574,212
Fund deficits at beginning of year	<u>(2,947,061)</u>	<u>(663,935)</u>	<u>-</u>	<u>(3,610,996)</u>
Fund balances (deficits) at end of year	<u>\$ 1,105,391</u>	<u>\$ (1,142,175)</u>	<u>\$ -</u>	<u>\$ (36,784)</u>

See accompanying Independent Auditors' Report.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Combining Statement of Revenues, Expenditures by Account,
and Changes in Fund Balances (Deficits)
General Fund
Year Ended September 30, 2007

	Operating	Public Service	Eliminations	Total
Revenues:				
Taxes:				
Property	\$ 633,874	\$ -	\$ -	\$ 633,874
Excise	363,122	-	-	363,122
Grants and contributions:				
Operating	22,059	-	-	22,059
Fees and other	76,324	14,433	-	90,757
Other	45,478	-	-	45,478
Total revenues	1,140,857	14,433	-	1,155,290
Expenditures:				
Salaries and wages	232,782	819,515	-	1,052,297
POL	-	63,625	-	63,625
Contribution to component unit	53,331	-	-	53,331
Travel	31,605	5,282	-	36,887
Supplies and materials	15,261	19,031	-	34,292
Allowances	27,051	-	-	27,051
Communications	29,540	-	-	29,540
Utilities	20,381	-	-	20,381
Professional services	8,855	-	-	8,855
Grants and subsidies	7,780	-	-	7,780
Repairs and maintenance	1,027	5,702	-	6,729
Capital outlay	2,508	634	-	3,142
Food stuffs	2,846	-	-	2,846
Contractual services	540	-	-	540
Printing and reproduction	137	-	-	137
Other	30,730	4,100	-	34,830
Total expenditures	464,374	917,889	-	1,382,263
Excess (deficiency) of revenues over (under) expenditures	676,483	(903,456)	-	(226,973)
Other financing sources (uses):				
Operating transfers in	-	425,216	(425,216)	-
Operating transfers out	(425,216)	-	425,216	-
Total other financing sources (uses), net	(425,216)	425,216	-	-
Extraordinary item:				
RMI and MISSA obligations under MOU	3,801,185	-	-	3,801,185
Change in fund balances (deficits)	4,052,452	(478,240)	-	3,574,212
Fund deficits at beginning of year	(2,947,061)	(663,935)	-	(3,610,996)
Fund balances (deficits) at end of year	\$ 1,105,391	\$ (1,142,175)	\$ -	\$ (36,784)

See accompanying Independent Auditors' Report.