

KWAJALEIN ATOLL LOCAL GOVERNMENT

**FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT**

YEAR ENDED SEPTEMBER 30, 2012

INDEPENDENT AUDITORS' REPORT

The Honorable Mayor Hirata Kabua
Kwajalein Atoll Local Government
Republic of the Marshall Islands:

We have audited the accompanying statement of net assets of the governmental activities and the governmental funds balance sheet for the general fund of the Kwajalein Atoll Local Government (KALGOV) as of September 30, 2012. These financial statements are the responsibility of the management of KALGOV. Our responsibility is to express an opinion on the respective financial statements based on our audit.

Except as discussed in the following paragraphs, 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 KALGOV'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.

Management has not recorded certain capital assets acquired prior to September 30, 2011 in governmental activities and, accordingly, has not recorded depreciation expense on those assets. Accounting principles generally accepted in the United States of America require that those capital assets be capitalized and depreciated, which would increase assets, net assets, and expenses of the governmental activities. The amount by which this departure would affect assets, net assets, and expenses of the governmental activities has not been determined.

Management has not recorded a liability for compensated absences in governmental activities and, accordingly, has not recorded an expense for the current period change in that liability. Accounting principles generally accepted in the United States of America require that compensated absences attributable to employee services already rendered and that are not contingent on a specific event that is outside the control of the employer and employee be accrued as liabilities and expenses as employees earn the rights to the benefits, which would increase liabilities, reduce net assets, and change expenses of the governmental activities. The amount by which this departure would affect liabilities, net assets, and expenses of the governmental activities has not been determined.

Because of inadequacies in the accounting records, we were unable to form an opinion regarding underlying supporting documentation evidencing the validity of revenues and expenditures/expenses recorded by the governmental activities and the general fund. Therefore, we were not able to satisfy ourselves about the amount at which revenues and expenditures/expenses are recorded for the governmental activities and the general fund for the year ended September 30, 2012. Accordingly, 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 for the year ended September 30, 2012.

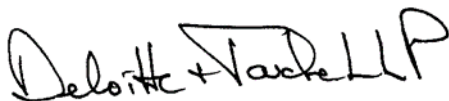
In our opinion, because of the effects of the matters discussed in the third and fourth paragraphs above, the financial statements referred to previously do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of the governmental activities of KALGOV as of September 30, 2012.

In addition, in our opinion, the financial statements referred to previously present fairly, in all material respects, the financial position of the general fund of KALGOV as of September 30, 2012.

The accompanying financial statements have been prepared assuming that KALGOV will continue as a going concern. As discussed in Note 8 to the financial statements, KALGOV's recurring net deficiency raise substantial doubt about its ability to continue as a going concern. Management's plans concerning these matters are also discussed in Note 8 to the financial statements. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Management has omitted the Management's Discussion and Analysis and the budgetary comparison schedule that accounting principles generally accepted in the United States of America requires to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 27, 2018, on our consideration of KALGOV'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 solely 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 effectiveness of KALGOV's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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

December 27, 2018

KWAJALEIN ATOLL LOCAL GOVERNMENT

Governmental Fund Balance Sheet / Statement of Net Assets
September 30, 2012

	<u>General Fund</u>	<u>Adjustments (Note 2)</u>	<u>Statement of Net Assets</u>
<u>ASSETS</u>			
Other receivables, net	\$ 12,007	\$ -	\$ 12,007
Capital assets, net of accumulated depreciation	<u>-</u>	<u>146,123</u>	<u>146,123</u>
Total assets	<u>\$ 12,007</u>	<u>146,123</u>	<u>158,130</u>
<u>LIABILITIES</u>			
Bank overdraft	\$ 8,204	-	8,204
Accounts payable	143,381	-	143,381
Other liabilities and accruals	36,241	-	36,241
Withholding taxes payable	3,397,703	-	3,397,703
Social security taxes payable	<u>6,533,074</u>	<u>-</u>	<u>6,533,074</u>
Total liabilities	<u>10,118,603</u>	<u>-</u>	<u>10,118,603</u>
Contingencies			
<u>FUND DEFICIT/NET ASSETS</u>			
Fund deficit:			
Unassigned	<u>(10,106,596)</u>	<u>10,106,596</u>	<u>-</u>
Total fund deficit	<u>(10,106,596)</u>	<u>10,106,596</u>	<u>-</u>
Total liabilities and fund deficit	<u>\$ 12,007</u>		
Net assets:			
Invested in capital assets		146,123	146,123
Unrestricted		<u>(10,106,596)</u>	<u>(10,106,596)</u>
Total net assets		<u>\$ (9,960,473)</u>	<u>\$ (9,960,473)</u>

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, 2012

	<u>General Fund</u>	<u>Adjustments (Note 2)</u>	<u>Statement of Activities</u>
Revenues:			
Taxes:			
Excise	\$ 935,991	\$ -	\$ 935,991
Land lease rebates	32,400	-	32,400
RepMar operating grants and contributions:			
Public Works Fund	248,000	-	248,000
Local Government Fund	23,013	-	23,013
License fees and other charges	73,067	-	73,067
Other	<u>35,693</u>	<u>-</u>	<u>35,693</u>
 Total revenues	 <u>1,348,164</u>	 <u>-</u>	 <u>1,348,164</u>
 Expenditures/expenses:			
General government	873,716	22,640	896,356
Public works	462,868	5,636	468,504
Public safety	460,103	2,243	462,346
Culture and recreation	<u>59,717</u>	<u>(942)</u>	<u>58,775</u>
 Total expenditures/expenses	 <u>1,856,404</u>	 <u>29,577</u>	 <u>1,885,981</u>
 Deficiency of revenues under expenditures	 <u>(508,240)</u>	 <u>(29,577)</u>	 <u>(537,817)</u>
 Extraordinary item:			
MISSA penalties and interest	(190,750)	-	(190,750)
RMI penalties and interest	<u>(478,839)</u>	<u>-</u>	<u>(478,839)</u>
	<u>(669,589)</u>	<u>-</u>	<u>(669,589)</u>
 Net change in fund deficit	 (1,177,829)	1,177,829	-
 Change in net assets	 -	 (1,207,406)	 (1,207,406)
 Fund deficit/net assets:			
Beginning of the year	<u>(8,928,767)</u>	<u>175,700</u>	<u>(8,753,067)</u>
 End of the year	 <u>\$ (10,106,596)</u>	 <u>\$ 146,123</u>	 <u>\$ (9,960,473)</u>

See accompanying notes to financial statements.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Notes to Financial Statements
September 30, 2012

(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. KALGOV is governed by an elected mayor and a nine member council.

Blended component units are entities that are legally separate from KALGOV, but are so related to KALGOV that they are, in substance, the same as KALGOV or entities providing services entirely or almost entirely to KALGOV. KALGOV accounts for the activities of the Kwajalein Atoll Port Authority (KAPA), a blended component unit and a Proprietary Fund Type - Enterprise Fund. KAPA was created to develop and maintain the port and wharf facilities at Ebeye. The KALGOV Office of Finance was designated to serve as its administrator. Because of inadequacies in the accounting records, the activities of KAPA are not presented in the accompanying basic financial statements as is required to conform to accounting principles generally accepted in the United States of America.

(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.

A. Government-Wide Financial Statements

The Statement of Net Assets and the Statement of Activities report financial 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, 2012.
- 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.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Notes to Financial Statements
September 30, 2012

(2) Summary of Significant Accounting Policies, Continued

A. Government-Wide Financial Statements, Continued

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.

B. 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		\$ (10,106,596)
Add:		
Capital assets	529,096	
Accumulated depreciation	<u>(382,973)</u>	<u>146,123</u>
Total net assets - governmental activities		\$ <u>(9,960,473)</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 follow:

Net change in fund deficit – governmental funds	\$ (1,177,829)
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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. For the current year, these amounts consist of:

Capital outlays, net of disposals	55,753	
Depreciation expense	<u>(85,330)</u>	<u>(29,577)</u>
Change in net assets – governmental activities		\$ <u>(1,207,406)</u>

KWAJALEIN ATOLL LOCAL GOVERNMENT

Notes to Financial Statements
September 30, 2012

(2) Summary of Significant Accounting Policies, Continued

C. Measurement Focus and Basis of Accounting

The government-wide financial statements are reported using the economic resources management 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 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 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 90 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 balances when received (in the case of contributions) or when approved by the grantor agency (in the case of grants).

D. 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.

E. Receivables

In general, tax revenue is recognized on the government-wide 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, 2012, is adequate to absorb currently estimated bad debts in the account balance.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Notes to Financial Statements
September 30, 2012

(2) Summary of Significant Accounting Policies, Continued

F. 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.

G. 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 five (5) years of service.
2. Three-fourths day (6) hours for each full bi-weekly pay period in the case of employees with five (5) years of service but less than fifteen (15) years of service.
3. One (1) day (8 hours) for each full bi-weekly pay period in the case of employees with fifteen (15) years of service.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Notes to Financial Statements
September 30, 2012

(2) Summary of Significant Accounting Policies, Continued

G. Compensated Absences, Continued

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.

Per Rule XVII - *Leave Privileges* of the policy adopted by the KALGOV Civil Service Commission, employees accrue four hours for every 40 hours completed in each pay period with total accumulation not to exceed 960 hours. The policy allows employees to receive a lump sum payment of one-half of their accumulated sick leave benefits upon retirement.

H. Fund Balance

Fund balance classifications are based on the extent to which KALGOV is bound to honor constraints on the specific purposes for which amounts in those funds can be spent. Amounts are reported under the following fund balance classifications:

- Non-spendable - includes fund balance amounts that cannot be spent either because it is not in spendable form or because of legal or contractual constraints.
- Restricted - includes fund balance amounts that are constrained for specific purposes which are externally imposed by providers, such as creditors or amounts constrained due to constitutional provisions or enabling legislation.
- Committed - includes fund balance amounts that are constrained for specific purposes that are internally imposed by the government through formal action of the highest level of decision making authority and does not lapse at year-end.
- Assigned - includes fund balance amounts that are intended to be used for specific purposes that are neither considered restricted or committed.
- Unassigned - includes negative fund balances in other governmental funds.

I. 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.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Notes to Financial Statements
September 30, 2012

(2) Summary of Significant Accounting Policies, Continued

J. New Accounting Standards

During fiscal year 2012, KALGOV implemented the following pronouncements.

- GASB Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, which amends Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, and addresses issues related to the frequency and timing of measurements for actuarial valuations first used to report funded status information in OPEB plan financial statements. The implementation of this pronouncement did not have a material effect on the accompanying financial statements.
- GASB Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions* (an amendment of GASB Statement No. 53), which will improve financial reporting by state and local governments by clarifying the circumstances in which hedge accounting continues to be applied when a swap counterparty, or a swap counterparty's credit support provider, is replaced. The implementation of this pronouncement did not have a material effect on the accompanying financial statements.

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

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

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

KWAJALEIN ATOLL LOCAL GOVERNMENT

Notes to Financial Statements
September 30, 2012

(2) Summary of Significant Accounting Policies, Continued

J. New Accounting Standards, Continued

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

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

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

In June 2012, GASB issued Statement No. 67, *Financial Reporting for Pension Plans*, which revises existing guidance for the financial reports of most pension plans, and Statement No. 68, *Accounting and Financial Reporting for Pensions*, which revises and establishes new financial reporting requirements for most governments that provide their employees with pension benefits. The provisions in Statement 67 are effective for financial statements for periods beginning after June 15, 2013. The provisions in Statement 68 are effective for fiscal years beginning after June 15, 2014. Management does not believe that the implementation of this statement will have a material effect on the financial statements of KALGOV.

(3) Capital Assets

Capital asset activity for the year ended September 30, 2012, was as follows:

	<u>Estimated Useful Lives</u>	<u>October 1, 2011</u>	<u>Additions</u>	<u>Deletions</u>	<u>September 30, 2012</u>
Depreciable capital assets:					
Equipment	1 - 3 years	\$ 271,515	\$ 7,180	\$ -	\$ 278,695
Furniture and fixtures	1 - 2 years	33,325	7,789	-	41,114
Transportation equipment	1 - 4 years	<u>168,503</u>	<u>40,784</u>	<u>-</u>	<u>209,287</u>
		473,343	55,753	-	529,096
Less accumulated depreciation		<u>(297,643)</u>	<u>(85,330)</u>	<u>-</u>	<u>(382,973)</u>
		\$ <u>175,700</u>	\$ <u>(29,577)</u>	\$ <u>-</u>	\$ <u>146,123</u>

KWAJALEIN ATOLL LOCAL GOVERNMENT

Notes to Financial Statements
September 30, 2012

(3) Capital Assets, Continued

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

General government	\$ 45,925
Public works	32,368
Culture and recreation	4,380
Public safety	<u>2,657</u>
	\$ <u>85,330</u>

(4) Social Security Taxes Payable

At September 30, 2012, KALGOV was liable for delinquent taxes payable to the Marshall Islands Social Security Administration (MISSA) in the amount of \$6,533,074. 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 \$6,533,074 has been reflected as current in the accompanying financial statements (see Note 7). During the year ending September 30, 2012, KALGOV recognized \$190,750 for penalties and interest associated with this liability as an extraordinary item.

(5) Withholding Taxes Payable

At September 30, 2012, KALGOV was liable for delinquent withholding taxes payable to the Republic of the Marshall Islands (RepMar) in the amount of \$3,397,703. No repayment schedule with RepMar exists and thus the entire \$3,397,703 has been reflected as a current liability in the accompanying financial statements. During the year ending September 30, 2012, KALGOV recognized \$478,839 for penalties and interest associated with this liability as an extraordinary item.

(6) Related Party Transactions

A receivable from Kwajalein Atoll Ports Authority (KAPA) of \$21,744 is included within other receivables in the accompanying statement of net assets as of September 30, 2012. KALGOV recorded an allowance for the entire receivable balance of \$21,744 as of September 30, 2012.

(7) Contributions from RepMar

The Tax Collection (Kwajalein Special Account) (Amendment) Act, 2009, (Public Law 2009-21) authorized the rebate of 40% of land lease payments collected by RepMar from the Kwajalein Atoll to be deposited into a special account to supplement grants appropriated by RepMar to KALGOV. During the year ended September 30, 2012, KALGOV recognized land lease rebates revenue of \$32,400 associated with Public Law 2009-21, which were remitted directly by RepMar to MISSA for application against KALGOV's outstanding obligation (see Note 9).

The Appropriations (Financial Year 2012) Act, 2011, (Public Law 2011-58) authorized grants-in-aid to local governments, of which \$23,013 was provided to KALGOV during the year ended September 30, 2012. In addition, Public Law 2011-58 authorized an appropriation for Ebeye Public Works, which is administered by KALGOV in accordance with a Memorandum of Understanding between RepMar and KALGOV. During the year ended September 30, 2012, KALGOV received \$248,000 for the purpose of administering public works activities on Kwajalein Atoll.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Notes to Financial Statements
September 30, 2012

(8) Contingencies

Compensated Absences

It is the policy of KALGOV to record expenditures for vacation and sick leave when leave is actually taken. Sick leave is compensated time for absence during working hours arising from employee illness or injury. At September 30, 2012, KALGOV records detailing outstanding vacation and sick leave credits has not made available. Management has taken position that KALGOV may still be liable for potential future vacation and sick leave payments in accordance with the compensated absences policy.

Insurance Coverage

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 elected to be self-insured for the risks of loss, to which it believes it is more economical to manage its risks internally.

Going Concern

KALGOV has reported an increase in fund deficit amounting to \$1,177,829 for the year ended September 30, 2012, which resulted in an accumulated fund deficit of \$10,106,596. KALGOV depends on its collection of taxes and fees to continue its operations. However, KALGOV is delinquent in remitting and settlement of MISSA contributions and RepMar withholding taxes. KALGOV has received annual subsidy from RepMar to support its public works and public safety activities. The continuation of KALGOV operations is dependent upon the aggressive collection of taxes and fees. In addition, in order for KALGOV to continue as a going concern, it may need to defer settlement of MISSA contributions and RepMar withholding taxes and increase subsidy support from RepMar.

(9) Subsequent Event

Effective October 1, 2013, Public Law 2009-21 was amended by the Tax Collection Amendment Act, 2013, (Public Law 2013-11), which authorized the rebate of 100% of land lease payments collected by RepMar from the Kwajalein Atoll for the payment of KALGOV debts owed to MISSA.