

KWAJALEIN ATOLL LOCAL GOVERNMENT

**FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT**

YEAR ENDED SEPTEMBER 30, 2014

INDEPENDENT AUDITORS' REPORT

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

Report on the Financial Statements

We have audited the accompanying statement of net position 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, 2014, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide basis for our audit opinions.

Basis for Adverse Opinion on Governmental Activities

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. Furthermore, 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.

Basis for Disclaimer of Opinion on Governmental Activities and the General Fund

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, 2014.

Adverse Opinion

In our opinion, because of the significance of the matters discussed in the “Basis for Adverse Opinion on Governmental Activities” paragraph, the financial statements referred to above do not present fairly the financial position of the governmental activities of KALGOV as of September 30, 2014 in accordance with accounting principles generally accepted in the United States of America.

Disclaimer of Opinion

Because of the significance of the matter discussed in the “Basis for Disclaimer of Opinion on Governmental Activities and the General Fund” paragraph, 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, 2014.

Unmodified Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the general fund of KALGOV as of September 30, 2014 in accordance with accounting principles generally accepted in the United States of America.

Emphasis-of-Matter

Going Concern

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. Our opinion is not modified with respect to this matter.

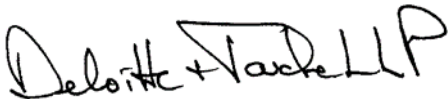
Other Matters

Required Supplementary Information

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.

Other Reporting Required by Government Auditing Standards

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.



December 27, 2018

KWAJALEIN ATOLL LOCAL GOVERNMENT

Governmental Funds Balance Sheet/Statement of Net Position
September 30, 2014

	<u>General Fund</u>	<u>Adjustments (Note 2)</u>	<u>Statement of Net Position</u>
<u>ASSETS</u>			
Cash	\$ 81	\$ -	\$ 81
Other receivables, net	15,588	-	15,588
Capital assets, net of accumulated depreciation	<u>-</u>	<u>79,734</u>	<u>79,734</u>
Total assets	<u>\$ 15,669</u>	<u>79,734</u>	<u>95,403</u>
<u>LIABILITIES</u>			
Bank overdraft	\$ 83,510	-	83,510
Accounts payable	160,395	-	160,395
Other liabilities and accruals	48,507	-	48,507
Withholding taxes payable	3,929,345	-	3,929,345
Social security taxes payable	<u>6,322,547</u>	<u>-</u>	<u>6,322,547</u>
Total liabilities	<u>10,544,304</u>	<u>-</u>	<u>10,544,304</u>
Contingencies			
<u>FUND DEFICIT/NET POSITION</u>			
Fund deficit:			
Unassigned	<u>(10,528,635)</u>	<u>10,528,635</u>	<u>-</u>
Total fund deficit	<u>(10,528,635)</u>	<u>10,528,635</u>	<u>-</u>
Total liabilities and fund deficit	<u>\$ 15,669</u>		
Net position:			
Net investment in capital assets		79,734	79,734
Unrestricted		<u>(10,528,635)</u>	<u>(10,528,635)</u>
Total net position		<u>\$ (10,448,901)</u>	<u>\$ (10,448,901)</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, 2014

	<u>General Fund</u>	<u>Adjustments (Note 2)</u>	<u>Statement of Activities</u>
Revenues:			
Taxes:			
Excise	\$ 844,779	\$ -	\$ 844,779
Land lease rebates	540,000	-	540,000
RepMar operating grants and contributions:			
Public Works Fund	248,000	-	248,000
Local Government Fund	22,576	-	22,576
License fees and other charges	142,412	-	142,412
Other	<u>34,101</u>	<u>-</u>	<u>34,101</u>
 Total revenues	 <u>1,831,868</u>	 <u>-</u>	 <u>1,831,868</u>
 Expenditures/expenses:			
General government	542,442	1,875	544,317
Public works	365,265	29,860	395,125
Public safety	329,272	10,154	339,426
Culture and recreation	<u>51,253</u>	<u>1,192</u>	<u>52,445</u>
 Total expenditures/expenses	 <u>1,288,232</u>	 <u>43,081</u>	 <u>1,331,313</u>
 Excess of revenues over expenditures	 <u>543,636</u>	 <u>(43,081)</u>	 <u>500,555</u>
 Extraordinary item:			
MISSA penalties and interest	(427,593)	-	(427,593)
RMI penalties and interest	<u>(168,516)</u>	<u>-</u>	<u>(168,516)</u>
	<u>(596,109)</u>	<u>-</u>	<u>(596,109)</u>
 Net change in fund deficit	 (52,473)	52,473	
 Change in net position	 -	 (95,554)	 (95,554)
 Fund deficit/net position:			
Beginning of the year	<u>(10,476,162)</u>	<u>122,815</u>	<u>(10,353,347)</u>
 End of the year	 <u>\$ (10,528,635)</u>	 <u>\$ 79,734</u>	 <u>\$ (10,448,901)</u>

See accompanying notes to financial statements.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Notes to Financial Statements
September 30, 2014

(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 Position 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 Position presents KALGOV's nonfiduciary assets and liabilities, with the difference reported as net position. Net position is reported in three categories:

- Net investment in capital assets consists of capital assets, net of accumulated depreciation plus construction or improvement of those assets.
- Restricted net position results when constraints placed on net position use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through enabling legislation. KALGOV has no restricted net position at September 30, 2014.
- Unrestricted net position consists of net position, which does not meet the definition of the two preceding categories. Unrestricted net position often is designated (for example, internally restricted), to indicate that management does not consider such 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, 2014

(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 position.

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

Total fund deficit - governmental funds		\$ (10,528,635)
Add:		
Capital assets	578,422	
Accumulated depreciation	<u>(498,688)</u>	
		<u>79,734</u>
Total net position - governmental activities		\$ <u>(10,448,901)</u>

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

Net change in fund deficit – governmental funds		\$ (52,473)
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	13,663	
Depreciation expense	<u>(56,744)</u>	
		<u>(43,081)</u>
Change in net position – governmental activities		\$ <u>(95,554)</u>

KWAJALEIN ATOLL LOCAL GOVERNMENT

Notes to Financial Statements
September 30, 2014

(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.

As of September 30, 2014, the carrying amount of cash and cash equivalents was \$81 and the corresponding bank balance was \$81, which 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.

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 \$92,803 at September 30, 2014, is adequate to absorb currently estimated bad debts in the account balance.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Notes to Financial Statements
September 30, 2014

(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. Deferred Outflows of Resources

In addition to assets, the statement of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element represents a consumption of net position that applies to a future period and so will not be recognized as an outflow of resources (deduction of net position) until then. KALGOV has no items that qualify for reporting in this category.

H. Compensated Absences

KALGOV's policy permits 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, 2014

(2) Summary of Significant Accounting Policies, Continued

H. 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.

I. Deferred Inflow of Resources

In addition to liabilities, the statement of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element represents an acquisition of net position that applies to a future period and so will not be recognized as an inflow of resources (additions to net position) until then. KALGOV has no items that qualify for reporting in this category.

J. 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.

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 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, 2014

(2) Summary of Significant Accounting Policies, Continued

L. New Accounting Standards

During fiscal year 2014, KALGOV implemented the following pronouncements:

- GASB 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 implementation of this pronouncement did not have a material effect on the accompanying financial statements.
- GASB Statement No. 67, *Financial Reporting for Pension Plans*, which revises existing guidance for the financial reports of most pension plans. The implementation of this pronouncement did not have a material effect on the accompanying financial statements.
- GASB Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*, which requires a state or local government guarantor that offers a nonexchange financial guarantee to another organization or government to recognize a liability on its financial statements when it is more likely than not that the guarantor will be required to make a payment to the obligation holders under the agreement. The implementation of this pronouncement did not have a material effect on the accompanying financial statements.

In June 2012, GASB issued Statement No. 68, *Accounting and Financial Reporting for Pension*, which revises and establishes new financial reporting requirements for most governments that provide their employees with pension benefits. 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.

In January 2013, GASB issued Statement No. 69, *Government Combinations and Disposals of Government Operations*, which improves accounting and financial reporting for state and local governments' combinations and disposal of government operations. Government combinations include mergers, acquisitions, and transfers of operations. A disposal of government operations can occur through a transfer to another government or a sale. The provisions in Statement 69 are effective for fiscal years beginning after December 15, 2013. Management does not believe that the implementation of this statement will have a material effect on the financial statements of KALGOV.

In November 2013, GASB issued Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date – an amendment of GASB Statement No. 68*, which addresses an issue regarding application of the transition provisions of Statement No. 68, *Accounting and Financial Reporting for Pensions*. The issue relates to amounts associated with contributions, if any, made by a state or local government employer or nonemployer contributing entity to a defined benefit pension plan after the measurement date of the government's beginning net pension liability. The provisions in Statement No. 71 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.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Notes to Financial Statements
September 30, 2014

(3) Capital Assets

Capital asset activity for the year ended September 30, 2014, was as follows:

	<u>Estimated Useful Lives</u>	<u>October 1, 2013</u>	<u>Additions</u>	<u>Deletions</u>	<u>September 30, 2014</u>
Depreciable capital assets:					
Equipment	1 - 3 years	\$ 280,238	\$ 1,640	\$ -	\$ 281,878
Furniture and fixtures	1 - 2 years	44,770	2,720	-	47,490
Transportation equipment	1 - 4 years	<u>239,751</u>	<u>9,303</u>	<u>-</u>	<u>249,054</u>
		564,759	13,663	-	578,422
Less accumulated depreciation		<u>(441,944)</u>	<u>(56,744)</u>	<u>-</u>	<u>(498,688)</u>
		\$ <u>122,815</u>	\$ <u>(43,081)</u>	\$ <u>-</u>	\$ <u>79,734</u>

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

General government	\$ 15,538
Public works	29,860
Culture and recreation	1,192
Public safety	<u>10,154</u>
	\$ <u>56,744</u>

(4) Social Security Taxes Payable

At September 30, 2014, KALGOV was liable for delinquent taxes payable to the Marshall Islands Social Security Administration (MISSA) in the amount of \$6,322,547. 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 \$6,322,547 has been reflected as current in the accompanying financial statements (see Note 7). During the year ended September 30, 2014, KALGOV recognized \$427,593 for penalties and interest associated with this liability as an extraordinary item.

(5) Withholding Taxes Payable

At September 30, 2014, KALGOV was liable for delinquent withholding taxes payable to the Republic of the Marshall Islands (RepMar) in the amount of \$3,929,345. No repayment schedule with RepMar exists and thus the entire \$3,929,345 has been reflected as a current liability in the accompanying financial statements. During the year ending September 30, 2014, KALGOV recognized \$168,516 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 \$18,104 is included within other receivables in the accompanying statement of net position as of September 30, 2014. KALGOV recorded an allowance for the entire receivable balance of \$18,104 as of September 30, 2014.

KWAJALEIN ATOLL LOCAL GOVERNMENT

Notes to Financial Statements
September 30, 2014

(7) Contributions from RepMar

The Tax Collection Amendment Act, 2013, (Public Law 2013-11) 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. During the year ended September 30, 2014, KALGOV recognized land lease rebates revenue of \$540,000 associated with Public Law 2013-11, which were remitted directly by RepMar to MISSA for application against KALGOV's outstanding obligation.

The Appropriations (Financial Year 2014) Act, 2013, (Public Law 2013-20) authorized grants-in-aid to local governments, of which \$22,576 was provided to KALGOV during the year ended September 30, 2014. In addition, Public Law 2013-20 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, 2014, KALGOV received \$248,000 for the purpose of administering public works activities on Kwajalein Atoll.

(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, 2014, 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 \$52,473 for the year ended September 30, 2014, which resulted in an accumulated fund deficit of \$10,528,635. 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.