

**NATIONAL ENVIRONMENTAL
PROTECTION AUTHORITY FUND**

**FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED SEPTEMBER 30, 2004 AND 2003



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INDEPENDENT AUDITORS' REPORT

Board of Directors
Republic of the Marshall Islands
National Environmental Protection Authority Fund:

We were engaged to audit the accompanying statements of net assets of the National Environmental Protection Authority Fund (EPA), a component unit of the Republic of the Marshall Islands (RepMar), as of September 30, 2004 and 2003, and the related statements of revenues, expenses and changes in net assets and of cash flows for the years then ended. These financial statements are the responsibility of EPA's management.

Because of inadequacies in EPA's accounting records and internal control over financial reporting, we were unable to form an opinion regarding the amounts recorded as advances (stated at \$58,236 and \$25,790, respectively) and net assets (stated at \$289,241 and \$311,075, respectively) in the accompanying statements of net assets, or the amounts recorded as grant revenues in the accompanying statement of revenues, expenses and changes in net assets (stated at \$171,229 and \$304,960, respectively).

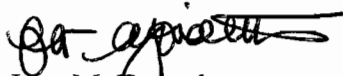
As discussed in notes 1 and 4 to the accompanying financial statements, the financial statements of EPA relate solely to those accounting records maintained by EPA and do not incorporate any accounts related to its operations that may be accounted for by RepMar's Treasury or by any of RepMar's other branches, departmental units or component units.

Since advances and grant revenues materially affect the determination of financial position, results of operations, and cash flows, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the financial statements referred to in the first paragraph.

The Management's Discussion and Analysis on pages 3 through 5 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This information is the responsibility of EPA's management. 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 8, 2005, on our consideration of EPA'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 the internal control over financial reporting or on compliance. That report is an integral part of an engagement to audit in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our engagement.

November 8, 2005


Jean M. Tonyokwe
Auditor-General

**NATIONAL ENVIRONMENTAL
PROTECTION AUTHORITY FUND**

Management's Discussion and Analysis
September 30, 2004

This section of the Environmental Protection Authority annual financial report presents our discussion and analysis for RMIEPA's financial performance during the fiscal year that ended on September 30, 2004. Please read it in conjunction with the financial statements, which follow this section.

FINANCIAL HIGHLIGHTS

RMIEPA's net assets decreased by \$21,834 or 7% from \$311,075 in 2003 to 289,241 in 2004. Operating revenues also decreased by \$101,819 or 25% from \$401,498 in 2003 to \$299,679 in 2004. Operating expenses, however, increased by \$89,840 or 64% from \$141,425 in 2003 to \$231,265 in 2004.

FINANCIAL ANALYSIS OF RMIEPA

The statement of Net Assets (page 6) and the Statement of Revenues, Expenses and Changes in Net Assets (page 7) provide an indication of RMIEPA's Financial condition. RMIEPA's net assets reflect the difference between assets and liabilities. An increase in net assets over time typically indicates an improvement in the agency' financial condition; a decrease in net asset shows the opposite..

A summary of RMIEPA's Statement of Net Assets is presented below:

Year Ended September 30	<u>2004</u>	<u>2003</u>
Current assets	\$ 261,522	\$ 282,095
Capital assets	<u>53,229</u>	<u>43,373</u>
Total assets	<u>314,751</u>	<u>325,468</u>
Current liabilities	<u>25,510</u>	<u>14,393</u>
Investment in Capital assets	53,229	43,373
Unrestricted	<u>236,012</u>	<u>267,702</u>
Total net assets	<u>289,241</u>	<u>311,075</u>
Total liabilities and net assets	<u>\$ 314,751</u>	<u>\$ 325,468</u>

As indicated above, the total assets was decreased by \$10,717 or 3.3% from \$325,468 in 2003 to \$314,751 in 2004. The decrease in total assets reflects project grants that were received from foreign funding sources under the regional and international environment conventions such as UNEP and SPREP that were transferred out from EPA to the newly established Office of Environment Planning Policy Coordination (OEPPC).

**NATIONAL ENVIRONMENTAL
PROTECTION AUTHORITY FUND**

Management's Discussion and Analysis
September 30, 2004

Total liabilities reflect an increase of \$11,117 or 77% from \$14,393 in 2003 to \$25,510 in 2004. The increase reflects improved settlement of the outstanding delinquent liabilities owed to both RepMar and the Marshall Islands Social Security Administration (MISSA) from prior administrations.

A Summary of RMIEPA's Statement of Revenues, Expenses and Change in Net Assets is presented below:

Year ended September 30	<u>2004</u>	<u>2003</u>
Operating revenues	\$ 299,679	\$ 401,498
Operating expenses	231,265	141,425
Nonoperating expenses	<u>90,248</u>	<u>-0-</u>
Change in net assets	(21,843)	260,073
Net assets at beginning of year	<u>311,075</u>	<u>51,002</u>
Net assets at end of year	<u>\$ 289,241</u>	<u>\$ 311,075</u>

The Statement of Revenues, Expenses and Changes in Net Assets identifies the various revenues and expense items that impact the change in net assets. As indicated above, RMIEPA's total revenues decreased by \$101,819 or 25% from \$401,498 to \$299,679 in 2004. The decrease reflects, in addition to the transferring funds out of the received projects grants from foreign funding sources, revenues from the enforcement of the regulation also decreased because many of the violations remain to be settled in the Court of Law.

Below is the summary of the major components of operating revenues for RMIEPA in 2004 compared to 2003:

Year ended September 30	<u>2004</u>	<u>2003</u>
<u>Operating revenues</u>		
Grants	\$ 171,229	\$ 304,960
Fines	101,677	65,000
Fees & Charges	15,807	18,740
Others	<u>10,966</u>	<u>12,798</u>
Totals	<u>\$ 299,679</u>	<u>\$ 401,498</u>

**NATIONAL ENVIRONMENTAL
PROTECTION AUTHORITY FUND**

Management's Discussion and Analysis
September 30, 2004

Total Expenses increased by \$180,088 or 127% from \$141,425 in 2003 to \$321,513 in 2004, resulting in a decrease in net asset at the end of the year by \$21,834 or 7% in change of net assets. The increase in operational expenses reflects matching funds allocated to CMI, increased cost of utilities, consultation fee, and other miscellaneous office expenses.

Year ended September 30	<u>2004</u>	<u>2003</u>
<u>Expenses</u>		
Salaries & Wages	\$ 52,551	\$ 49,861
Supplies and materials	26,687	20,393
Travel	25,663	16,493
Communication	2,171	12,742
Matching	30,748	-0-
Payment to RepMar	90,248	-0-
Other	93,445	41,936
Total	<u>\$ 321,513</u>	<u>\$ 141,425</u>

CAPITAL ASSETS

Net Capital Assets increased by \$9,856 in 2004 primarily as a result of the acquisition of machinery and other office equipment. A summary of RMIEPA's capital assets is presented below:

	<u>2004</u>	<u>2003</u>
Equipment	\$ 44,173	\$ 26,347
Vehicle	<u>27,495</u>	<u>19,995</u>
	71,668	46,342
Less accumulated depreciation	<u>(18,439)</u>	<u>(2,969)</u>
Total	<u>\$ 53,229</u>	<u>\$ 43,373</u>

ADDITIONAL FINANCIAL INFORMATION

This discussion and analysis is designed to provide RMIEPA's counterparts with an overview of RMIEPA's financial operations and financial condition. Should the reader have questions regarding the information included in this report or wish to request for additional information, please contact the National Environmental Protection Authority, General Manager, at P.O. Box 1322, Majuro, MH 96960

**NATIONAL ENVIRONMENTAL
PROTECTION AUTHORITY FUND**

Statements of Net Assets
September 30, 2004 and 2003

	2004	2003
<u>ASSETS</u>		
Current assets:		
Cash	\$ 197,649	\$ 256,295
Receivables, net	5,637	10
Advances	58,236	25,790
Total current assets	261,522	282,095
Capital assets, net	53,229	43,373
	\$ 314,751	\$ 325,468
<u>LIABILITIES AND NET ASSETS</u>		
Current liabilities:		
Accounts payable	\$ 13,781	\$ 1,858
Other liabilities and accruals	11,729	12,535
Total liabilities	25,510	14,393
Commitments and contingencies		
Net assets:		
Invested in capital assets	53,229	43,373
Unrestricted	236,012	267,702
Total net assets	\$ 314,751	\$ 325,468

See accompanying notes to financial statements.

**NATIONAL ENVIRONMENTAL
PROTECTION AUTHORITY FUND**

Statements of Revenues, Expenses, and Changes in Net Assets
Years Ended September 30, 2004 and 2003

	2004	2003
Operating revenues:		
Grants	\$ 171,229	\$ 304,960
Fines	101,677	65,000
Fees and charges	15,807	18,740
Other	10,966	12,798
Total operating revenues	299,679	401,498
Operating expenses:		
Salaries and wages	52,551	49,861
Supplies and materials	26,687	20,393
Travel	25,663	16,493
Communications	2,171	12,742
Rentals	4,428	8,111
Utilities	16,147	5,000
Printing and reproduction	5,870	2,713
Consultant fee	9,725	-
Freight	1,527	2,475
CMI Matching Fund	30,748	-
Depreciation	15,470	2,303
Miscellaneous	40,278	21,334
Total operating expenses	231,265	141,425
Operating income	68,414	260,073
Nonoperating expenses:		
Contributions to the primary government	90,248	-
Net income (loss)	(21,834)	260,073
Net assets at beginning of year	311,075	51,002
Net assets at end of year	\$ 289,241	\$ 311,075

See accompanying notes to financial statements.

**NATIONAL ENVIRONMENTAL
PROTECTION AUTHORITY FUND**

Statements of Cash Flows
Years Ended September 30, 2004 and 2003

	2004	2003
Cash flows from operating activities:		
Operating grants received	\$ 171,229	\$ 304,960
Cash received from customers	111,857	86,340
Cash payments to suppliers for goods and services	(183,767)	(122,320)
Cash payments to employees for services	(53,357)	(45,300)
Other operating revenues	10,966	12,798
Net cash provided by operating activities	56,928	236,478
Cash flows from capital and related financing activities:		
Acquisition of capital assets	(25,326)	(45,046)
Net cash used in capital and related financing activities	(25,326)	(45,046)
Cash flows from noncapital and related financing activities:		
Payments to the primary government	(90,248)	-
Net cash used in noncapital and related financing activities	(90,248)	-
Net increase in cash	(58,646)	191,432
Cash at beginning of year	256,295	64,863
Cash at end of year	\$ 197,649	\$ 256,295
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 68,414	\$ 260,073
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	15,470	2,303
(Increase) decrease in assets:		
Receivables	(5,627)	2,600
Advances	(32,446)	(23,876)
Increase (decrease) in liabilities:		
Accounts payable	11,923	(9,183)
Payable to affiliates	-	11,361
Other liabilities and accruals	(806)	(6,800)
Net cash provided by operating activities	\$ 56,928	\$ 236,478

See accompanying notes to financial statements.

NATIONAL ENVIRONMENTAL PROTECTION AUTHORITY FUND

Notes to Financial Statements
September 30, 2004 and 2003

(1) Organization

The National Environmental Protection Authority Fund (EPA), a component unit of the Republic of the Marshall Islands (RepMar), was created by the National Environmental Protection Authority Act of 1984 (Public Law No. 1984-31, the Act). EPA began operations as a statutory corporation on December 19, 1984, in accordance with the Act. The objectives of EPA are to preserve and improve the quality of the environment of the Republic of the Marshall Islands.

The operations of EPA were accounted for as a separate fund within RepMar's Ministry of Finance. In April 1997, EPA established a separate bank account outside of RepMar's Treasury for the purpose of receiving and disbursing funds in accordance with Public Law No. 1984-31. Accordingly, the accompanying financial statements relate solely to those accounting records maintained by EPA and do not incorporate any accounts related to EPA's operations that may be accounted for by RepMar's Treasury or any of RepMar's other branches, departmental units or component units.

EPA is governed by a Chairman and four other members, all of whom are appointed by the President of RepMar.

EPA's financial statements are incorporated into the financial statements of RepMar as a component unit.

(2) Summary of Significant Accounting Policies

The accounting policies of EPA conform to accounting principles generally accepted in the United States of America, as applicable to governmental entities, specifically proprietary funds. Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, requires that proprietary activities apply all applicable GASB pronouncements as well as Statements and Interpretations issued by the Financial Accounting Standards Board (FASB), Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989. EPA has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

GASB issued Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, which was subsequently amended by Statement No. 37, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, and modified by Statement No. 38, *Certain Financial Statement Disclosures*. These statements establish financial reporting standards for governmental entities which require that management's discussion and analysis of the financial activities be included with the basic financial statements and notes and modify certain other financial statement disclosure requirements.

**NATIONAL ENVIRONMENTAL
PROTECTION AUTHORITY FUND**

Notes to Financial Statements
September 30, 2004 and 2003

(2) Summary of Significant Accounting Policies, Continued

To conform to the requirements of GASB Statement 34, retained earnings are presented in the following net asset categories:

- Investment in capital assets; capital assets, net of accumulated depreciation, plus construction or improvement of those assets.
- Unrestricted; net assets that are not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action of management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Basis of Accounting

Proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operation of the fund are included in the statements of net assets. Proprietary fund operating statements present increases and decreases in net total assets. The accrual basis of accounting is utilized by proprietary funds. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. All other revenues are reported as nonoperating. Operating expenses includes the cost of sales and services, administrative expenses, and depreciation on capital assets. Expenses not meeting this definition are reported as nonoperating expenses.

Cash

For purposes of the statements of net assets and cash flows, cash is defined as cash on hand and cash held in demand accounts. As of September 30, 2004 and 2003, the carrying amount of cash was \$197,649 and \$256,295, respectively, and the corresponding bank balances were \$201,914 and \$285,955, respectively. Of the bank balance amounts, \$201,914 and \$282,418, respectively, are maintained in a financial institution subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2004 and 2003, bank deposits in the amount of \$100,000 are FDIC insured. EPA does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized.

**NATIONAL ENVIRONMENTAL
PROTECTION AUTHORITY FUND**

Notes to Financial Statements
September 30, 2004 and 2003

(2) Summary of Significant Accounting Policies, Continued

Receivables

All receivables are due from businesses and individuals located within the Republic of the Marshall Islands and are interest free and uncollateralized. The allowance for uncollectible accounts is stated at an amount which management believes will be adequate to absorb possible losses on accounts receivable that may become uncollectible based on evaluations of the collectibility of these accounts and prior collection experience.

Fixed Assets

EPA does not have a capitalization policy for fixed assets; however, items with a cost that equals or exceeds \$100 are generally capitalized at the time of acquisition. Depreciation is calculated using the straight-line method based on the estimated useful lives of the respective assets. The estimated useful lives of these assets are as follows:

Motor vehicles	3 years
Other furniture and equipment	5 years

Taxes

Corporate profits are not subject to income tax in the Republic of the Marshall Islands. The Government of the Republic of the Marshall Islands imposes a gross receipts tax of 3% on revenues. EPA is specifically exempt from this tax.

New Accounting Standards

During fiscal year 2004, EPA implemented GASB Statement No. 39, *Determining Whether Certain Organizations Are Component Units* (an amendment of GASB Statement 14), which provides additional guidance on GASB Statement No.14, in determining whether an entity should be reported as a component unit based on the nature and significance of its relationship with a primary government. Implementation of this statement had no impact on the financial statements.

For fiscal year 2005, EPA will be implementing GASB Statement No. 40, *Deposit and Investment Risk Disclosures* (an amendment of GASB Statement No. 3), which addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. As an element of interest risk, GASB Statement No. 40 requires certain disclosures of investments that have fair values that are highly sensitive to changes in interest rates. Management does not believe that the implementation of this statement will have a material effect on the financial statements of EPA.

In November 2003, GASB issued Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. GASB Statement No. 42 establishes standards for impairment of capital assets when service utility has declined significantly and unexpectedly. The provisions of this Statement are effective for periods beginning after December 15, 2004. Management does not believe that the implementation of this statement will have a material effect on the financial statements of EPA.

**NATIONAL ENVIRONMENTAL
PROTECTION AUTHORITY FUND**

Notes to Financial Statements
September 30, 2004 and 2003

(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 EPA.

In May 2004, GASB issued 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 provisions of this Statement are effective for periods beginning after June 15, 2005. Management does not believe that the implementation of this statement will have a material effect on the financial statements of EPA.

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

(3) Fixed Assets

Capital assets activity for the years ended September 30, 2004 and 2003 were as follows:

	October 1, <u>2003</u>	<u>Additions</u>	<u>Retirements</u>	September 30, <u>2004</u>
Motor vehicles	\$ 19,995	\$ 7,500	\$ -	\$ 27,495
Office furniture and equipment	<u>26,347</u>	<u>17,826</u>	<u>-</u>	<u>44,173</u>
	46,342	25,326	-	71,668
Less accumulated depreciation	<u>(2,969)</u>	<u>(15,470)</u>	<u>-</u>	<u>(18,439)</u>
	<u>\$ 43,373</u>	<u>\$ 9,856</u>	<u>\$ -</u>	<u>\$ 53,229</u>
	October 1, <u>2002</u>	<u>Additions</u>	<u>Retirements</u>	September 30, <u>2003</u>
Motor vehicles	\$ -	\$ 19,995	\$ -	\$ 19,995
Office furniture and equipment	<u>1,288</u>	<u>25,059</u>	<u>-</u>	<u>26,347</u>
	1,288	45,054	-	46,342
Less accumulated depreciation	<u>(666)</u>	<u>(2,303)</u>	<u>-</u>	<u>(2,969)</u>
	<u>\$ 622</u>	<u>\$ 42,751</u>	<u>\$ -</u>	<u>\$ 43,373</u>

**NATIONAL ENVIRONMENTAL
PROTECTION AUTHORITY FUND**

Notes to Financial Statements
September 30, 2004 and 2003

(4) Related Party Transactions

EPA was created by the Nitijela of RepMar under Public Law No. 1984-31. As EPA is governed by a Chairman and four other members who are appointed by the President of RepMar, EPA is thus considered a component unit of RepMar. Accordingly, EPA is affiliated with all RepMar-owned and affiliated entities and utilizes services from affiliated entities, including communications and utility services, at substantially the same terms and conditions as those incurred from third parties.

During the years ended September 30, 2004 and 2003, the separate fund maintained within RepMar's Treasury recorded an operating transfer in from RepMar's General Fund as a Nitijela appropriation of \$32,368 and \$223,550, respectively, and expenditures of \$32,470 and \$197,188, respectively, which pertain to operational activities of EPA in accordance with Public Law No. 1984-31 (see note 1).

EPA occupies certain office space belonging to RepMar at no cost. No lease agreement has been executed to formalize this arrangement. However, management is of the opinion that no rental payments for the use of the office space are anticipated. The fair value of this contribution is presently not determinable. Accordingly, the contributed use of facilities has not been recognized as revenue and expenditures in the accompanying financial statements.

(5) Risk Management

EPA 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. EPA has elected to purchase commercial automobile insurance from independent third parties for the risks of loss to which it is exposed with respect to the use of motor vehicles. Settled claims have not exceeded this commercial coverage in any of the past three years. For other risks of loss to which it is exposed, EPA has elected not to purchase commercial insurance. Instead, EPA believes it is more economical to manage its risks internally. Claims expenses and liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. These losses include an estimate of claims that have been incurred but not reported. No material losses have resulted from EPA's risk management activities.

(6) Contingency

EPA does not maintain general liability insurance coverage on its operations. In the event of a loss, EPA may be self-insured to a material extent.