

**NATIONAL ENVIRONMENTAL
PROTECTION AUTHORITY FUND**

**FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED SEPTEMBER 30, 2005 AND 2004

INDEPENDENT AUDITORS' REPORT

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

We were engaged to audit the accompanying statement 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, 2005, and the related statements of revenues, expenses and changes in net assets and of cash flows for the year then ended. These financial statements are the responsibility of EPA's management. The financial statements of EPA for the year ended September 30, 2004 were audited by other auditors, whose report, dated November 8, 2005, expressed a disclaimer of opinion on those statements.

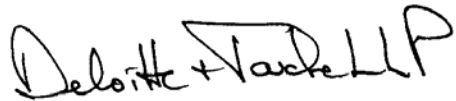
Because of inadequacies in EPA's accounting records and internal control over financial reporting, we were unable to form an opinion regarding the amounts recorded as advances, receivables and net assets in the accompanying statement of net assets, or the amounts recorded as grant revenues and other revenues in the accompanying statement of revenues, expenses and changes in net assets.

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, receivables, grant revenues, and other 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 February 13, 2007, 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.

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

February 13, 2007

**NATIONAL ENVIRONMENTAL
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Management's Discussion and Analysis
September 30, 2005

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, 2005. Please read it in conjunction with the financial statements, which follow this section.

FINANCIAL HIGHLIGHTS

RMIEPA's net assets decreased by \$63,007 or 29% from \$214,968 in 2004 to \$151,961 in 2005. Operating revenues decreased by \$216,394 or 66% from \$328,671 in 2004 to \$112,277 in 2005. Operating expenses also decreased by \$161,845 or 48% from \$334,530 in 2004 to \$172,685 in 2005.

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's financial condition.

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

As of September 30	<u>2005</u>	<u>2004</u>
Current assets	\$ 146,691	\$ 195,249
Capital assets	<u>36,558</u>	<u>53,229</u>
Total assets	\$ <u>183,249</u>	\$ <u>248,478</u>
Current liabilities	\$ <u>31,288</u>	\$ <u>33,510</u>
Invested in capital assets	36,558	53,229
Unrestricted	<u>115,403</u>	<u>161,739</u>
Total net assets	<u>151,961</u>	<u>214,968</u>
Total liabilities & net assets	\$ <u>183,249</u>	\$ <u>248,478</u>

As indicated above, the total assets was decreased by \$65,229 or 26% from \$248,478 in 2004 \$183,249 in 2005. This decrease in total assets reflects project grants received from foreign funding sources like UNEP and SPREP and also less local revenues being generated from unsettled violation notices.

Total liabilities reflect a decrease of \$2,222 or 7.0% from \$33,510 in 2004 to \$31,288 in 2005. The decrease reflects improved settlement of the outstanding delinquent liabilities owed to both RepMar and the Marshall Islands Social Security Administration (MISSA) from prior administrations.

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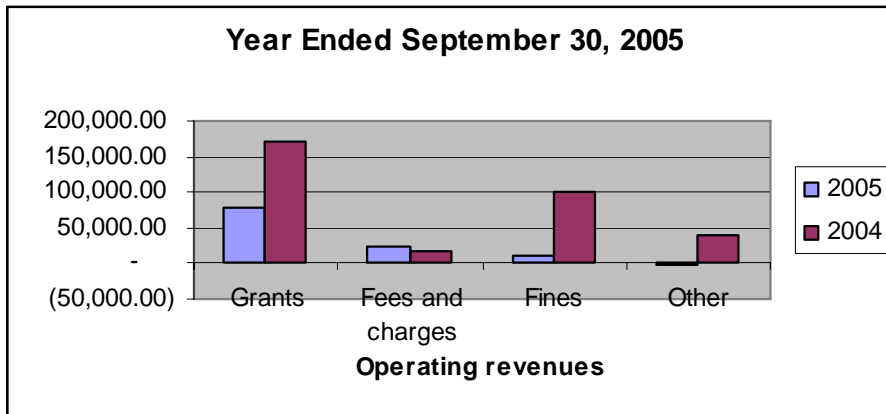
Management's Discussion and Analysis
September 30, 2005

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

Year Ended September 30	<u>2005</u>	<u>2004</u>
Operating revenues	\$ 112,277	\$ 328,671
Operating expenses	<u>172,685</u>	<u>334,530</u>
Operating loss	<u>(60,408)</u>	<u>(5,859)</u>
Non-operating expenses	<u>2,599</u>	<u>90,248</u>
Change in net assets	(63,007)	(96,107)
Net assets at beginning of year	<u>214,968</u>	<u>311,075</u>
Net assets at end of year	<u>\$ 151,961</u>	<u>\$ 214,968</u>

The Statement of Revenues, Expenses and Changes in Net Assets identifies the various revenue and expense items that impact the change in net assets. As indicated above, RMIEPA's total revenues decreased by \$216,394 or 66% from \$328,671 in 2004 to \$112,277 in 2005. The decrease reflects, in addition to the completion of the projects that received grants from foreign funding sources, less revenue was also generated from the enforcement and collection of fines from violations as lots of these violation notices were never acted upon by the offices concerned.

The graph below shows the major components of operating revenues for 2005 compared with 2004.

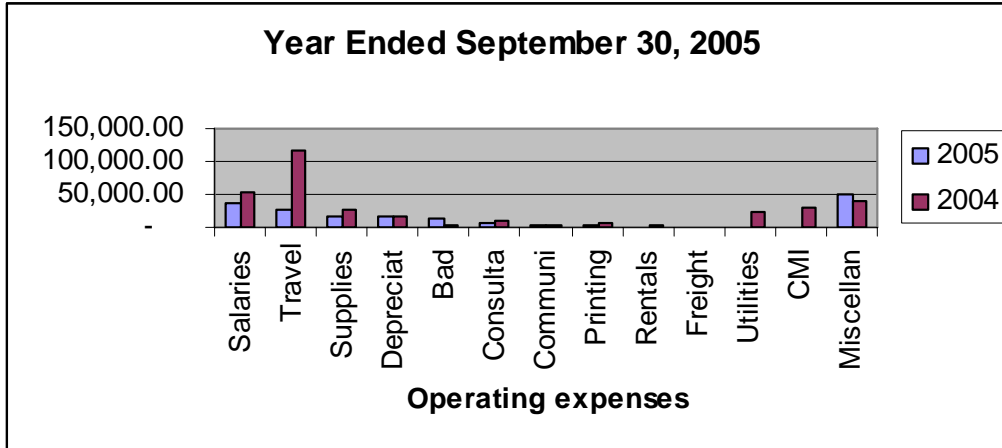


Total operating expenses also decreased by \$161,845 or 48% from \$334,530 in 2004 to \$172,685 in 2005. This decrease reflects less operating revenues being generated and the phasing out of the project grants from outside.

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Management's Discussion and Analysis
September 30, 2005

The graph below shows the major components of operating expenses for 2005 compared with 2004.



CAPITAL ASSETS

Net capital Assets decreased by \$16,671 in 2005 primarily as a result of the acquisition of motor vehicles and machinery and equipment. A summary of RMIEPA's capital assets is presented below:

	<u>2005</u>	<u>2004</u>
Motor vehicles	\$ 27,495	\$ 27,495
Office furniture and equipment	<u>37,197</u>	<u>44,173</u>
	64,692	71,668
Less accumulated depreciation	<u>(28,134)</u>	<u>(18,439)</u>
	<u>\$ 36,558</u>	<u>\$ 53,229</u>

Additional information on RMIEPA's capital assets is disclosed within note 3 to the accompanying financial statements.

**NATIONAL ENVIRONMENTAL
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Statements of Net Assets
September 30, 2005 and 2004

	<u>2005</u>	<u>2004</u>
<u>ASSETS</u>		
Current assets:		
Cash	\$ 148,689	\$ 197,649
Receivables, less allowance for doubtful accounts of \$17,747 and \$3,042 in 2005 and 2004, respectively	16,250	2,595
Advances	<u>(18,248)</u>	<u>(4,995)</u>
Total current assets	146,691	195,249
Capital assets, net	<u>36,558</u>	<u>53,229</u>
	<u>\$ 183,249</u>	<u>\$ 248,478</u>
<u>LIABILITIES AND NET ASSETS</u>		
Current liabilities:		
Accounts payable	\$ 19,190	\$ 21,781
Other liabilities and accruals	<u>12,098</u>	<u>11,729</u>
Total liabilities	<u>31,288</u>	<u>33,510</u>
Commitments and contingencies		
Net assets:		
Invested in capital assets	36,558	53,229
Unrestricted	<u>115,403</u>	<u>161,739</u>
	<u>151,961</u>	<u>214,968</u>
Total net assets	<u>\$ 183,249</u>	<u>\$ 248,478</u>

See accompanying notes to financial statements.

**NATIONAL ENVIRONMENTAL
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Statements of Revenues, Expenses, and Changes in Net Assets
Years Ended September 30, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Operating revenues:		
Grants	\$ 77,607	\$ 171,229
Fees and charges	24,588	15,807
Fines	11,925	101,677
Other	<u>(1,843)</u>	<u>39,958</u>
Total operating revenues	<u>112,277</u>	<u>328,671</u>
Operating expenses:		
Salaries and wages	35,400	52,551
Travel	25,668	117,886
Supplies and materials	16,218	26,687
Depreciation	15,212	15,470
Bad debts	14,705	3,042
Consultant fee	8,250	9,725
Communications	2,832	2,171
Printing and reproduction	1,798	5,870
Rentals	1,560	4,428
Freight	360	1,527
Utilities	176	24,147
CMI matching fund	-	30,748
Miscellaneous	<u>50,506</u>	<u>40,278</u>
Total operating expenses	<u>172,685</u>	<u>334,530</u>
Operating loss	(60,408)	(5,859)
Nonoperating expenses:		
Contributions to the primary government	-	90,248
Loss on disposal of fixed assets	<u>2,599</u>	<u>-</u>
Total nonoperating expenses	<u>2,599</u>	<u>90,248</u>
Change in net assets	(63,007)	(96,107)
Net assets at beginning of year	<u>214,968</u>	<u>311,075</u>
Net assets at end of year	<u>\$ 151,961</u>	<u>\$ 214,968</u>

See accompanying notes to financial statements.

**NATIONAL ENVIRONMENTAL
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Statements of Cash Flows
Years Ended September 30, 2005 and 2004

	2005	2004
Cash flows from operating activities:		
Operating grants received	\$ 18,817	\$ 171,229
Cash received from customers	78,353	154,857
Cash payments to suppliers for goods and services	(109,959)	(215,801)
Cash payments to employees for services	(35,031)	(53,357)
Net cash (used in) provided by operating activities	(47,820)	56,928
Cash flows from capital and related financing activities:		
Acquisition of capital assets	(1,460)	(25,326)
Proceeds from disposal of fixed assets	320	-
Net cash used in capital and related financing activities	(1,140)	(25,326)
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 change in cash	(48,960)	(58,646)
Cash at beginning of year	197,649	256,295
Cash at end of year	\$ 148,689	\$ 197,649
Reconciliation of operating loss to net cash (used in) provided by operating activities:		
Operating loss	\$ (60,408)	\$ (5,859)
Adjustments to reconcile operating loss to net cash (used in) provided by operating activities:		
Depreciation	15,212	15,470
Bad debts	14,705	-
(Increase) decrease in assets:		
Receivables	(28,360)	(2,585)
Advances	13,253	30,785
Increase (decrease) in liabilities:		
Accounts payable	(2,591)	19,923
Other liabilities and accruals	369	(806)
Net cash (used in) provided by operating activities	\$ (47,820)	\$ 56,928

See accompanying notes to financial statements.

NATIONAL ENVIRONMENTAL PROTECTION AUTHORITY FUND

Notes to Financial Statements
September 30, 2005 and 2004

(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.

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Notes to Financial Statements
September 30, 2005 and 2004

(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, 2005 and 2004, the carrying amount of cash was \$148,689 and \$197,649, respectively, and the corresponding bank balances were \$153,436 and \$201,914, respectively. Of the bank balance amounts, \$147,971 and \$201,914, respectively, are maintained in a financial institution subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2005 and 2004, bank deposits in the amount of \$100,000 are FDIC insured. Custodial risk is the risk that in the event of a bank failure, EPA'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. EPA does not have a deposit policy for custodial credit risk. Accordingly, these deposits are exposed to custodial credit risk. EPA does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized.

**NATIONAL ENVIRONMENTAL
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Notes to Financial Statements
September 30, 2005 and 2004

(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's capitalization policy for fixed assets requires that items with a cost that equals or exceeds \$300 be 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 2005, EPA implemented GASB Statement No. 39, *Determining Whether Certain Organizations Are Component Units* (an amendment of GASB Statement 14) and GASB Statement No. 40, *Deposit and Investment Risk Disclosures* (an amendment of GASB Statement No. 3). GASB Statement No. 39 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. GASB Statement No. 40 addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. As an element of interest risk, GASB Statement No. 40 requires certain disclosures of investments that have fair values that are highly sensitive to changes in interest rates. Implementation of these Statements had no impact on the financial statements.

During fiscal year 2006, EPA will be implementing the following pronouncements:

- GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, which establishes standards for impairment of capital assets when its service utility has declined significantly and unexpectedly.
- GASB Statement No. 46, *Net Assets Restricted by Enabling Legislation (an amendment to GASB Statement No. 34)*, which requires that limitations on the use of net assets imposed by enabling legislation be reported as restricted net assets.

**NATIONAL ENVIRONMENTAL
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Notes to Financial Statements
September 30, 2005 and 2004

(1) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

- GASB Statement No. 47, *Accounting for Termination Benefits*, which establishes guidance for state and local governmental employers on accounting and financial reporting for termination of benefits.
- GASB Technical Bulletin No. 2004-2, *Recognition of Pension and Other Postemployment Benefit Expenditures/Expense and Liabilities by Cost-Sharing Employers*, which clarifies the requirements of GASB Statement Nos. 27 and 45 for recognition of pension and other postemployment benefit expenditures/expense and liabilities by cost-sharing employers.

Management does not consider that the implementation of these pronouncements will have a material impact 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.

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.

**NATIONAL ENVIRONMENTAL
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Notes to Financial Statements
September 30, 2005 and 2004

(3) Fixed Assets

Capital assets activity for the years ended September 30, 2005 and 2004 were as follows:

	October 1, 2004	<u>Additions</u>	<u>Retirements</u>	September 30, 2005
Motor vehicles	\$ 27,495	\$ -	\$ -	\$ 27,495
Office furniture and equipment	<u>44,173</u>	<u>1,460</u>	<u>(8,436)</u>	<u>37,197</u>
	71,668	-	-	64,692
Less accumulated depreciation	<u>(18,439)</u>	<u>(15,212)</u>	<u>5,517</u>	<u>(28,134)</u>
	<u>\$ 53,229</u>	<u>\$ (13,752)</u>	<u>\$ (2,919)</u>	<u>\$ 36,558</u>
	October 1, 2003	<u>Additions</u>	<u>Retirements</u>	September 30, 2004
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>(2969)</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>

(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, 2005 and 2004, the separate fund maintained within RepMar's Treasury recorded an operating transfer in from RepMar's General Fund as a Nitijela appropriation of \$33,000 and \$32,368, respectively, and expenditures of \$150,355 and \$32,470, 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.

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Notes to Financial Statements
September 30, 2005 and 2004

(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.

(7) Restatement

The 2004 financial statements have been restated to reflect an error in the recording of the allowance for doubtful accounts and to correct the recording of certain prior year revenues and expenses.

Net assets at beginning of the year, as originally stated	\$ 289,241
Allowance for doubtful accounts misstated	(3,042)
Other revenues unrecorded	28,992
Utilities	(8,000)
Travel expense unrecorded	<u>(92,223)</u>
	\$ <u>214,968</u>