

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

FINANCIAL STATEMENTS  
AND  
INDEPENDENT AUDITORS' REPORT

YEARS ENDED SEPTEMBER 30, 2002 AND 2001

INDEPENDENT AUDITORS' REPORT

Board of Directors  
Kwajalein Atoll Joint Utilities Resources, Inc.:

We have audited the accompanying balance sheets of Kwajalein Atoll Joint Utilities Resources, Inc. (KAJUR), a component unit of the Republic of the Marshall Islands, as of September 30, 2002 and 2001, and the related statements of (loss) income and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of KAJUR's management. Our responsibility is to express an opinion on these financial statements based on our audits.

Except as discussed in the following paragraph, we conducted our audits 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

Because of inadequacies in KAJUR's accounting records and internal control, we were unable to form an opinion regarding cash, receivables, inventories, plant and equipment, bank overdraft, accounts payable, accrued liabilities, contributed capital, revenues and expenses as of and for the year ended September 30, 2000, balances which materially affect the determination of results of operations and cash flows for the year ended September 30, 2001.

Because of the matter discussed in the preceding paragraph, the scope of our work was not sufficient to express, and we do not express, an opinion on the statements of income and retained earnings and cash flows for the year ended September 30, 2001.

In our opinion, the balance sheets of KAJUR as of September 30, 2002 and 2001, and the related statements of loss and retained earnings and cash flows for the year ended September 30, 2002, present fairly, in all material respects, the financial position of KAJUR as of September 30, 2002 and 2001, and the results of its operations and its cash flows for the year ended September 30, 2002, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated May 14, 2003, on our consideration of KAJUR's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

*Deloitte & Touche*

May 14, 2003

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Balance Sheets  
September 30, 2002 and 2001

	<u>2002</u>	<u>2001</u>
<u>ASSETS</u>		
Current assets:		
Cash	\$ 9,377	\$ 14,852
Receivables:		
Utility services, net of allowance for doubtful accounts of \$2,389,393 in 2002 and 2001	551,569	564,287
Due from RepMar (note 5)	206,250	263,842
Due from ASPA (note 5)	167,500	-
Employee receivables	-	613
Other	40,986	27,871
Inventories	<u>188,259</u>	<u>205,682</u>
Total current assets	1,163,941	1,077,147
Plant and equipment, net (note 4)	<u>8,769,729</u>	<u>11,422,700</u>
	<u>\$ 9,933,670</u>	<u>\$ 12,499,847</u>
<u>LIABILITIES AND STOCKHOLDER'S EQUITY</u>		
Current liabilities:		
Bank overdraft	\$ 42,085	\$ 68,179
Accounts payable	759,293	260,367
Due to affiliates (note 5)	416,157	379,438
Accrued liabilities	<u>340,334</u>	<u>393,264</u>
Total current liabilities	1,557,869	1,101,248
Stockholder's equity:		
Common stock, \$1 par value, 100,000 shares authorized, issued and outstanding	100,000	100,000
Retained earnings	<u>8,275,801</u>	<u>11,298,599</u>
Total stockholder's equity	8,375,801	11,398,599
Contingencies (notes 3 and 6)	<u>\$ 9,933,670</u>	<u>\$ 12,499,847</u>

See accompanying notes to financial statements.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Statements of (Loss) Income and Retained Earnings  
Years Ended September 30, 2002 and 2001

	<u>2002</u>	<u>2001</u>
Operating revenues:		
Electric and service billings	\$ 2,170,054	\$ 1,863,077
Water	261,152	243,100
Other	<u>4,725</u>	<u>1,889</u>
Total operating revenues	<u>2,435,931</u>	<u>2,108,066</u>
Operating expenses:		
Fuel and lubricants	1,649,436	1,669,812
Depreciation	983,061	740,400
Salaries, wages and benefits	709,934	640,623
Supplies and materials	213,048	197,415
Operations and maintenance	189,540	178,350
Travel and transportation	138,761	163,914
Rental	66,503	62,154
Communications	65,635	74,726
Contractual services	18,780	69,423
Equipment	337	4,014
Bad debts	-	109,336
Miscellaneous	<u>42,412</u>	<u>71,712</u>
Total operating expenses	<u>4,077,447</u>	<u>3,981,879</u>
Operating loss	<u>(1,641,516)</u>	<u>(1,873,813)</u>
Nonoperating revenues (expenses):		
Capital grants (note 5)	1,326,763	2,423,707
Operating subsidies (note 5)	498,000	550,000
Interest expense	(3,499)	-
Capital outlays (note 5)	(524,521)	-
Loss on disposal of fixed assets	<u>(2,678,025)</u>	<u>-</u>
Total nonoperating revenues (expenses), net	<u>(1,381,282)</u>	<u>2,973,707</u>
Net (loss) income	(3,022,798)	1,099,894
Retained earnings at beginning of year	<u>11,298,599</u>	<u>10,198,705</u>
Retained earnings at end of year	\$ <u>8,275,801</u>	\$ <u>11,298,599</u>

See accompanying notes to financial statements.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Statements of Cash Flows  
Years Ended September 30, 2002 and 2001

	<u>2002</u>	<u>2001</u>
Cash flows from operating activities:		
Operating loss	\$ (1,641,516)	\$ (1,873,813)
Adjustments to reconcile operating loss to net cash used for operating activities:		
Depreciation	983,061	740,400
Bad debts	-	109,336
Loss on disposal of fixed assets	2,678,025	-
(Increase) decrease in assets:		
Utility services receivables	12,718	178,782
Due from RepMar	57,592	(65,000)
Due from ASPA	(167,500)	-
Employee receivables	613	(613)
Other receivables	(13,115)	(27,593)
Inventories	17,423	(44,565)
Increase (decrease) in liabilities:		
Accounts payable	498,926	(145,893)
Due to affiliates	36,719	314,639
Accrued liabilities	<u>(52,930)</u>	<u>197,224</u>
Net cash used for operating activities	<u>2,410,016</u>	<u>(617,096)</u>
Cash flows from noncapital financing activities:		
Operating subsidies (note 5)	498,000	550,000
(Decrease) increase in bank overdraft	(26,094)	68,179
Interest payments	<u>(3,499)</u>	<u>-</u>
Net cash provided by noncapital financing activities	<u>468,407</u>	<u>618,179</u>
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets	(3,686,140)	(2,440,706)
Capital grants (note 5)	1,326,763	2,423,707
Capital outlays (note 5)	<u>(524,521)</u>	<u>-</u>
Net cash used for capital and related financing activities	<u>(2,883,898)</u>	<u>(16,999)</u>
Net decrease in cash	(5,475)	(15,916)
Cash at beginning of year	<u>14,852</u>	<u>30,768</u>
Cash at end of year	\$ <u><u>9,377</u></u>	\$ <u><u>14,852</u></u>

See accompanying notes to financial statements.

# KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Notes to Financial Statements  
September 30, 2002 and 2001

## (1) Organization

The Kwajalein Atoll Joint Utilities Resources, Inc. (KAJUR), a component unit of the Republic of the Marshall Islands, was incorporated under the laws of the Republic of the Marshall Islands (RepMar) on September 1, 1990, to generate and distribute utilities on the island of Ebeye. On October 19, 1990, the Board of Directors of the Kwajalein Atoll Development Authority (KADA) authorized the transfer of \$14,075,046 in utility plant and equipment to KAJUR. KAJUR has sold 100,000 shares of \$1 par value common stock to KADA, which is the sole owner of common stock of KAJUR. KAJUR's financial statements are incorporated into the general purpose financial statements of RepMar as a component unit.

On October 28, 1999, RepMar and KADA awarded a twenty-four month management contract to the American Samoa Power Authority (ASPA) to assume operational control of KAJUR. The term of the contract is from November 2, 1999 to October 31, 2001 and conditions of the contract are included in the management contract between RepMar, KADA and ASPA. On November 9, 2001, the Cabinet of RepMar approved the extension of the management contract for an additional two years with the same conditions.

## (2) Summary of Significant Accounting Policies

The accounting policies of KAJUR 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. KAJUR has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

### 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

All 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 this fund are included in the balance sheets.

Stockholder's equity (i.e., net assets) is segregated into common stock and retained earnings components. Proprietary fund operating statements present increases and decreases in net total assets.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Notes to Financial Statements  
September 30, 2002 and 2001

(2) Summary of Significant Accounting Policies, Continued

Basis of Accounting, Continued

The accrual basis of accounting is utilized by proprietary funds. Under this method, revenues are recorded when earned and expenses recorded at the time liabilities are incurred. Revenues are recorded as billed to customers on a monthly cycle billing basis. At the end of each month, unbilled revenues are accrued for each cycle based on the most recent cycle billing.

Cash

For purposes of the balance sheets and statements of cash flows, cash is defined as cash on hand and cash in checking accounts. At September 30, 2002 and 2001, substantially all of KAJUR'S cash is with a non-federally insured bank.

Receivables and Allowance for Doubtful Accounts

KAJUR provides electric services to government agencies, businesses and individuals located on the island of Ebeye and bills for these services on a monthly basis. The allowance for doubtful 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. The allowance is established through a provision for bad debts charged to operating expenses. Receivables are not collateralized.

Inventories

Inventories of fuel and supplies are stated at the lower of cost (first-in, first-out) or market (net realizable value) at September 30, 2002 and 2001. Bulk fuel inventories are held for power plant use.

Plant and Equipment

Plant and equipment are stated at cost. Depreciation of plant and equipment is calculated on the straight-line method based on the estimated useful lives of the respective assets.

Compensated Absences

Vested or accumulated vacation leave is recorded as an expense and liability as the benefits accrue to employees. The liability as of September 30, 2002 and 2001, is \$102,667 and \$112,668, respectively, and is included within the balance sheets as accrued liabilities. Sick pay benefits vest at 50% and are recorded as an expense and liability as the benefits accrue to employees. The liability as of September 30, 2002 and 2001, is \$43,760 and \$40,875, respectively, and is included within the balance sheets as accrued liabilities.

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Notes to Financial Statements  
September 30, 2002 and 2001

(3) Risk Management

KAJUR 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. KAJUR has elected not to purchase commercial insurance for the risks of loss to which it is exposed. Instead, KAJUR 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. No losses as a result of these risks have occurred for the past three years.

(4) Plant and Equipment

A summary of plant and equipment as of September 30, 2002 and 2001, is as follows:

	<u>Estimated Useful Lives</u>	<u>2002</u>	<u>2001</u>
Plant and machinery	20 - 25 years	\$ 9,727,293	\$ 10,537,921
Distribution system	20 - 25 years	2,387,708	1,307,541
Water system	20 - 25 years	748,873	2,665,082
Other equipment	5 years	907,171	404,843
Plant and equipment in service		<u>13,771,045</u>	<u>14,915,387</u>
Less accumulated depreciation		<u>(5,704,752)</u>	<u>(6,960,019)</u>
Net plant and equipment in service		8,066,293	7,955,368
Construction-in-progress		<u>703,436</u>	<u>3,467,332</u>
Total plant and equipment, net		<u>\$ 8,769,729</u>	<u>\$ 11,422,700</u>

(5) Related Party Transactions

KAJUR is wholly owned by KADA, which was created on September 1, 1990, by a public law of RepMar. KADA is operated by a Board of Directors, who are appointed by the Cabinet of RepMar. KAJUR is therefore affiliated with all RepMar owned and affiliated entities.

KAJUR is affiliated with ASPA, a company with whom RepMar and KADA have contracted to manage its operations. Related management fee expense is incurred by RepMar.

KAJUR utilizes services from certain affiliated entities at substantially the same terms and conditions as those incurred from third parties. A summary of related party transactions for the years ended September 30, 2002 and 2001 and the related receivable and payable balances as of September 30, 2002 and 2001, are as follows:

	<u>2002</u>		
	<u>Expenses</u>	<u>Receivable</u>	<u>Payable</u>
American Samoa Power Authority (ASPA)	\$ 101,943	\$ 167,500	\$ 102,472
Marshall Islands Social Security Administration	66,948	-	225,034
Marshall Islands National Telecommunications Authority	65,635	-	9,745
RepMar	-	206,250	78,906
	<u>\$ 234,526</u>	<u>\$ 373,750</u>	<u>\$ 416,157</u>

KWAJALEIN ATOLL JOINT UTILITIES RESOURCES, INC.

Notes to Financial Statements  
September 30, 2002 and 2001

(5) Related Party Transactions, Continued

		<u>2001</u>	
	<u>Expenses</u>	<u>Receivable</u>	<u>Payable</u>
American Samoa Power Authority (ASPA)	\$ -	\$ -	\$ 49,521
Marshall Islands Social Security Administration	51,765	-	203,585
Marshall Islands National Telecommunications Authority	74,726	-	35,526
RepMar	<u>-</u>	<u>263,842</u>	<u>90,806</u>
	<u>\$ 126,491</u>	<u>\$ 263,842</u>	<u>\$ 379,438</u>

In accordance with the management contract between RepMar, KADA and ASPA, RepMar and KADA are required to make working capital available for KAJUR's operations. During the years ended September 30, 2002 and 2001, RepMar made \$498,000 and \$550,000, respectively, available for this purpose. These amounts are recorded as operating subsidies in the accompanying financial statements.

As of September 30, 2002 and 2001, KAJUR maintained demand deposit accounts with a related financial institution in the amount of \$9,077 and \$14,852, respectively.

On October 8, 1999, RepMar entered into a loan agreement with the Asian Development Bank for the Ebeye Health and Infrastructure Project. Under the terms of the loan agreement, loan funds are to be made available for the rehabilitation and expansion of the existing water supply and sewerage systems on Ebeye Island, and the upgrading of Ebeye's power generation and distribution system. During the years ended September 30, 2002 and 2001, RepMar made available to KAJUR loan funds in the amount of \$83,091 and \$2,189,600, respectively, as capital grants in accordance with the terms and conditions of the loan agreement. KAJUR is under no obligation to repay these amounts to RepMar.

KAJUR received additional capital grants from ASPA through grant awards from the U.S. Department of the Interior (DOI). During the years ended September 30, 2002 and 2001, \$868,672 and \$34,107, respectively, were received by KAJUR for the funding of equipment and infrastructure projects related to these grants. Additionally, during the years ended September 30, 2002 and 2001, KAJUR received \$375,000 and \$-0-, respectively, in matching funds related to these grants from RepMar. During the year ended September 30, 2002, KAJUR refurbished a school building funded by a DOI grant amounting to \$524,521 which was transferred to RepMar.

KAJUR received additional capital grants from RepMar during the years ended September 30, 2002 and 2001 in the amounts of \$-0- and \$200,000, respectively.

(6) Going Concern

KAJUR has incurred significant net operating losses since inception. KAJUR depends on KADA and RepMar for cash and noncash funding to continue its operations. Although KADA and RepMar have provided funding in the past, no formal agreement exists to provide funds in the future, except as described in note 5. The continuation of KAJUR's operations is dependent upon future financial support from KADA and RepMar and/or significant improvements in operations.