

TOBOLAR COPRA PROCESSING PLANT, INC.

FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT

YEARS ENDED SEPTEMBER 30, 2001 AND 2000



INDEPENDENT AUDITORS' REPORT

Board of Directors
Tobolar Copra Processing Plant, Inc.:

We have audited the accompanying balance sheets of Tobolar Copra Processing Plant, Inc. (TCPPI), a component unit of the Republic of the Marshall Islands, as of September 30, 2001 and 2000, and the related statements of earnings (loss) and deficit and cash flows for the years then ended. These financial statements are the responsibility of the management of TCPPI. Our responsibility is to express an opinion on these financial statements based on our audits.

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.

In our opinion, such financial statements present fairly, in all material respects, the financial position of TCPPI as of September 30, 2001 and 2000, and the results of its operations and its cash flows for the years then ended 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 April 4, 2002, on our consideration of TCPPI'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.

A handwritten signature in cursive script that reads "Deloitte & Touche".

April 4, 2002

TOBOLAR COPRA PROCESSING PLANT, INC.

Balance Sheets
September 30, 2001 and 2000

	<u>2001</u>	<u>2000</u>
<u>ASSETS (note 5)</u>		
Current assets:		
Cash	\$ <u>50</u>	\$ <u>450</u>
Receivables:		
Affiliate (note 6)	650,000	132,071
Trade	86,067	20,967
Employees	14,544	10,626
Advances to copra buyers	<u>13,334</u>	<u>13,334</u>
	763,945	176,998
Allowance for doubtful accounts	<u>(30,973)</u>	<u>(22,000)</u>
	<u>732,972</u>	<u>154,998</u>
Inventories (note 3)	<u>1,028,354</u>	<u>535,516</u>
Total current assets	1,761,376	690,964
Fixed assets, net (note 4)	1,096,062	655,865
Deposit	<u>-</u>	<u>75,000</u>
	<u>\$ 2,857,438</u>	<u>\$ 1,421,829</u>
<u>LIABILITIES AND STOCKHOLDER'S EQUITY (DEFICIENCY)</u>		
Current liabilities:		
Bank overdraft	\$ 42,886	\$ 4,174
Notes payable (notes 5 and 9)	1,100,000	1,100,000
Accounts payable	106,356	73,726
Payable to affiliates (note 6)	636,211	556,368
Advances from RepMar (note 6)	500,000	500,000
Accrued interest	48,016	64,415
Other payables	<u>108,194</u>	<u>10,743</u>
Total current liabilities	<u>2,541,663</u>	<u>2,309,426</u>
Stockholder's equity (deficiency):		
Common stock, \$1 par value, 2,500,000 shares authorized, 1,931,596 shares paid-in and unissued	1,931,596	1,931,596
Deficit	<u>(1,236,728)</u>	<u>(2,440,100)</u>
	694,868	(508,504)
Treasury stock, at cost, 379,093 shares	<u>(379,093)</u>	<u>(379,093)</u>
Total stockholder's equity (deficiency)	<u>315,775</u>	<u>(887,597)</u>
Commitment and contingencies (note 9)		
	<u>\$ 2,857,438</u>	<u>\$ 1,421,829</u>

See accompanying notes to financial statements.

TOBOLAR COPRA PROCESSING PLANT, INC.

Statements of Earnings (Loss) and Deficit
Years Ended September 30, 2001 and 2000

	<u>2001</u>	<u>2000</u>
Sales (note 8)	\$ 208,822	\$ 1,252,551
Cost of copra products manufactured and sold	<u>1,753,565</u>	<u>2,666,804</u>
Gross loss	<u>(1,544,743)</u>	<u>(1,414,253)</u>
General and administrative expenses:		
Salaries and wages	67,696	55,961
Management fee (note 9)	50,000	50,000
Insurance	45,136	40,975
Communications	9,511	8,098
Bad debts	8,973	-
Professional fees	6,856	2,797
Office supplies	3,414	3,036
Miscellaneous	<u>14,590</u>	<u>8,084</u>
Total general and administrative expenses	<u>206,176</u>	<u>168,951</u>
Loss from operations	<u>(1,750,919)</u>	<u>(1,583,204)</u>
Other income (expense):		
Operating subsidies from RepMar (notes 6 and 9)	1,849,964	845,000
Capital contributions (note 6)	1,200,000	-
Interest expense	<u>(95,673)</u>	<u>(124,987)</u>
Total other income (expense), net	<u>2,954,291</u>	<u>720,013</u>
Net earnings (loss)	1,203,372	(863,191)
Deficit at beginning of year	<u>(2,440,100)</u>	<u>(1,576,909)</u>
Deficit at end of year	\$ <u>(1,236,728)</u>	\$ <u>(2,440,100)</u>

See accompanying notes to financial statements.

TOBOLAR COPRA PROCESSING PLANT, INC.

Statements of Cash Flows
Years Ended September 30, 2001 and 2000

	<u>2001</u>	<u>2000</u>
Cash flows from operating activities:		
Loss from operations	\$ (1,750,919)	\$ (1,583,204)
Adjustments to reconcile loss from operations to net cash used for operating activities:		
Depreciation	58,928	78,345
Bad debts	8,973	-
(Increase) decrease in assets:		
Receivables:		
Affiliate	132,071	(132,071)
Trade	(65,100)	(1,937)
Employees	(3,918)	5,629
Inventories	(492,838)	375,500
Increase (decrease) in liabilities:		
Accounts payable	32,630	52,958
Payable to affiliates	79,843	431,871
Other payables	<u>97,451</u>	<u>(2,700)</u>
Net cash used for operating activities	<u>(1,902,879)</u>	<u>(775,609)</u>
Cash flows from noncapital financing activities:		
Operating subsidies from RepMar (notes 6 and 9)	1,849,964	845,000
Net borrowings under bank overdraft facility	38,712	3,238
Interest paid on short-term borrowings	<u>(112,072)</u>	<u>(98,919)</u>
Net cash provided by noncapital financing activities	<u>1,776,604</u>	<u>749,319</u>
Cash flows from capital and related financing activities:		
Deposit for acquisition of capital assets	-	(75,000)
Acquisition of capital assets	(424,125)	-
Contributions from RepMar (note 6)	<u>550,000</u>	<u>-</u>
Net cash provided by (used for) capital and related financing activities	<u>125,875</u>	<u>(75,000)</u>
Net decrease in cash	(400)	(101,290)
Cash at beginning of year	<u>450</u>	<u>101,740</u>
Cash at end of year	\$ <u><u>50</u></u>	\$ <u><u>450</u></u>
Noncash investing, capital, and financing activities (note 6):		
Noncash increase in receivable from affiliates	\$ (650,000)	\$ -
Noncash increase in capital contributions	<u>650,000</u>	<u>-</u>
	\$ <u><u>-</u></u>	\$ <u><u>-</u></u>

See accompanying notes to financial statements.

TOBOLAR COPRA PROCESSING PLANT, INC.

Notes to Financial Statements
September 30, 2001 and 2000

(1) Organization

Tobolar Copra Processing Plant, Inc. (TCPPI) was granted a corporate charter on August 13, 1977, under the laws of the Trust Territory of the Pacific Islands, as subsequently adopted by the Republic of the Marshall Islands (RepMar). TCPPI was established for the primary purpose of engaging in the production and processing of copra products on Majuro Atoll. TCPPI is funded, in part, through operational appropriations from the Nitijela (the RepMar Legislature). TCPPI's principal lines of business are copra oil, copra cake and soap products. The principal market for the copra oil and copra cake are companies and farmers located in the United States. Sales are based on the world market price at the time of sale for the respective products. Soap products are sold primarily to customers in the Marshall Islands. Raw copra is purchased at a price set by the Board of Directors of TCPPI (the Board).

TCPPI's articles of incorporation authorize the issuance of 2,500,000 shares of \$1 par value common stock. The Marshall Islands Development Authority (MIDA), a component unit of RepMar, owns 1,552,503 of these shares and TCPPI retains 379,093 shares in treasury. Share certificates have not been issued as of September 30, 2001.

TCPPI's financial statements are incorporated into the general purpose financial statements of RepMar as a component unit.

(2) Summary of Significant Accounting Policies

The accounting policies of TCPPI 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. TCPPI 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

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 on the balance sheets. Proprietary fund operating statements present increases and decreases in net total assets.

TOBOLAR COPRA PROCESSING PLANT, INC.

Notes to Financial Statements
September 30, 2001 and 2000

(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 are recorded at the time liabilities are incurred.

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. TCPPI is exempt from this tax.

Cash

For purposes of the balance sheets and the statements of cash flows, cash is defined as cash on hand and cash held in demand deposits. As of September 30, 2001 and 2000, cash was \$50 and \$450, respectively, and the corresponding bank balance was \$7,863 and \$5,008, respectively, which is maintained in one bank subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2001 and 2000, bank deposits were fully FDIC insured.

Receivables

All receivables are due from companies and farmers in the United States and copra buyers and others, including employees and an affiliate (see note 6), within the Republic of the Marshall Islands. 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 uncollectible receivables charged to expense.

Inventories

Inventories consist of raw copra, copra oil, copra cake, and soap and materials. Raw copra is valued at the lower of cost (first-in, first-out method) or market value. Copra oil, copra cake, and soap and materials are valued at the lower of production cost, which includes raw copra, direct labor and factory overhead, or market (net realizable value).

Fixed Assets

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

TCPPI capitalizes interest expense in order to recognize all costs associated with construction projects based on TCPPI's weighted average borrowing rate. During the years ended September 30, 2001 and 2000, \$18,285 and \$-0-, respectively, of eligible interest expense was capitalized.

TOBOLAR COPRA PROCESSING PLANT, INC.

Notes to Financial Statements
September 30, 2001 and 2000

(3) Inventories

Inventories at September 30, 2001 and 2000, consist of the following:

	<u>2001</u>	<u>2000</u>
Copra oil	\$ 807,346	\$ 375,605
Raw copra	179,524	54,741
Soap and materials	40,343	52,291
Copra cake	<u>1,141</u>	<u>52,879</u>
	<u>\$ 1,028,354</u>	<u>\$ 535,516</u>

(4) Fixed Assets

Fixed assets at September 30, 2001 and 2000, consist of the following:

	<u>Estimated Useful Lives</u>	<u>2001</u>	<u>2000</u>
Building and structure	10 - 20 years	\$ 1,888,115	\$ 1,888,115
Equipment	5 - 10 years	1,192,152	1,173,867
Other	3 - 5 years	<u>58,264</u>	<u>58,264</u>
		3,138,531	3,120,246
Less accumulated depreciation		<u>(2,523,309)</u>	<u>(2,464,381)</u>
		615,222	655,865
Construction work in progress		<u>480,840</u>	<u>-</u>
		<u>\$ 1,096,062</u>	<u>\$ 655,865</u>

(5) Notes Payable

A schedule of TCPPI's short-term borrowings as of September 30, 2001 and 2000, is as follows:

	<u>2001</u>	<u>2000</u>
Bank credit line of \$1,000,000, with various terms, due on various dates, interest at bank's reference rate plus 2.5% (9% and 12% as of September 30, 2001 and 2000, respectively), collateralized by a general security agreement over all assets of TCPPI and a guarantee from RepMar.	\$ 1,000,000	\$ 1,000,000
Note payable to the Marshall Islands Ports Authority of \$50,000, advanced on January 23, 1998, due September 30, 1998, interest at 10%, unsecured (see note 9).	50,000	50,000

TOBOLAR COPRA PROCESSING PLANT, INC.

Notes to Financial Statements
September 30, 2001 and 2000

(5) Notes Payable, Continued

	<u>2001</u>	<u>2000</u>
Note payable to the Marshall Islands Ports Authority of \$50,000, advanced on February 27, 1998, due September 30, 1998, interest at 10%, unsecured (see note 9).	50,000	50,000
	<u>\$ 1,100,000</u>	<u>\$ 1,100,000</u>

(6) Related Party Transactions

TCPPI is wholly owned by MIDA, which was created on September 13, 1984, by a public law of RepMar. MIDA is operated by a Board of Directors, who are appointed by the Cabinet of RepMar. TCPPI is therefore affiliated with all RepMar-owned and affiliated entities, including the Marshall Islands Ports Authority (MIPA). As of September 30, 2001 and 2000, TCPPI has notes payable to MIPA aggregating \$100,000 (see note 5).

TCPPI is affiliated with Pacific International, Inc. (PII), a company with whom TCPPI has contracted to manage its operations (see note 9).

PII is also TCPPI's agent for copra cake sales to customers in the United States, where only United States registered corporations, which includes PII, are allowed to sell copra cake. PII remits payments to TCPPI for such copra cake sales once PII receives payments from the customers in the United States. Therefore, these copra cake sales are not considered to be sales to PII. Total copra cake sales to customers in the United States for the years ended September 30, 2001 and 2000 amounted to \$177,692 and \$132,071, respectively, and the related receivable from PII as of September 30, 2001 and 2000 amounted to \$-0- and \$132,071, respectively.

During the years ended September 30, 2001 and 2000, the operations of TCPPI were funded by appropriations, totaling \$1,849,964 and \$845,000, respectively, from the Nitijela of RepMar (see note 9).

During the year ended September 30, 2001, TCPPI received a \$1,200,000 development grant from RepMar for capital improvement projects. As of September 30, 2001, TCPPI has received \$550,000 of this grant with the remaining balance of \$650,000 being recorded as a receivable from affiliate.

During the year ended September 30, 1999, TCPPI obtained advances from RepMar, in accordance with Cabinet Minute C.M. 154(99), of \$500,000 to permit continued purchase of copra and the operation of the facility. No interest rate has been determined for these advances.

TCPPI utilizes services from its affiliates at the same rates charged to third parties and at substantially more favorable terms than those afforded to third parties. A summary of related party transactions is as follows:

TOBOLAR COPRA PROCESSING PLANT, INC.

Notes to Financial Statements
September 30, 2001 and 2000

(6) Related Party Transactions, Continued

	<u>2001</u>	
	<u>Expenses</u>	<u>Payables</u>
Pacific International, Inc. and affiliates	\$ 619,623	\$ 351,233
Bank of Marshall Islands	346,583	189,274
Marshalls Energy Company, Inc.	48,148	37,438
Marshall Islands Social Security Administration	32,605	8,901
Marshall Islands Ports Authority	1,525	35,114
Other	<u>7,483</u>	<u>14,251</u>
	<u>\$ 1,055,967</u>	<u>\$ 636,211</u>
	 <u>2000</u>	
	<u>Expenses</u>	<u>Payables</u>
Pacific International, Inc. and affiliates	\$ 838,543	\$ 447,539
Marshalls Energy Company, Inc.	94,469	48,042
Marshall Islands Social Security Administration	17,556	16,745
Marshall Islands Ports Authority	11,926	24,682
Other	<u>64,422</u>	<u>19,360</u>
	<u>\$ 1,026,916</u>	<u>\$ 556,368</u>

During the years ended September 30, 2001 and 2000, all revenues were derived from entities and individuals not considered to be affiliates of TCPPI.

(7) Management

TCPPI is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; error and omissions; injuries to employees; and natural disasters. TCPPI has elected to purchase commercial insurance from independent third parties for the risks of loss to which it is exposed. Settled claims from these risks have not exceeded commercial insurance coverage for the past three years.

(8) Significant Customers

Approximately 85% and 97% of total sales were earned from one and two customers during the years ended September 30, 2001 and 2000, respectively.

(9) Commitment and Contingencies

Commitment

A five-year management agreement was renewed effective January 1, 1995 with PII, wherein PII is to manage the operations of TCPPI for an annual fee of \$50,000, adjusted each year by the change in the United States consumer price index as of December 31. This agreement expired on December 31, 1999 and has not been renewed. PII continues to manage TCPPI at the discretion of the Board on a monthly basis, while a new agreement is considered by the Board.

TOBOLAR COPRA PROCESSING PLANT, INC.

Notes to Financial Statements
September 30, 2001 and 2000

(9) Commitment and Contingencies, Continued

Contingencies

TCPPI has suffered recurring operating losses and has a significant working capital deficiency and stockholder's deficiency at September 30, 2001 that raise substantial doubt about its ability to continue as a going concern. TCPPI depends on RepMar for cash funding to continue its operations. For the years ended September 30, 2001 and 2000, TCPPI received operating subsidies of \$1,849,964 and \$845,000, respectively, from the Nitijela of RepMar. In addition, TCPPI obtained cash contributions from RepMar of \$550,000 during the year ended September 30, 2001 (see note 6). Although RepMar has provided funding in the past, TCPPI does not have a formal agreement with RepMar to provide funds in the future. In the event that operating subsidies from RepMar are reduced or eliminated, management of TCPPI will reduce the price at which raw copra is purchased.

Public Law 1992-2 was enacted on February 17, 1992. This law established the Tobolar Copra Processing Authority (the Authority). The objectives of the Authority include assuming responsibility for the management, operation and maintenance of all aspects of copra processing for RepMar. The Authority is specifically authorized and directed by Public Law 1992-2 to enter into appropriate arrangements with TCPPI for the assumption of all rights and title to any and all assets, equipment, contracts, liabilities, rights, obligations, functions, powers, etc., that TCPPI may have or control, including all rights to the use of the name "Tobolar". This assumption will occur once TCPPI has been liquidated. Although no steps have been taken at this date to liquidate TCPPI, it is anticipated that such action will be taken.

The real property on which the copra processing plant and related facilities are located is leased by MIDA from RepMar. No provision has yet been made for the sublease to TCPPI of the real property on which the processing plant is located. No rental payments for the use of the real property or warehouses are anticipated.

TCPPI is currently in default of repayment terms of two notes payable to the Marshall Islands Ports Authority (MIPA) (see note 5). In accordance with the associated promissory notes, in the event of default, the total sum of principal and interest shall become immediately due and payable at the option of MIPA, without notice. In the event of commencement of suit to enforce payment of these notes payable, TCPPI will be liable for an additional sum equal to 5% of the total amount due. As of September 30, 2001, TCPPI has not received written notice of commencement of suit from MIPA with respect to TCPPI's default.

(10) Subsequent Event

During the period October 1, 2001 through April 4, 2002, TCPPI has received payments from RepMar amounting to \$1,104,235.