

MAJURO WATER AND SEWER COMPANY, INC.

**(A COMPONENT UNIT OF THE
REPUBLIC OF THE MARSHALL ISLANDS)**

**FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED SEPTEMBER 30, 2016 AND 2015

MAJURO WATER AND SEWER COMPANY, INC.
(A COMPONENT UNIT OF THE REPUBLIC OF THE MARSHALL ISLANDS)

Years Ended September 30, 2016 and 2015
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INDEPENDENT AUDITORS' REPORT

Board of Directors
Majuro Water and Sewer Company, Inc.:

Report on the Financial Statements

We have audited the accompanying financial statements of Majuro Water and Sewer Company, Inc. (MWSC), a component unit of the Republic of the Marshall Islands, which comprise the statements of net position as of September 30, 2016 and 2015, and the related statements of revenues, expenses and changes in net position and of cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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 from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Majuro Water and Sewer Company, Inc. as of September 30, 2016 and 2015, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis-of-Matter

Going Concern

The accompanying financial statements have been prepared assuming that MWSC will continue as a going concern. As discussed in Note 8 to the financial statements, MWSC's recurring losses from operations raise substantial doubt about its ability to continue as a going concern. Management's plans concerning these matters are also discussed in Note 8 to the financial statements. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

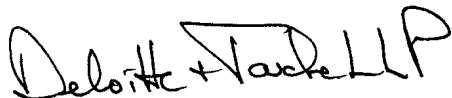
Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 3 through 6 be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated June 2, 2017, on our consideration of MWSC's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering MWSC's internal control over financial reporting and compliance.



June 2, 2017

MAJURO WATER AND SEWER COMPANY, INC.
(A COMPONENT UNIT OF THE REPUBLIC OF THE MARSHALL ISLANDS)

Management's Discussion and Analysis
Years Ended September 30, 2016 and 2015

FINANCIAL HIGHLIGHTS

MWSC's net position decreased by \$305,852 in 2016 compared to a decrease of \$142,646 in 2015. The significant decrease was mainly due to an increase in operational expenses and a reduction in contributions from RepMar.

Total operating revenues increased by \$304,727 from \$1,367,055 in 2015 to \$1,671,782 in 2016. Within the operating revenues, utility billings increased by \$238,260 from \$943,930 in 2015 to \$1,182,190 in 2016. Hook-ups and delivery billings increased by \$46,354 from \$408,746 in 2015 to \$455,100 in 2016. The significant increase in revenue is due to the increase in customer base and demand. Furthermore, there has been an additional \$369,621 allowance provided for uncollectable accounts in 2016 compared with \$310,560 in 2015.

Operating expenses increased by \$242,649 from \$1,618,071 in 2015 to \$1,860,720 in 2016. The main contributing factor for the increase in operating expenses is an increase in salaries and wages and benefits of \$29,173, electricity of \$16,042, petroleum, oil and lubricants of \$10,977, depreciation and amortization of \$36,768, spare parts of \$62,244, travel of \$1,439, office supplies of \$3,178, communications of \$6,693, repairs and maintenance of \$11,674, freight and handling of \$31,136 and miscellaneous of \$76,274, offset by a decrease in contractual services of \$26,821 and insurance of \$16,128.

The Statement of Cash Flows net increase in cash was \$70,193 in 2016 compared with net increase of \$105,681 in 2015. The operating activities of MWSC resulted in a net cash outflow of \$111,107 in 2016 compared to a net cash outflow of \$19,535 for 2015. The increase in net cash outflows from operations was offset to a degree by net cash provided from noncapital financing activities of \$149,458 in 2016.

FINANCIAL ANALYSIS OF MWSC

The Statement of Net Position and the Statement of Revenues, Expenses and Changes in Net Position provide an indication of MWSC's financial condition. MWSC's net position reflects the difference between assets and liabilities. An increase in net position over time typically indicates an improvement in financial condition.

A Summary of MWSC's Statements of Net Position is presented below:

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Current and other assets	\$ 1,125,681	\$ 939,114	\$ 878,508
Capital assets	<u>1,138,340</u>	<u>1,209,568</u>	<u>1,167,321</u>
Total assets	<u>2,264,021</u>	<u>2,148,682</u>	<u>2,045,829</u>
Current liabilities	<u>2,399,990</u>	<u>1,978,799</u>	<u>1,733,300</u>
Net position:			
Net investment in capital assets	1,138,340	1,209,568	1,167,321
Restricted	155,083	310,222	177,554
Unrestricted	<u>(1,429,392)</u>	<u>(1,349,907)</u>	<u>(1,032,346)</u>
Total net position	\$ <u>(135,969)</u>	\$ <u>169,883</u>	\$ <u>312,529</u>

As indicated above, total assets increased by \$115,339 from \$2,148,682 in 2015 to \$2,264,021 in 2016.

MAJURO WATER AND SEWER COMPANY, INC.

Management's Discussion and Analysis Years Ended September 30, 2016 and 2015

Total liabilities reflects an increase of \$421,191 from \$1,978,799 in 2015 to \$2,399,990 in 2016. The net position decreased by \$305,852 from a positive \$169,883 in 2015 to a negative \$135,969 in 2016. There were no non-current liabilities as of September 30, 2016, 2015 and 2014.

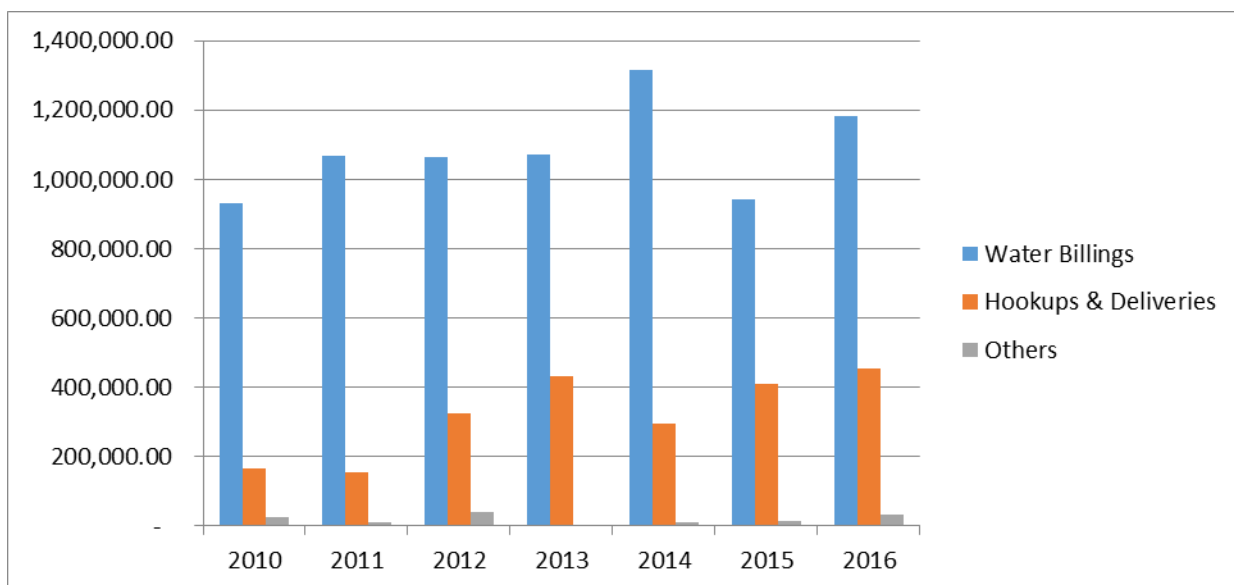
A summary of MWSC's Statements of Revenues, Expenses, and Changes in Net Position is presented below:

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Revenues:			
Operating revenues	\$ 1,302,161	\$ 1,056,495	\$ 1,157,746
Non-operating	<u>150,000</u>	<u>300,000</u>	<u>300,000</u>
Total revenues	<u>1,452,161</u>	<u>1,356,495</u>	<u>1,457,746</u>
Expenses:			
Operating expenses	1,860,720	1,618,071	1,639,836
Non-operating expenses	<u>542</u>	<u>1,487</u>	<u>616</u>
Total expenses	<u>1,861,262</u>	<u>1,619,558</u>	<u>1,640,452</u>
Capital contributions	<u>103,249</u>	<u>120,417</u>	<u>562,568</u>
Change in net position	\$ <u>(305,852)</u>	\$ <u>(142,646)</u>	\$ <u>379,862</u>

The Statement of Revenue, Expenses and Changes in Net Position identifies that various revenue and expense items that impacted the change in net position. As indicated above, MWSC's operating revenues increased by \$245,666 from \$1,056,495 in 2015 to \$1,302,161 in 2016. An increase in 2016 revenue consists of utility billings of \$238,260, hook-up and delivery sales of \$46,354 and an increase in bad debts expense of \$59,061.

Non-operating revenues represent operating subsidies and grants received. RepMar discontinued financial support to assist MWSC with the payment of the monthly electricity bills owed to MEC. The subsidy of \$150,000 received from RepMar in 2016 for Capital Improvement Projects was to acquire spare parts. The grant received from the Asian Development Bank (ADB) in 2016 of \$103,249 was to procure safety gear, equipment and a vehicle.

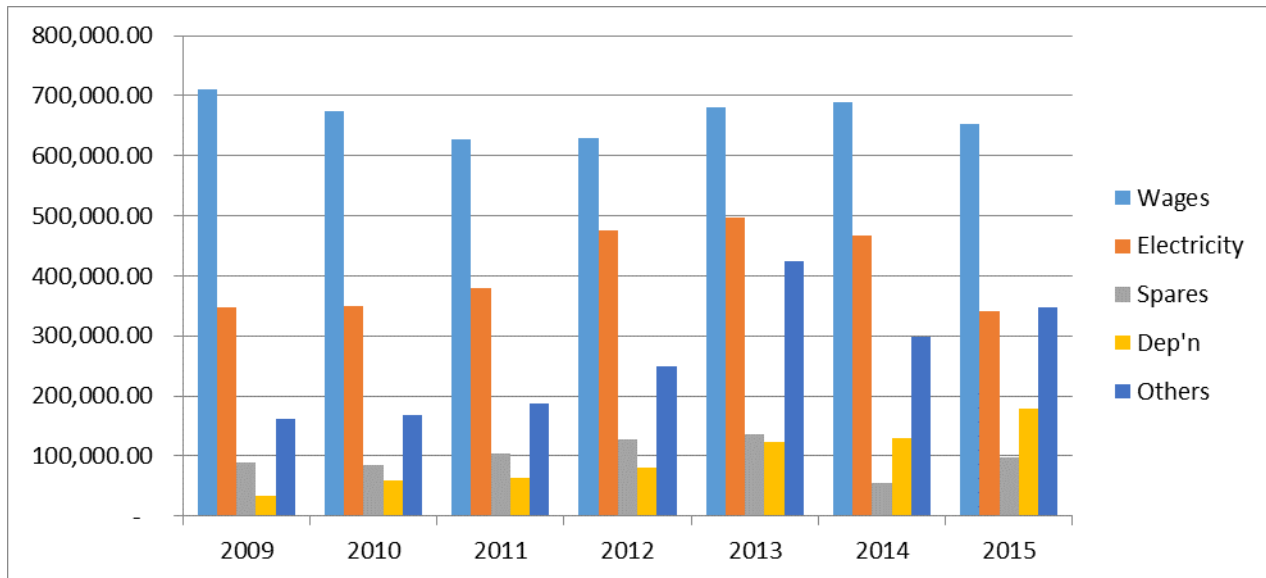
The graph below shows the major components of operating revenues for 2016 compared with the years 2010 through 2015.



MAJURO WATER AND SEWER COMPANY, INC.

Management's Discussion and Analysis
Years Ended September 30, 2016 and 2015

Operating expenses increased by \$242,649 to \$1,860,720 in 2016 from \$1,618,071 in 2015. The graph below shows the major components of operating expenses for 2016 compared with the years 2010 to 2015.



CAPITAL ASSETS

Net capital assets decreased by \$71,228 in 2016 as a result of the acquisition of a vehicle at \$32,278, machinery and equipment of \$89,658 and office equipment of \$22,271 less depreciation for the year of \$215,435.

MWSC received capital contributions of \$103,249 in 2016. A contribution was received of \$103,249 from the Asian Development Bank (ADB) to procure safety gear, equipment and a vehicle. Please refer to note 4 to the financial statements for additional information on MWSC's capital assets.

FUTURE OUTLOOK ON SUSTAINABILITY

Future sustainability for MWSC will require four major changes.

1. Increase in our customer base. Currently, we have approximately 1,000 water customers out of a possible 3,214 connections. MWSC needs to connect all households within the DUD to our sewer collection system (2,383 out of 2,490 households connected). Increasing our customer base will better spread the operating costs of providing both sanitation and water services to Majuro. It will also mean a significant increase in operating revenue.
2. Renovation and repair of our water and sanitation assets to improve reliability, and consequently, service to our customers. Without these improvements to standby, reliability of operations and monitoring to understand our business performance. The risks of failure of service are too high.
3. Institutional strengthening is a must for a sustainable business. MWSC will need to improve its institutional structure to meet the requirements of the RMI-SOE Act, which outlines a governance framework, and fiscal aims of the business.
4. Tariff reform to recognize the cost of operating the business.

MAJURO WATER AND SEWER COMPANY, INC.

Management's Discussion and Analysis
Years Ended September 30, 2016 and 2015

MWSC's Focus in the Coming Years

MWSC's focus in the coming year will be four fold:

1. Develop a long term (20 Years) Strategic Plan for the business, along with a 5 Year Development Plan in compliance with the commitments of the National Strategic Plan and the SOE Act.
2. Obtain funding to initiate replacement of the existing sewage ocean outfall.
3. Establish the most appropriate arrangements to ensure water security for Majuro and initiate plans for the required facilities to source funding for the works.
4. Renovate and repair existing water, sewer, and salt-water assets, provided funding is made available.

Management's Discussion and Analysis for the year ended September 30, 2015 is set forth in MWSC's report on the audit of financial statements, which is dated November 14, 2016. Such Management's Discussion and an Analysis explains the major factors impacting the 2015 financial statements and can be obtained from MWSC's General Manager via the contact information below.

ADDITIONAL FINANCE INFORMATION

The discussion and analysis is designed to provide MWSC's financial operations and financial condition. Should the reader have questions regarding the information included in this report or wish to request additional financial information, please contact the Majuro Water and Sewer Company, Inc. Manager at P.O. Box 1751 Majuro, MH 96960.

MAJURO WATER AND SEWER COMPANY, INC.
(A COMPONENT UNIT OF THE REPUBLIC OF THE MARSHALL ISLANDS)

Statements of Net Position
September 30, 2016 and 2015

<u>ASSETS</u>	<u>2016</u>	<u>2015</u>
Current assets:		
Cash	\$ 325,306	\$ 255,113
Receivables:		
Utility	1,488,544	1,764,872
Affiliates	157,615	202,947
Grants	-	72,800
Other	92,477	26,913
	<u>1,738,636</u>	<u>2,067,532</u>
Less allowance for doubtful accounts	<u>(1,451,773)</u>	<u>(1,705,988)</u>
	<u>286,863</u>	<u>361,544</u>
Inventory	437,321	244,464
Prepaid expenses	76,191	77,993
Total current assets	1,125,681	939,114
Capital assets, net	<u>1,138,340</u>	<u>1,209,568</u>
	<u>\$ 2,264,021</u>	<u>\$ 2,148,682</u>
 <u>LIABILITIES AND NET POSITION</u> 		
Current liabilities:		
Accounts payable	\$ 137,125	\$ 84,559
Payable to affiliates	2,214,547	1,839,854
Other accrued liabilities	48,318	54,386
Total current liabilities	<u>2,399,990</u>	<u>1,978,799</u>
Commitment and contingency		
Net position:		
Net investment in capital assets	1,138,340	1,209,568
Restricted	155,083	310,222
Unrestricted	<u>(1,429,392)</u>	<u>(1,349,907)</u>
Total net position	<u>(135,969)</u>	<u>169,883</u>
	<u>\$ 2,264,021</u>	<u>\$ 2,148,682</u>

See accompanying notes to financial statements.

MAJURO WATER AND SEWER COMPANY, INC.
(A COMPONENT UNIT OF THE REPUBLIC OF THE MARSHALL ISLANDS)

Statements of Revenues, Expenses and Changes in Net Position
Years Ended September 30, 2016 and 2015

	2016	2015
Operating revenues:		
Utility billings	\$ 1,182,190	\$ 943,930
Hook-up and deliveries	455,100	408,746
Other	34,492	14,379
	1,671,782	1,367,055
Less uncollectable accounts	(369,621)	(310,560)
	1,302,161	1,056,495
Operating expenses:		
Salaries, wages and benefits	681,439	652,266
Electricity	356,818	340,776
Depreciation and amortization	215,435	178,667
Spare parts	159,985	97,741
Petroleum, oil and lubricants	61,407	50,430
Freight and handling	41,851	10,715
Travel	41,653	40,214
Office supplies	32,260	29,082
Repairs and maintenance	32,178	20,504
Communications	29,801	23,108
Contractual services	28,185	55,006
Insurance	24,813	40,941
Miscellaneous	154,895	78,621
	1,860,720	1,618,071
Operating loss	(558,559)	(561,576)
Nonoperating revenues (expenses):		
Contributions from RepMar	150,000	300,000
Penalties and interest	(542)	(1,487)
	149,458	298,513
Capital contributions:		
Other grants and contributions	103,249	120,417
Change in net position	(305,852)	(142,646)
Net position at beginning of year	169,883	312,529
Net position at end of year	\$ (135,969)	\$ 169,883

See accompanying notes to financial statements.

MAJURO WATER AND SEWER COMPANY, INC.
(A COMPONENT UNIT OF THE REPUBLIC OF THE MARSHALL ISLANDS)

Statements of Cash Flows
Years Ended September 30, 2016 and 2015

	2016	2015
Cash flows from operating activities:		
Cash received from customers	\$ 1,304,042	\$ 1,223,254
Cash payments to suppliers for goods and services	(766,030)	(522,248)
Cash payments to employees for services	(649,119)	(720,541)
Net cash used for operating activities	(111,107)	(19,535)
Cash flows from noncapital financing activities:		
Contributions received from RepMar	150,000	300,000
Penalties and interest paid	(542)	(1,487)
Net cash provided by noncapital financing activities	149,458	298,513
Cash flows from capital and related financing activities:		
Capital contributions received	72,800	-
Acquisition of capital assets	(40,958)	(173,297)
Net cash provided by (used for) capital and related financing activities	31,842	(173,297)
Net change in cash	70,193	105,681
Cash at beginning of year	255,113	149,432
Cash at end of year	\$ 325,306	\$ 255,113
Reconciliation of operating loss to net cash used for operating activities:		
Operating loss	\$ (558,559)	\$ (561,576)
Adjustments to reconcile operating loss to net cash used for operating activities:		
Depreciation and amortization	215,435	178,667
Bad debts	369,621	310,560
(Increase) decrease in assets:		
Receivables:		
Utility	(347,508)	(511,886)
Affiliates	45,332	347,779
Other	(65,564)	20,305
Inventory	(192,857)	2,237
Prepaid expenses	1,802	(51,120)
Increase (decrease) in liabilities:		
Accounts payable	35,145	(40,468)
Payable to affiliates	374,693	354,242
Other accrued liabilities	11,353	(68,275)
Net cash used for operating activities	\$ (111,107)	\$ (19,535)
Summary disclosure of noncash financing activities:		
Capital assets donated by foreign donors:		
Capital assets	\$ (103,249)	\$ (47,617)
Capital contributions	103,249	47,617
	\$ -	\$ -

See accompanying notes to financial statements.

MAJURO WATER AND SEWER COMPANY, INC.
(A COMPONENT UNIT OF THE REPUBLIC OF THE MARSHALL ISLANDS)

Notes to Financial Statements
September 30, 2016 and 2015

(1) Organization

Majuro Water and Sewer Company, Inc. (MWSC) was granted a corporate charter by the Cabinet of the Republic of the Marshall Islands (RepMar) on January 26, 1989. MWSC's principal lines of business are predominantly the collection and distribution of fresh water and wastewater. The principal markets for the collection and distribution of fresh water and wastewater are government agencies, businesses and residential customers located on the atoll of Majuro.

An exclusive franchise to construct, maintain and operate the fresh water, waste water and sewer system within Majuro Atoll was granted to MWSC by RepMar on March 9, 1989. Simultaneously, RepMar leased to MWSC, at no cost, the Majuro Atoll fresh water, waste water and sewer system. The term of both the lease and the franchise was for a ten year period commencing on March 9, 1989, and was to continue thereafter unless terminated by either party six months after written notice to the other.

On February 19, 2003, RepMar and MWSC entered into a Water and Sewer Franchise Agreement (the Agreement) to provide water and sewer service to the atoll of Majuro. The Agreement incorporates a lease agreement for MWSC to lease from RepMar the water and sewer system for a period of ten years at a rate of \$100,000 per annum, commencing three years after the lease is in effect (February 19, 2006). The Agreement also forgave loans related to the construction of the water and sewer system and transferred the water system infrastructure to RepMar. RepMar and MWSC elected to record the forgiveness of these loans, and the related transfer of the water and sewer system asset from MWSC to RepMar, during the year ended September 30, 2002.

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

(2) Summary of Significant Accounting Policies

GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, which was subsequently amended by GASB Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus*, and modified by GASB Statement No. 38, *Certain Financial Statement Note Disclosures*, establishes 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 modifies certain other financial statement disclosure requirements.

To conform to the requirements of GASB Statement 34, equity is presented in the following net position categories:

- Net investment in capital assets - capital assets, net of accumulated depreciation, plus construction or improvement of those assets.
- Restricted net position - resources in which MWSC is legally or contractually obligated to spend resources in accordance with restrictions either externally imposed by creditors, grantors, contributors, and the like, or imposed by law.
- Unrestricted - net position that is not subject to externally imposed stipulations. Unrestricted net position 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.

MAJURO WATER AND SEWER COMPANY, INC.
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Notes to Financial Statements
September 30, 2016 and 2015

(2) Summary of Significant Accounting Policies, Continued

Estimates

The preparation of financial statements in accordance 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 deferred outflows of resources, liabilities and deferred inflows of resources, 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 deferred outflows of resources, and liabilities and deferred inflows of resources associated with the operation of the fund are included in the statements of net position. Proprietary fund operating statements present increases and decreases in net position. 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. MWSC considers utility revenues and costs that are directly related to utility operations to be operating revenues and expenses. Revenues and expenses related to financing and other activities are reflected as nonoperating.

Operating and Non-Operating Revenue and Expenses

Operating revenues and expenses generally result directly from the operation and maintenance of MWSC. Non-operating revenues and expenses result from capital and related financing activities as well as certain other non-recurring income and expense items. Other capital grants and contributions for the years ended September 30, 2016 and 2015, consist of the following:

	<u>2016</u>	<u>2015</u>
Asian Development Bank	\$ 103,249	\$ 40,407
U.S. Department of the Interior	-	72,800
Australian Embassy	-	<u>7,210</u>
	<u>\$ 103,249</u>	<u>\$ 120,417</u>

Cash

Custodial credit risk is the risk that in the event of a bank failure, MWSC's deposits may not be returned to it. Such deposits are not covered by depositor 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. MWSC does not have a deposit policy for custodial credit risk.

For purposes of the statements of net position and cash flows, cash is defined as cash on hand and cash held in demand accounts. As of September 30, 2016 and 2015, cash was \$325,306 and \$255,113, respectively, and the corresponding bank balances were \$308,049 and \$276,891, respectively. Of the bank balances, \$285,035 and \$256,882, respectively, are maintained in a financial institution subject to Federal Deposit Insurance Corporation (FDIC) insurance with the remaining amounts of \$23,014 and \$20,009, respectively, being maintained in a financial institution not subject to depository insurance. As of September 30, 2016 and 2015, bank deposits in the amount \$250,000 were FDIC insured. MWSC does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC coverage are uncollateralized. Accordingly, these deposits were exposed to custodial credit risk.

MAJURO WATER AND SEWER COMPANY, INC.
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Notes to Financial Statements
September 30, 2016 and 2015

(2) Summary of Significant Accounting Policies, Continued

Receivables

All receivables are due from government agencies, businesses and individuals located within the Republic of the Marshall Islands and are interest free and uncollateralized. 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 expense and accounts that are ultimately written-off are charged against the allowance.

Inventory

Inventory is valued at the lower of cost (first-in, first-out) or market (net realizable value).

Plant and Equipment

Plant and equipment are stated at cost. Depreciation of plant and equipment and amortization of leasehold improvements are calculated on the straight-line method based on the estimated useful lives of the respective assets. Individual items with a cost of \$500 and an expected useful life of two years or longer are capitalized. The estimated useful lives of these assets are as follows:

Vehicles	2 - 4 years
Office equipment	3 - 8 years
Buildings and leasehold improvements	4 years
Machinery and equipment	5 - 10 years

Deferred Outflows of Resources

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

Deferred Inflows of Resources

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

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 revenue tax of 3% on revenues. Pursuant to the Income Tax Act of 1989, as amended, sales of water and sewer services by public utility companies are exempt from gross revenue tax. Accordingly, MWSC is exempt from this tax relating to gross revenue from sales of water and sewer services.

Reclassifications

Certain balances in the 2015 financial statements have been reclassified to conform to the 2016 presentation.

MAJURO WATER AND SEWER COMPANY, INC.
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Notes to Financial Statements
September 30, 2016 and 2015

(2) Summary of Significant Accounting Policies, Continued

Revenue Recognition

Sales of water are recorded as billed to customers on a monthly billing cycle basis with customer water meters being read at the end of each month. Revenue is recognized in the period the meters are read. Wastewater treatment is billed at a flat rate of \$12 per month for residential accounts and \$9 per pan for commercial and government accounts. Water delivery sales and hook-up fees are recorded when the services are provided to customers.

New Accounting Standards

During the year ended September 30, 2016, MWSC implemented the following pronouncements:

- GASB Statement No. 72, *Fair Value Measurement and Application*, which addresses accounting and financial reporting issues related to fair value measurements and requires entities to expand their fair value disclosures by determining major categories of debt and equity securities within the fair value hierarchy on the basis of the nature and risk of the investment.
- GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, which eliminates two of the four categories of authoritative GAAP that exist under the existing hierarchy prescribed by Statement No. 55. The two categories that will remain under the new standard are (1) GASB Statements and (2) GASB technical bulletins and implementation guides in addition to AICPA guidance that the GASB clears.
- GASB Statement No. 79, *Certain External Investment Pools and Pool Participants*, addresses for certain external investment pools and their participants the accounting and financial reporting implications that result from changes in the regulatory provisions referenced by previous accounting and financial reporting standards. Those provisions were based on the Investment Company Act of 1940, Rule 2a7. Rule 2a7 contains the Securities and Exchange Commission's regulations that apply to money market funds and were significantly amended in 2014.

The implementation of these statements did not have a material effect on the accompanying financial statements.

In June 2015, GASB issued Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not Within the Scope of GASB Statement No. 68*, and Amendments to Certain Provisions of GASB Statements No. 67 and No. 68, which aligns the reporting requirements for pensions and pension plans not covered in GASB Statements No. 67 and No. 68 with the reporting requirements in Statement No. 68. The provisions in Statement No. 73 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In June 2015, GASB issued Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which replaces Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and addresses financial reporting requirements for governments whose employees are provided with postemployment benefits other than pensions (other postemployment benefits or OPEB). The provisions in Statement No. 74 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

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Notes to Financial Statements
September 30, 2016 and 2015

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In June 2015, GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, which replaces the requirements of Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and provides guidance on reporting by governments that provide OPEB to their employees and for governments that finance OPEB for employees of other governments. The provisions in Statement No. 75 are effective for fiscal years beginning after June 15, 2017. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In January 2016, GASB issued Statement No. 80, *Blending Requirements for Certain Component Units - an amendment of GASB Statement No. 14*, which improves financial reporting by clarifying the financial statement presentation requirements for certain component units. The provisions in Statement No. 80 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In August 2015, GASB issued Statement No. 77, *Tax Abatement Disclosures*, which requires governments that enter into tax abatement agreements to disclose certain information about the agreements. The provisions in Statement No. 77 are effective for fiscal years beginning after December 15, 2015. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In December 2015, GASB issued Statement No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*, which addresses a practice issue regarding the scope and applicability of Statement No. 68, *Accounting and Financial Reporting for Pensions*. The provisions in Statement No. 78 are effective for fiscal years beginning after December 15, 2015. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In January 2016, GASB issued Statement No. 80, *Blending Requirements for Certain Component Units - an amendment of GASB Statement No. 14*, which improves financial reporting by clarifying the financial statement presentation requirements for certain component units. The provisions in Statement No. 80 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In March 2016, GASB issued Statement No. 81, *Irrevocable Split-Interest Agreements*, which improves accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement. The provisions in Statement No. 81 are effective for fiscal years beginning after December 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In March 2016, GASB issued Statement No. 82, *Pension Issues - an amendment of GASB Statements No. 67, No. 68, and No. 73*, which addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements. The provisions in Statement No. 82 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

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(3) Risk Management

MWSC 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. MWSC has elected to purchase commercial insurance from independent third parties for the risks of loss to which it is exposed. However, as of September 30, 2016 and 2015, respectively, MWSC is self-insured for any losses that could befall its buildings, equipment and inventory. 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 in any of the past three years.

(4) Capital Assets

Capital asset activity for the years ended September 30, 2016 and 2015 was as follows:

	2016			
	<u>October 1, 2015</u>	<u>Additions</u>	<u>Retirements</u>	<u>September 30, 2016</u>
Vehicles	\$ 204,945	\$ 32,278	\$ (75,250)	\$ 161,973
Machinery and equipment	609,879	89,658	-	699,537
Office equipment	203,646	22,271	-	225,917
Buildings and leasehold improvements	<u>952,501</u>	<u>-</u>	<u>-</u>	<u>952,501</u>
	1,970,971	144,207	(75,250)	2,039,928
Less accumulated depreciation and amortization	<u>(761,403)</u>	<u>(215,435)</u>	<u>75,250</u>	<u>(901,588)</u>
	<u>\$ 1,209,568</u>	<u>\$ (71,228)</u>	<u>\$ -</u>	<u>\$ 1,138,340</u>
	2015			
	<u>October 1, 2014</u>	<u>Additions</u>	<u>Retirements</u>	<u>September 30, 2015</u>
Vehicles	\$ 188,945	\$ 16,000	\$ -	\$ 204,945
Machinery and equipment	579,260	52,340	(21,721)	609,879
Office equipment	172,534	31,112	-	203,646
Buildings and leasehold improvements	<u>831,039</u>	<u>121,462</u>	<u>-</u>	<u>952,501</u>
	1,771,778	220,914	(21,721)	1,970,971
Less accumulated depreciation and amortization	<u>(604,457)</u>	<u>(178,667)</u>	<u>21,721</u>	<u>(761,403)</u>
	<u>\$ 1,167,321</u>	<u>\$ 42,247</u>	<u>\$ -</u>	<u>\$ 1,209,568</u>

During the years ended September 30, 2016 and 2015, MWSC was the beneficiary of certain donated capital assets of \$103,249 and \$47,617, respectively, from foreign donors.

(5) Restricted Net Position

Restricted net position at September 30, 2016 and 2015, consists of the following:

	<u>2016</u>	<u>2015</u>
RepMar:		
Compact of Free Association Public Infrastructure Sector Grants	\$ <u>155,083</u>	\$ <u>310,222</u>

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(6) Related Party Transactions

MWSC is a component unit of RepMar and is therefore affiliated with all RepMar-owned and affiliated entities. MWSC's utility service is provided to RepMar and all RepMar-owned and affiliated entities. Services are extended to these entities at more favorable terms and conditions than those afforded to third parties. MWSC utilizes services from certain affiliated entities at substantially more favorable terms and conditions than those provided to third parties.

During the years ended September 30, 2016 and 2015, MWSC received contributions under the Compact of Free Association Public Infrastructure Sector grants from RepMar of \$150,000 and \$300,000, respectively.

A summary of related party transactions for the years ended September 30, 2016 and 2015, and related receivable and payable balances as of September 30, 2016 and 2015, is as follows:

	2016			
	Revenues	Expenses	Receivables	Payables
RepMar	\$ 272,978	\$ 26,234	\$ 11,899	\$ 8,944
Marshalls Energy Company, Inc.	25,345	356,818	30,114	2,162,917
Marshall Islands National Telecommunications Authority	2,038	19,879	1,556	1,000
Marshall Islands Social Security Administration	1,404	133,562	1,164	39,576
Majuro Resort, Inc.	52,893	532	5,746	1,239
Other	<u>131,215</u>	<u>31,747</u>	<u>107,136</u>	<u>871</u>
	<u>\$ 485,873</u>	<u>\$ 568,772</u>	<u>\$ 157,615</u>	<u>\$ 2,214,547</u>
	2015			
	Revenues	Expenses	Receivables	Payables
RepMar	\$ 205,451	\$ 25,769	\$ 143,495	\$ -
Marshalls Energy Company, Inc.	28,036	340,776	50,592	1,831,532
Marshall Islands National Telecommunications Authority	2,220	17,996	1,332	-
Marshall Islands Social Security Administration	674	137,755	543	-
Majuro Resort, Inc.	53,664	444	4,530	1,172
Other	<u>31,904</u>	<u>345</u>	<u>2,455</u>	<u>7,150</u>
	<u>\$ 321,949</u>	<u>\$ 523,085</u>	<u>\$ 202,947</u>	<u>\$ 1,839,854</u>

Receivables from and payables to affiliates are uncollateralized, are interest free and have no set repayment terms.

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(7) Commitment

On February 19, 2003, RepMar and MWSC entered into a franchise agreement to provide water and sewer service to the atoll of Majuro. The agreement incorporates a lease agreement for MWSC to lease from RepMar the water and sewer system for a period of ten years at a rate of \$100,000 per annum, commencing three years after the lease is in effect (February 19, 2006).

MWSC is currently delinquent on \$1,000,000 of payments for the franchise agreement dating back to 2003. The delinquent amount is based on a rate of \$100,000 per annum for 10 years.

During the years ended September 30, 2016 and 2015, MWSC did not record the liability per the franchise agreement due to lack of capacity to make the payments in the foreseeable future. MWSC essentially depends on financing from RepMar and MEC to be able to continue as a going concern. Thus, management will negotiate the franchise terms with RepMar. If negotiations fail, MWSC may become liable for the above amounts but management does not believe that it will possess the ability to liquidate that liability.

(8) Going Concern

MWSC has incurred losses from operations of \$558,559 and \$561,576 during the years ended September 30, 2016 and 2015, respectively and used a substantial amount of working capital in its operation resulting in a working capital deficiency of \$1,274,309 at September 30, 2016. Furthermore, at September 30, 2016 total liabilities exceeded total assets by \$135,969.

Management believes that the continuation of MWSC's operations is dependent upon the future financial support of RepMar, compensation by RepMar for the cost of actual utility service provided, the collection of long outstanding utility receivables, and/or significant improvements in operations, among other matters. Additionally, in order for MWSC to continue as a going concern, it may need to delay payments to the Marshalls Energy Company, Inc. a related party, for electricity usage.

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Board of Directors
Majuro Water and Sewer Company, Inc.:

We have audited, in accordance with the 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, the financial statements of Majuro Water and Sewer Company, Inc. (MWSC), which comprise the statement of net position as of September 30, 2016, and the related statements of revenues, expenses, and changes in net position and of cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated June 2, 2017. Our report included an emphasis-of-matter paragraph regarding going concern.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered MWSC's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of MWSC's internal control. Accordingly, we do not express an opinion on the effectiveness of MWSC's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

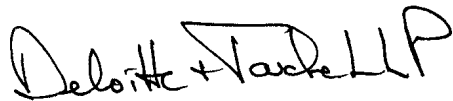
Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether MWSC's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

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

June 2, 2017

MAJURO WATER AND SEWER COMPANY, INC.
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Unresolved Prior Year Findings
Year Ended September 30, 2016

There are no unresolved audit findings from prior year audits of MWSC.