

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, 2017 and 2016

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

Years Ended September 30, 2017 and 2016
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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, 2017 and 2016, 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, 2017 and 2016, 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.

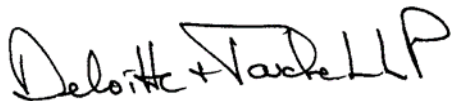
Other Matters

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 22, 2018, 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 solely 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 effectiveness of MWSC's 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 22, 2018

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, 2017 and 2016

FINANCIAL HIGHLIGHTS

Majuro Water and Sewer Company Inc.'s (MWSC) net position decreased by \$187,575 in 2017 compared to a decrease of \$305,852 in 2016. The significant decrease was mainly due to a decrease in revenues and an increase in operational expenses.

Total operating revenues decreased by \$270,891 from \$1,671,782 in 2016 to \$1,400,891 in 2017. Within the operating revenues, utility billings decreased by \$12,353 from \$1,182,190 in 2016 to \$1,169,837 in 2017. Hook-ups and deliveries decreased by \$228,457 from \$455,100 in 2016 to \$226,643 in 2017. The significant decrease in revenue is due to less demand in water deliveries. Furthermore, there has been an additional \$332,104 allowance provided for uncollectable accounts in 2017 compared with \$369,621 in 2016.

Operating expenses increased by \$39,783 from \$1,860,720 in 2016 to \$1,900,503 in 2017. The main contributing factor for the increase in operating expenses is an increase in electricity \$68,567, contractual services \$11,369, depreciation and amortization \$80,100 and insurance \$8,257, offset by a decrease in salaries, wages and benefits \$23,450, spare parts \$35,590, petroleum, oil and lubricants \$13,722, travel \$11,693, communications \$1,288, repairs and maintenance \$6,832, office supplies \$8,154, freight and handling \$19,804 and miscellaneous \$7,977.

The statement of cash flows net decrease in cash was \$169,692 in 2017 compared with net increase of \$70,193 in 2016. The operating activities of MWSC resulted in a net cash inflow of \$9,866 in 2017 compared to a net cash outflow of \$111,107 in 2016. The increase in net cash from operations in 2017 was offset to a degree by the decrease in net cash from noncapital financial activities of \$675 and net cash from capital and related financing activities of \$178,883.

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>2017</u>	<u>2016</u>	<u>2015</u>
Current assets	\$ 815,375	\$ 1,125,681	\$ 939,114
Capital assets, net	<u>1,666,504</u>	<u>1,138,340</u>	<u>1,209,568</u>
Total assets	\$ <u>2,481,879</u>	\$ <u>2,264,021</u>	\$ <u>2,148,682</u>
Current liabilities	\$ <u>2,805,423</u>	<u>2,399,990</u>	\$ <u>1,978,799</u>
Net position:			
Net investment in capital assets	1,666,504	1,138,340	1,209,568
Restricted	85,300	155,083	310,222
Unrestricted	<u>(2,075,348)</u>	<u>(1,429,392)</u>	<u>(1,349,907)</u>
Total net position	<u>(323,544)</u>	<u>(135,969)</u>	<u>169,883</u>
Total liabilities and net position	\$ <u>2,481,879</u>	\$ <u>2,264,021</u>	\$ <u>2,148,682</u>

As indicated above, total assets increased by \$217,858 from \$2,264,021 in 2016 to \$2,481,879 in 2017.

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Management's Discussion and Analysis
Years Ended September 30, 2017 and 2016

Total liabilities reflect an increase of \$405,433 from \$2,399,990 in 2016 to \$2,805,423 in 2017. The net position decreased by \$187,575 from a net deficit of \$135,969 in 2016. There were no non-current liabilities at September 30, 2017 and 2016.

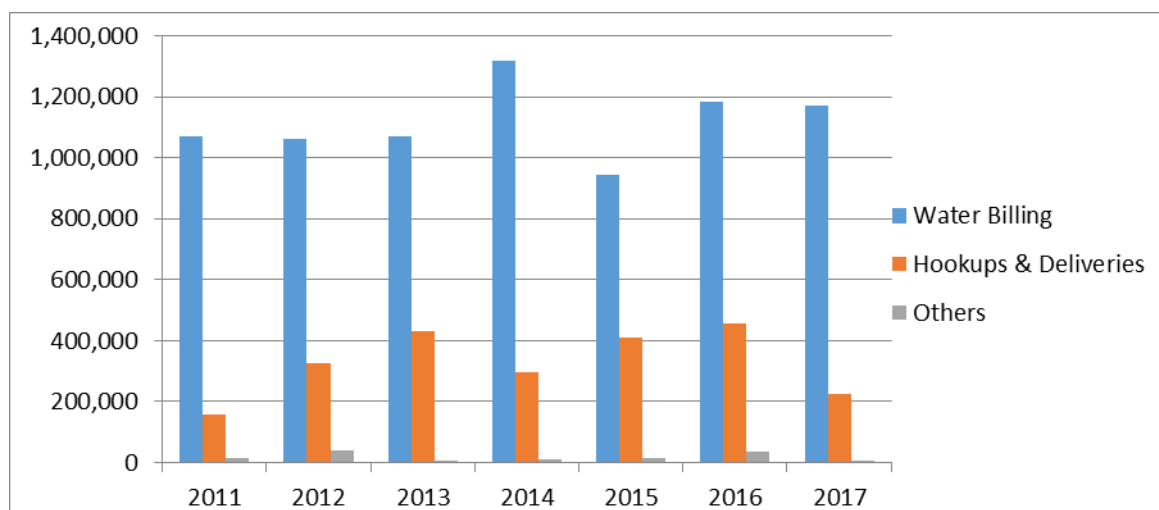
A summary of MWSC's Statements of Revenues, Expenses, and Changes in Net Position is presented below:

Revenues:	<u>2017</u>	<u>2016</u>	<u>2015</u>
Net operating revenues	\$ 1,068,787	\$ 1,302,161	\$ 1,056,495
Nonoperating revenues	<u> -</u>	<u>150,000</u>	<u>300,000</u>
Total revenues	<u>1,068,787</u>	<u>1,452,161</u>	<u>1,356,495</u>
 Expenses:			
Operating expenses	1,900,503	1,860,720	1,618,071
Nonoperating expenses	<u> 675</u>	<u> 542</u>	<u> 1,487</u>
Total expenses	<u>1,901,178</u>	<u>1,861,262</u>	<u>1,619,558</u>
Capital contributions	<u> 644,816</u>	<u> 103,249</u>	<u> 120,418</u>
Change in net position	\$ <u>(187,575)</u>	\$ <u>(305,852)</u>	\$ <u>(142,646)</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 decreased by \$233,374 from \$1,302,161 in 2016 to \$1,068,787 in 2017. A decrease in revenue for 2017 consists of utility billing \$1,169,837 hook-up and deliveries \$226,643, others \$4,411 and a decrease in bad debts expense of \$37,517.

Nonoperating revenues represent operating subsidies and grants received. RepMar discontinued financial support to assist MWSC with the payment of the monthly electricity bills owed to Marshalls Energy Company, Inc. The grants received from the Government of Japan in 2017 of \$603,216 pertain to reversed osmosis units, water truck and spare parts. The grants received from Republic of the Marshall Islands Port Authority of \$41,600 pertain to pumps for Airport runway.

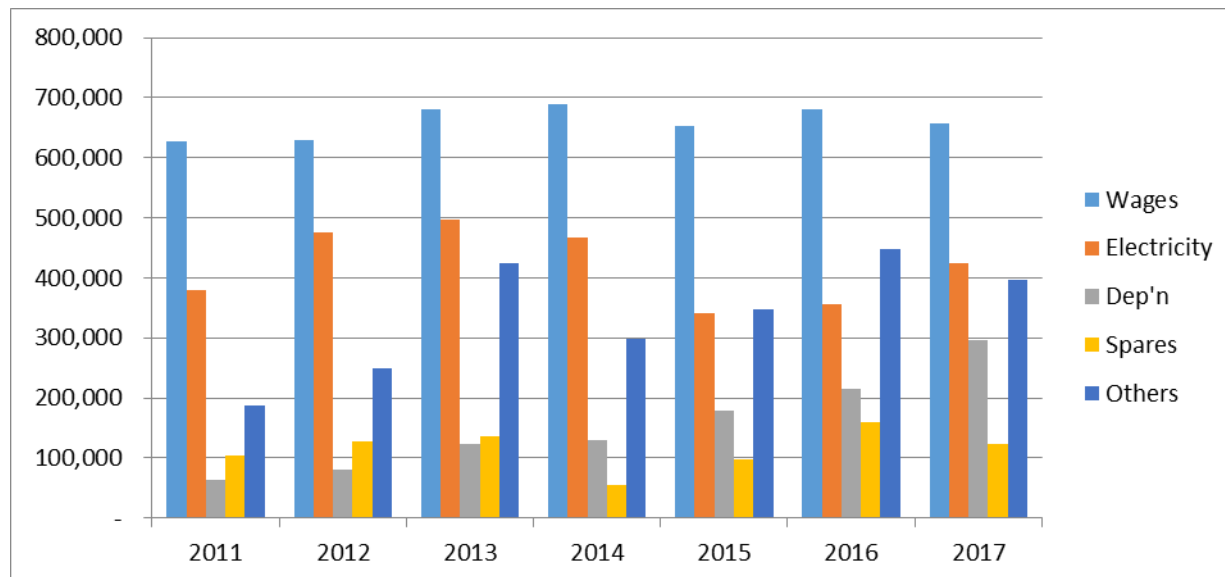
The graph below shows the major components of operating revenues for 2017 compared with the years 2011 through 2016.



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Management's Discussion and Analysis
 Years Ended September 30, 2017 and 2016

Operating expenses increased by \$39,783 to \$1,900,503 in 2017 from \$1,860,720 in 2016. The graph below shows the major components of operating expenses for 2017 compared with the years 2011 to 2016.



CAPITAL ASSETS

Net capital assets increased by \$528,164 in 2017 as a result of the acquisition of vehicles for a total cost of \$142,500, machinery and equipment of \$665,171 and office equipment of \$13,934 less total depreciation and amortization for the year of \$295,535.

MWSC received capital contributions of \$644,816 in 2017. The contribution of \$603,216 are from the Government of Japan for reversed osmosis units, water truck and spare parts. The capital contribution of \$41,600 from Republic of the Marshall Islands Ports Authority is for the Airport runway pumps. Please refer to note 4 to the financial statements for additional information on MWSC's capital assets.

FUTURE OUTLOOK ON SUSTAINABILITY

Future sustainability for Majuro Water & Sewer Company will require four major changes:

1. Increase in our customer base. Currently, we have some 1,249 water customers and 2,454 sewer customers out of a possible 3,703. Increasing our customer base without having major expansions to our assets will mean a significant increase in revenue without proportional increase in operating costs.

Encouraging new customers will require a concerted long term community awareness and educational program to have them understand the value and benefits of connecting to our water and sewer system.

2. Renovate and repair our water, sewer and saltwater assets to improve reliability, and consequently, service to our customers.

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Management's Discussion and Analysis
Years Ended September 30, 2017 and 2016

FUTURE OUTLOOK ON SUSTAINABILITY, CONTINUED

3. Tariff reform to recognize the cost of operating the business and to recognize inflation since the last tariff adjustment was 11 years ago. MWSC will prepare tariff reform proposal based on present and future needs for Board approval.
4. Initiate survey of all services provided.

MWSC'S FOCUS IN THE COMING YEAR

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

1. Continued implementation of development goals under the guidance of the 20-Year Development Plan. Lift stations, saltwater stations and parts of the water treatment plants are being targeted for upgrades with leftover Department of Interior funding from the grant used to complete the 20-year development plan. These stations are also being examined for energy efficiency improvements from the Sustainable Energy Development Project (SEDeP) implemented by the World Bank on behalf of the RMI.
2. Submit application to USDA in regards to the replacement of the sewage outfall. A replacement outfall is provided at Delap which allows sewage to be dispersed and assimilated into the environment, away from the coastline. Public health is significantly improved along the coastline at Delap.
3. Utilize available funding from ADB to begin project preparation for the following projects:
 - a. MWSC's Non Revenue Water Improvement Plan. This plan will improve MWSC's capability to capture lost revenue in our water system and will provide MWSC with a water balance on the system.
 - b. Establishing an asset management and GIS system. With the objective of accurate and reliable information about the location, condition and performance of its assets.
 - c. Macerator Facility/Rehab of Pump Stations No. 1. This facility will provide a physical treatment of sewage streams and output to the newly rebuilt outfall in Delap. Large solids will macerated into smaller particles for easier/better dispersion of outfall.
4. Establishing a Statement of Corporate Intent that will cover current fiscal year and the next two fiscal years.
5. Establishing a Business Plan that will cover current fiscal year and the next two fiscal years.
6. Hire an Attorney to collect long outstanding debts and other legal issues.

Management's Discussion and Analysis for the year ended September 30, 2016 is set forth in MWSC's report on the audit of financial statements, which is dated June 2, 2017. Such Management's Discussion and Analysis explains the major factors impacting the 2016 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. General Manager at P.O. Box 1751 Majuro, MH 96960.

MAJURO WATER AND SEWER COMPANY, INC.
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Statements of Net Position
September 30, 2017 and 2016

<u>ASSETS</u>	<u>2017</u>	<u>2016</u>
Current assets:		
Cash	\$ 155,614	\$ 325,306
Receivables:		
Utility	1,650,277	1,488,544
Affiliates	185,316	157,615
Other	87,498	92,477
	<u>1,923,091</u>	<u>1,738,636</u>
Less allowance for doubtful accounts	<u>(1,684,342)</u>	<u>(1,451,773)</u>
	<u>238,749</u>	<u>286,863</u>
Inventory	410,742	437,321
Prepaid expenses	<u>10,270</u>	<u>76,191</u>
Total current assets	815,375	1,125,681
Capital assets, net	<u>1,666,504</u>	<u>1,138,340</u>
	<u>\$ 2,481,879</u>	<u>\$ 2,264,021</u>
<u>LIABILITIES AND NET POSITION</u>		
Current liabilities:		
Accounts payable	\$ 169,125	\$ 137,125
Payable to affiliates	2,582,355	2,214,547
Other accrued liabilities	53,943	48,318
Total current liabilities	<u>2,805,423</u>	<u>2,399,990</u>
Commitment and contingency		
Net position:		
Net investment in capital assets	1,666,504	1,138,340
Restricted	85,300	155,083
Unrestricted	<u>(2,075,348)</u>	<u>(1,429,392)</u>
Total net position	<u>(323,544)</u>	<u>(135,969)</u>
	<u>\$ 2,481,879</u>	<u>\$ 2,264,021</u>

See accompanying notes to financial statements.

MAJURO WATER AND SEWER COMPANY, INC.
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Statements of Revenues, Expenses and Changes in Net Position
Years Ended September 30, 2017 and 2016

	2017	2016
Operating revenues:		
Utility billings	\$ 1,169,837	\$ 1,182,190
Hook-up and deliveries	226,643	455,100
Other	4,411	34,492
	1,400,891	1,671,782
Total operating revenues		
Less uncollectable accounts	(332,104)	(369,621)
	1,068,787	1,302,161
Total net operating revenues		
Operating expenses:		
Salaries, wages and benefits	657,989	681,439
Electricity	425,385	356,818
Depreciation and amortization	295,535	215,435
Spare parts	124,395	159,985
Petroleum, oil and lubricants	47,685	61,407
Contractual services	39,554	28,185
Insurance	33,070	24,813
Travel	29,960	41,653
Communications	28,513	29,801
Repairs and maintenance	25,346	32,178
Office supplies	24,106	32,260
Freight and handling	22,047	41,851
Miscellaneous	146,918	154,895
	1,900,503	1,860,720
Total operating expenses		
Operating loss	(831,716)	(558,559)
Nonoperating revenues (expenses), net:		
Contributions from RepMar	-	150,000
Penalties and interest	(675)	(542)
	(675)	149,458
Total nonoperating (expenses) revenues, net		
Capital contributions:		
Government of Japan	603,216	-
Republic of the Marshall Islands Ports Authority	41,600	-
Other grants and contributions	-	103,249
	644,816	103,249
Total capital contributions		
Change in net position	(187,575)	(305,852)
Net position at beginning of year	(135,969)	169,883
Net position at end of year	\$ (323,544)	\$ (135,969)

See accompanying notes to financial statements.

MAJURO WATER AND SEWER COMPANY, INC.
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Statements of Cash Flows
Years Ended September 30, 2017 and 2016

	2017	2016
Cash flows from operating activities:		
Cash received from customers	\$ 1,116,901	\$ 1,304,042
Cash payments to suppliers for goods and services	(439,859)	(766,030)
Cash payments to employees for services	(667,176)	(649,119)
Net cash provided by (used for) operating activities	9,866	(111,107)
Cash flows from noncapital financing activities:		
Contributions received from RepMar	-	150,000
Penalties and interest paid	(675)	(542)
Net cash provided by (used for) noncapital financing activities	(675)	149,458
Cash flows from capital and related financing activities:		
Capital contributions received	90,800	72,800
Acquisition of capital assets	(269,683)	(40,958)
Net cash provided by (used for) capital and related financing activities	(178,883)	31,842
Net change in cash	(169,692)	70,193
Cash at beginning of year	325,306	255,113
Cash at end of year	\$ 155,614	\$ 325,306
Reconciliation of operating loss to net cash provided by (used for) operating activities:		
Operating loss	\$ (831,716)	\$ (558,559)
Adjustments to reconcile operating loss to net cash provided by (used for) operating activities:		
Depreciation and amortization	295,535	215,435
Uncollectable accounts	332,104	369,621
(Increase) decrease in assets:		
Receivables:		
Utility	(261,268)	(347,508)
Affiliates	(27,701)	45,332
Other	4,979	(65,564)
Inventory	26,579	(192,857)
Prepaid expenses	65,921	1,802
Increase (decrease) in liabilities:		
Accounts payable	26,272	35,145
Payable to affiliates	367,808	374,693
Other accrued liabilities	11,353	11,353
Net cash provided by (used for) operating activities	\$ 9,866	\$ (111,107)
Summary disclosure of noncash financing activities:		
Capital assets donated by foreign donors:		
Capital assets	\$ (554,016)	\$ (103,249)
Capital contributions	554,016	103,249
	\$ -	\$ -

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, 2017 and 2016

(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, 2017 and 2016

(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, 2017 and 2016, consist of the following:

	<u>2017</u>	<u>2016</u>
Asian Development Bank	\$ <u> </u> -	\$ <u>103,249</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 of cash flows, cash is defined as cash on hand and cash held in demand accounts. As of September 30, 2017 and 2016, cash was \$155,614 and \$325,306, respectively, and the corresponding bank balances were \$211,373 and \$308,049, respectively. Of the bank balances, \$84,483 and \$285,035, respectively, are maintained in a financial institution subject to Federal Deposit Insurance Corporation (FDIC) insurance with the remaining amounts of \$126,890 and \$23,014, respectively, being maintained in a financial institution not subject to depository insurance. As of September 30, 2017 and 2016, bank deposits in the amount \$84,483 and \$250,000, respectively, 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. MWSC has not experienced any losses in such accounts and management believes it is not exposed to any significant credit risk on its deposits.

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Notes to Financial Statements
September 30, 2017 and 2016

(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).

Capital Assets

Capital assets 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.

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

Notes to Financial Statements
September 30, 2017 and 2016

(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, 2017, MWSC implemented the following pronouncements:

- GASB Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not Within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*, which aligns the reporting requirements for pensions and pension plans not covered in GASB Statements 67 and 68 with the reporting requirements in Statement 68.
- GASB 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).
- GASB Statement No. 77, *Tax Abatement Disclosures*, which requires governments that enter into tax abatement agreements to disclose certain information about the agreements.
- GASB 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*.
- GASB 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.
- GASB 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 implementation of these statements did not have a material effect on the accompanying financial statements.

MAJURO WATER AND SEWER COMPANY, INC.
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Notes to Financial Statements
September 30, 2017 and 2016

(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 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 November 2016, GASB issued Statement No. 83, *Certain Asset Retirement Obligations*, which addresses accounting and financial reporting for certain asset retirement obligations (AROs) associated with the retirement of a tangible capital asset. The provisions in Statement No. 83 are effective for fiscal years beginning after June 15, 2018. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In January 2017, GASB issued Statement No. 84, *Fiduciary Activities*, which establishes criteria for identifying fiduciary activities of all state and local governments. The provisions in Statement No. 84 are effective for fiscal years beginning after December 15, 2018. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In March 2017, GASB issued Statement No. 85, *Omnibus 2017*, which addresses practice issues that have been identified during implementation and application of certain GASB Statements including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefits). The provisions in Statement No. 85 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 May 2017, GASB issued Statement No. 86, *Certain Debt Extinguishment Issues*, which improves consistency in accounting and financial reporting for in-substance defeasance of debt. The provisions in Statement No. 86 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 June 2017, GASB issued Statement No. 87, *Leases*, which establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. The provisions in Statement No. 87 are effective for fiscal years beginning after December 15, 2019. Management has yet to determine whether the implementation of this statement will have a material effect on the financial statements.

MAJURO WATER AND SEWER COMPANY, INC.
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Notes to Financial Statements
September 30, 2017 and 2016

(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, 2017 and 2016, 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, 2017 and 2016 was as follows:

	2017			September 30, 2017
	October 1, 2016	Additions	Retirements	
Vehicles	\$ 161,973	\$ 142,500	\$ (49,300)	\$ 255,173
Machinery and equipment	699,537	665,171	(24,114)	1,340,594
Office equipment	225,917	16,028	(17,290)	224,655
Buildings and leasehold improvements	<u>952,501</u>	<u>-</u>	<u>-</u>	<u>952,501</u>
	2,039,928	823,699	(90,704)	2,772,923
Less accumulated depreciation and amortization	<u>(901,588)</u>	<u>(295,535)</u>	<u>90,704</u>	<u>(1,106,419)</u>
	<u>\$ 1,138,340</u>	<u>\$ 528,164</u>	<u>\$ -</u>	<u>\$ 1,666,504</u>
	2016			
	October 1, 2015	Additions	Retirements	September 30, 2016
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>

During the years ended September 30, 2017 and 2016, MWSC was the beneficiary of certain donated capital assets of \$554,016 and \$103,249, respectively, from foreign donors.

(5) Restricted Net Position

Restricted net position at September 30, 2017 and 2016, consists of the following:

	2017	2016
RepMar:		
Compact of Free Association Public Infrastructure Sector Grants	\$ <u>85,300</u>	\$ <u>155,083</u>

MAJURO WATER AND SEWER COMPANY, INC.
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Notes to Financial Statements
September 30, 2017 and 2016

(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 year ended September 30, 2016, MWSC received contributions under the Compact of Free Association Public Infrastructure Sector grants from RepMar of \$150,000.

During the year ended September 30, 2017, RepMar made direct payments to a vendor of \$1,350,850 on behalf of MWSC for feasibility study associated with potential future Capital Improvement associated with the water reservoir. These payments were made under Compact Public Infrastructure Sector Grant. Total amount of Grant allocated amounted to \$1,800,000.

A summary of related party transactions for the years ended September 30, 2017 and 2016, and related receivable and payable balances as of September 30, 2017 and 2016, is as follows:

	<u>2017</u>			
	<u>Revenues</u>	<u>Expenses</u>	<u>Receivables</u>	<u>Payables</u>
RepMar	\$ 206,867	\$ 60,034	\$ 58,328	\$ 15,032
Marshalls Energy Company, Inc. (MEC)	16,104	425,385	51,160	2,566,501
Marshall Islands National Telecommunications Authority	6,926	18,287	6,354	-
Marshall Islands Social Security Administration	661	139,447	1,164	-
Majuro Resort, Inc.	47,305	2,193	10,776	-
Others	<u>65,686</u>	<u>-</u>	<u>57,534</u>	<u>822</u>
	<u>\$ 343,549</u>	<u>\$ 645,346</u>	<u>\$ 185,316</u>	<u>\$ 2,582,355</u>
	<u>2016</u>			
	<u>Revenues</u>	<u>Expenses</u>	<u>Receivables</u>	<u>Payables</u>
RepMar	\$ 272,978	\$ 26,234	\$ 11,899	\$ 8,944
Marshalls Energy Company, Inc. (MEC)	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
Others	<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>

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

(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.

MAJURO WATER AND SEWER COMPANY, INC.
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Notes to Financial Statements
September 30, 2017 and 2016

(7) Commitment, Continued

During the years ended September 30, 2017 and 2016, 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 \$831,716 and \$558,559 during the years ended September 30, 2017 and 2016, respectively and used a substantial amount of working capital in its operation resulting in a working capital deficiency of \$1,990,048 at September 30, 2017.

Furthermore, at September 30, 2017, total liabilities exceeded total assets by \$323,544.

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, 2017, 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 22, 2018. 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.

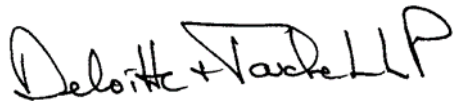
Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not 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 + Tatchell LLP". The signature is written in a cursive, slightly stylized font.

June 22, 2018



MAJURO ATOLL WASTE COMPANY

Schedule of Prior Year Findings and Questioned Costs
Year Ended September 30, 2017

Questioned Costs:

There are no questioned costs reported as of September 30, 2017.

Summary Schedule of Prior Audit Findings

<u>Finding Number</u>	<u>Finding</u>	<u>Status as of September 30, 2017</u>
2016-001	Financial Reporting	Corrective action was taken.
2016-002	Local noncompliance	Corrective action was taken.
2016-003	Procurement code	Corrective action was taken.