MARSHALL ISLANDS SHIPPING CORPORATION

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

FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT

YEARS ENDED SEPTEMBER 30, 2014 AND 2013

MARSHALL ISLANDS SHIPPING CORPORATION
(A COMPONENT UNIT OF THE REPUBLIC OF THE MARSHALL ISLANDS)

Years Ended September 30, 2014 and 2013
Table of Contents

Deloitte.

Deloitte & Touche LLP
361 South Marine Corps Drive
Tamuning, GU 96913-3911
USA

Tel: (671)646-3884
Fax: (671)649-4932
www.deloitte.com

INDEPENDENT AUDITORS' REPORT

Board of Directors
Marshall Islands Shipping Corporation:

Report on the Financial Statements

We have audited the accompanying financial statements of the Marshall Islands Shipping Corporation (MISC), a component unit of the Republic of the Marshall Islands, which comprise the statements of net position as of September 30, 2014 and 2013, 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 the Marshall Islands Shipping Corporation as of September 30, 2014 and 2013, 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.

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 to 10 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 July 9, 2015, on our consideration of MISC'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 financing reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering MISC's internal control over financial reporting and compliance.

Deloitte + Touche LLP

July 9, 2015

Marshalls Islands Shipping Corporation (MISC) herewith presents a discussion and analysis of the company's financial performance for the financial year ended 30th September 2014. It is to be read in conjunction with the financial statements following this section.

FINANCIAL HIGHLIGHTS

MISC's net position at the end of the fiscal year 2014 was $224,931 compared to net position of $135,699 in 2013. The increase in net positon from 2013 to 2014 is a positive indicator of the stabilization of MISC operations.

In 2014, MISC increased its shipping fleet from three (3) to five (5) with the donation of two (2) new shipping vessels from the government of Japan. The building of the two new shipping vessels, one of which is a landing craft, was completed and delivered to MISC in November 2013.

MISC's total net operating revenue was increased significantly by $626,835 (61%) from $1,032,368 in 2013 compared to $1,659,203 in 2014. As expected, MISC's net operating revenues increased significantly with the increase of MISC's shipping fleet size. Along with the two new ships and the ongoing efforts to provide relief to the outer islands affected by the drought disaster declared by RepMar in June and July 2013, charter revenue has been the primary driver for the increases in operating revenues for MISC. MISC's charter revenue increased significantly by $790,046 (525%) from $150,551 in 2013 to $940,597 in 2014. With the exception of passenger revenues, the increase in charter revenues has had a negative impact to MISC's other operating revenues. MISC's cargo revenues decreased by $36,444 (7%) to $485,324 in 2014 compared to $521,768 in 2013. MISC's ship sales revenue decreased by $38,299 (17%) to $180,860 in 2014 compared to $219,159 in 2013. Other revenue sources decreased by $27,621 (49%) to $28,895 in 2014 compared to $56,516 in 2013. MISC's passenger revenue increased by $15,462 (15%) from $101,401 in 2013 to $116,863 in 2014.

Total operating expenses increased from 2013 to 2014. Total operating expenses were $2,869,028 in 2014 compared to $2,032,030 in 2013. Overall, MISC increased its total operating expenses by $836,998 (41%). Personnel and petroleum, oil, and lube (POL) expenses continue to remain as MISC's leading operational expenses. Up until 2014, MISC's recurrent expenditure for the salary and wage bill was on a declining trend. With the two new shipping vessels, it was expected that operating expenses would have increased accordingly. Salaries, wages and benefit expenses were reduced by $68,075 (8%) from $838,263 in 2012 to $770,188 in 2013 but increased significantly by $280,395 (36%) to $1,050,583 in 2014. POL expenses have been on the rise with the increase in field and charter trips completed. With the two new shipping vessels donated by Japan, POL expenses increased by $82,519 (26%) from $314,021 in 2012 to $396,540 in 2013 and increased significantly by $339,029 (85%) to $735,569.

MISC's operating loss increased by $210,163 (21%) from an operating loss of $999,662 in 2013 compared to an operating loss of $1,209,825 in 2014. Although MISC has maintained its efforts to reduce its operating expenses, MISC will continue to operate at a loss of approximately $1M to $1.5M annually based on the current tariff rate structure that has been in place since the early 1980's.

MISC continues to depend on subsidies from RepMar, which accounts for approximately 43% of MISC's source of operating and non-operating revenues during 2014. The subsidy received from RepMar in 2014 did not include the funding to support the Shipping Vessel Repairs and Maintenance Act. In 2013, the subsidies from RepMar accounted for approximately 54% of MISC's source of operating and non-operating revenues. The 2013 subsidy included the funding to support the Shipping Vessel Repairs and Maintenance Act. Without the approval of RepMar to allow the management of MISC to increase its tariff rates, it is expected that MISC will always operate at a loss and its future sustainability will continue to be a burden on RepMar.

FINANCIAL ANALYSIS OF MISC

The Statement of Net Position and the Statement of Revenues, Expenses and Changes in Net Position provide an indication of MISC's financial condition. MISC's net position reflects the difference between total assets and total liabilities. An increase in net position over time normally indicates an improvement in financial condition. As illustrated in the figures below, MISC's net position increased for the year ended 30th September 2014.

The Summary Statement of Net Position for MISC is presented below:

	2014	2013	2012
Current and other assets	$ 450,275	$ 448,217	$ 173,749
Capital assets	242,444	69,295	127,034
Total assets	692,719	517,512	300,783
Current liabilities	467,788	381,813	390,827
Total liabilities	467,788	381,813	390,827
Net position:			
Net investment in capital assets	242,444	69,295	127,034
Unrestricted	(17,513)	66,404	(217,078)
Total net position	$ 224,931	$ 135,699	$ (90,044)

Total assets increased from $300,783 in 2012 to $517,512 in 2013, and increased further to $692,719 in 2014. The increase in total assets by $216,729 (72%) from 2012 to 2013 is driven primarily by a significant increase in total net receivables by $190,448 (289%) from $65,978 in 2012 to $256,426 in 2013. In June 2013, RepMar declared a state of disaster for the northern atolls affected by drought. The increase in net receivables reflects the charter trips provided by MISC to support the ongoing disaster relief efforts. In 2014, total assets increased further by $175,207 (34%) primarily due to a significant increase in capital assets with the acquisition of vehicles including utility flatbeds.

Net capital assets decreased from $127,034 in 2012 to $69,295 in 2013 and increased significantly to $242,444 in 2014. In 2013, net capital assets decreased significantly by $57,739 (45%) as a result of the annual depreciation charge of $61,174 offset by the purchase of motorboats in the amount of $3,435. In 2014, net capital assets increased significantly by $173,149 (250%) with the purchase of equipment, vehicles, and motorboats in the total amount of $245,087 offset by the annual depreciation amount of $71,938. The dry dock repairs extending the life span of the vessels are currently being treated as a direct expense provided the shipping vessel asset have yet to be transferred to MISC as required under the Public Law 2005-41. Public Law 2005-41 established the MISC and authorized all movable and immovable property of the shipping services under the Ministry of Transportation and Communication be vest absolutely in MISC.

Total liabilities were stable in 2012 and 2013 at $390,827 and $381,813, respectively. In 2014, total liabilities increased by $85,975 (23%) to $467,788. Total liabilities of $296,217 (63%) in 2014 represent amounts due to RepMar related parties, including RMI Ports Authority (RMIPA). MISC rents warehouse and storage space from RMIPA but is not currently able to service the obligation due to cash flow constraints.

Refer to note 4 to the accompanying financial statements for additional information relating to capital assets.

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

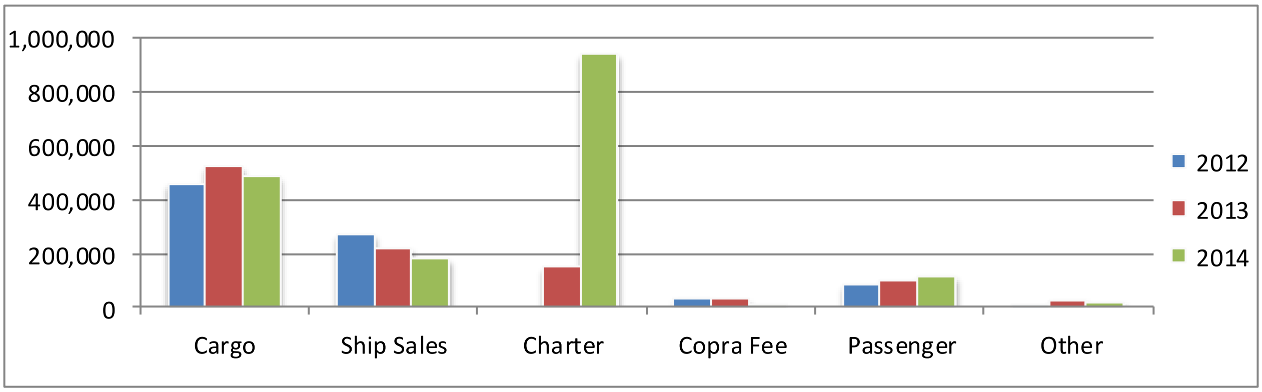
	2014	2013	2012
Revenue:			
Operating revenue	$ 1,659,203	$ 1,032,368	$ 841,608
Expenses:			
Operating expenses	2,869,028	2,032,030	2,007,138
Operating loss	(1,209,825)	(999,662)	(1,165,530)
Nonoperating revenues	1,299,057	1,225,405	1,396,335
Change in net position	$ 89,232	$ 225,743	$ 230,805

The Statements of Revenue, Expenses and Changes in Net Position identify the various revenue and expense items that contributed to the change in net position. MISC's total operating revenue increased by $190,760 (23%) to a total of $1,032,368 in 2013 compared to $841,608 in 2012. In 2014, MISC's total operating revenue increased further by $626,835 (61%) to a total of $1,659,203. The major factors contributing to the increase in operating revenue for 2014 is driven by two factors. With the State of Drought Disaster Declaration issued by RepMar in June and July 2013, ongoing relief efforts resulted in the increase in MISC chartering revenue. In addition, RepMar received two new shipping vessels from the government of Japan in December 2013. The increase in vessels bringing MISC's existing shipping fleet to a total five (5) is another driver for the increase in operating revenues. All shipping vessels in MISC's fleet were in service during 2014.

Charter revenue increased significantly by $790,046 (525%) from $150,551 in 2013 to $940,597 in 2014; cargo sales decreased by $36,444 (7%) from $521,768 in 2013 to $485,324 in 2014; ship sales decreased by $38,299 (17%) from $219,159 in 2013 to $180,860 in 2014; passenger sales increased by $15,462 (15%) from $101,401 in 2013 to $116,863 in 2014; and all other revenue decreased by $27,621 (49%) from $56,516 in 2013 to $28,895 in 2014.

Revenue recognized from ship sales, on the other hand, have been on a declining trend. Ship sales service aboard the shipping vessels to the outer island consumers has been one of MISC's alternative sources of income and cash flow to subsidize its operations and was initiated in 2009. As an indicator of its success to provide an alternative source of income to cross subsidize the MISC operations, the revenue from the ship sales historically consisted of approximately 31-33% of MISC's operating revenue mix in 2010 - 2012. In 2013, however, the ship sales as a percentage of MISC's operating revenue mix dropped to 21%, attributed primarily due to the authorization issued by RepMar for MISC to allow private vendors to establish ship sale operations on selected shipping vessels. In 2014, the ship sale revenues decreased further to 10% of MISC's operating revenue mix due. In this case, the decreasing ship sale revenues are a reflection of the trade off by MISC as a result of the significant increases in charter revenues. It is crucial that MISC continues to review its ship sales process to identify and remediate any internal control gaps in order to maximize the revenue generation opportunity. As a burden on the RepMar national budget, ship sales provide a viable business solution for MISC as an alternative source of revenue for cross subsidization opportunities for MISC while continuing to operate with low tariff rates.

The graphic below shows the major components of MISC's operating revenue from 2012 through to 2014:



MISC's total operating expenses from 2012 to 2013 have remained consistent and increased slightly. Total operating expenses increased slightly by $24,892 (1%) from $2.00M in 2012 compared to $2.03M in 2013. In 2014, the total operating expenses increased significantly by $0.8M (41%) to $2.87M. As expected, the addition of the two new shipping vessels resulted in the significant increases in total operating expenses in 2014. For 2014, the top five components of operating expenses are: (1) Salaries, Wages and Benefits, (2) Petroleum, Oil & Lube (POL), (3) Materials and Supplies (4) Foodstuff and (5) Cost of Goods Sold.

Salaries, wages and benefits remain as the leading operational expense and decreased by $68,075 (8%) from $0.84M in 2012 to $0.77M in 2013 and increased significantly by $280,395 (36%) to $1.05M in 2014. Since 2011, MISC's salaries, wages and benefits for MISC had been on a declining trend as a result of management's efforts to reduce and control its recurrent expenditures for personnel due to a shortage of workload due to the loss of one its shipping vessels, Jeljelat AE, back in January 2011. As expected, the salary and wage bill increase in 2014 with the additional two new shipping vessels received in December 2013.

POL expenses increased by $82,519 (26%) from $314,021 in 2012 to $396,540 in 2013, and increased further by $339,029 (85%) to $735,569 in 2014. In 2013, there were an increase in charter trips to provide relief services in response the State of Disaster Declaration effective June and July 2013. In 2014, the additional two new shipping vessels received in December 2013 is the main contributor for the significant increase in POL expenses.

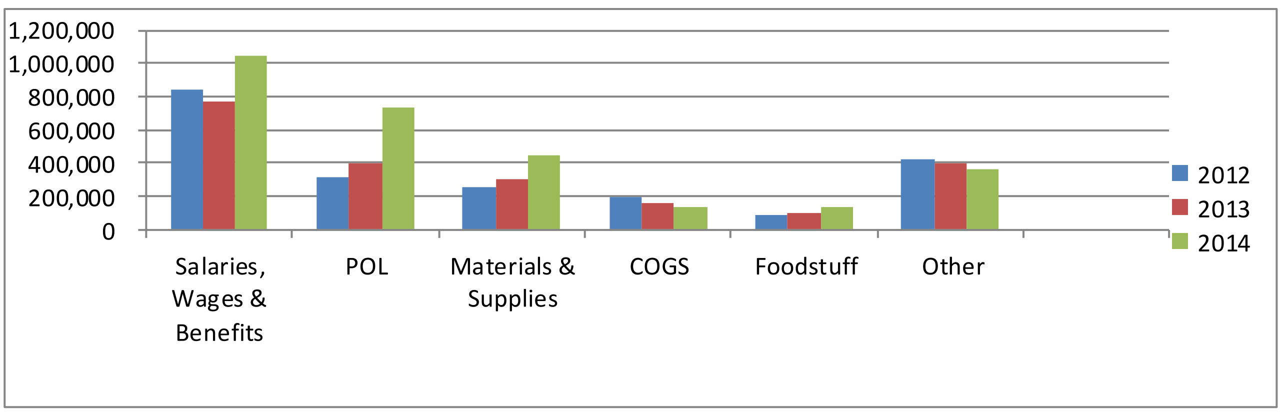
Materials and supplies expenses increased by $53,151 (21%) from $248,580 in 2012 to $301,731 in 2013 and increased further by $147,595 (49%) to $449,326 in 2014. With the establishment of the Shipping Vessel Repairs and Maintenance Act in 2011, annual subsidy is granted by RepMar for proper and timely repairs and maintenance to be undertaken by MISC to ensure the good and operable conditions of the shipping fleet for the safety and reliability of sea transportation services for the RMI outer island community. Although MISC did not receive its repair and maintenance subsidy for 2014, an increase in materials and supplies expense offer a positive indicator that this remains a priority focus for MISC.

Foodstuff expenses increased by $11,924 (14%) from $84,621 in 2012 to $96,545 in 2013 and increased further by $40,736 (42%) to $137,281 in 2014. The significant increase in 2014 is expected as a result of the two new shipping vessel received from the government of Japan.

Cost of goods sold (COGS) is an operating expense component introduced in 2009 for the ship sales aboard the shipping vessels to the outer island consumers. Ship sales service aboard the shipping vessels to the outer island consumers provides MISC an alternative source of income to subsidize its operations. COGS decreased by $28,762 (15%) from $190,825 in 2012 to $162,063 in 2013 and decreased further by $28,604 (18%) to $133,459 in 2014. The decrease in cost of goods sold for 2013 is attributed primarily to the allowance of private vendors to establish ship sales aboard selected shipping vessels. For 2014, the decrease in cost of goods sold is expected with the decreases in ship sales.

Other expenses decreased by $25,865 (8%) from $330,828 in 2012 to $304,963 in 2013 but increased by $57,847 (19%) in 2014 to $362,810. The rent component is the main driver for the increase in other expenses in 2014. Repair and maintenance expenses are included in the other expenses. MISC did not have any of its shipping vessels undergo dry dock services in 2014.

The following graphic shows the major components of operating expenses from 2012 through to 2014:



The operating loss before non-operating revenues (i.e. RepMar subsidy) for 2014 was approximately $1.2M compared to $1.0M and $1.2M in 2013 and 2012, respectively. In 2013, the decrease in operating loss by $165,868 (14%) is primarily attributed to the increase in operating revenues from the increase in field trips and charter trips and ongoing efforts by management to reduce its recurrent expenditure on the salary and wage bill. In 2014, operating loss increased by $210,163 (21%) with the addition of the two new shipping vessels donated by the government of Japan.

Total subsidies, for operations and for repairs and maintenance, were $1,299,057 in 2014 compared to $1,225,405 in 2013 and $1,396,335 in 2012. The subsidy amount of $1,299,057 received from RepMar in 2014 represents MISC's operating subsidy only. Unlike 2012 and 2013, MISC did not receive the repair and maintenance subsidy in 2014. The subsidy to support the Shipping Vessel Repairs and Maintenance Act fluctuates annually based on the repairs and maintenance schedule and costing developed with the technical assistance of the Japan International Cooperation Agency (JICA) and has taken into account major repairs that will need to be completed and the inclusion of two additional vessels to the MISC fleet.

The operating subsidy received from RepMar in 2014 was increased by $73,652 (6%). With its current tariff rate structure, MISC is not able to achieve full cost recovery to cover its operational costs and maintain adequate major and ongoing repairs and maintenance without financial support from RepMar. The future financial sustainability and conditions of the MISC shipping fleet will continue to depend on sufficient financial support from RepMar.

CAPITAL ASSET AND DEBT

Net capital assets increased significantly by $173,149 (250%) in 2014 as a result of the acquisition of equipment, vehicles, and motorboats for a total cost of $245,087 less total depreciation for the year of $71,938.

Refer to note 4 to the accompanying financial statements for additional information relating to capital assets.

MISC did not incur any long-term debt during the year nor did MISC have any outstanding long-term debt at the end of the year.

CASH FLOW

Net cash used for operating activities for 2014 was $0.99M compared to net cash used for operating activities of $1.11M in 2013 and $1.31M in 2012. The cash provided by operational activities was absorbed entirely by MISC's operational costs. Additionally, injection of cash flow from the RepMar subsidies were received in the amount of $1.30M, $1.22M and $1.40M during 2014, 2013 and 2012, respectively. During 2012 and 2013, the RepMar subsidies were utilized by MISC to cover its operational expenses in the same amount of $0.84M; and for repairs and maintenance expenses in the amount $0.56M and $0.42M, respectively. In 2014, the RepMar subsidies were utilized by MISC to cover its operational expenses in the amount of $1.30M. MISC did not receive RepMar subsidies for repairs and maintenance expenses. The repair and maintenance subsidy amount is determined by a schedule developed in January 2011 under the JICA Preparatory Study for the "Project for Improvement of Domestic Shipping Services in the Marshall Islands".

FUTURE OUTLOOK ON SUSTAINABILITY

MISC plays an important role in the lives of people living in the outer islands. The regular fieldtrip services are essential to transfer people and basic needs from the capital city to the outer islands and vice versa.

As an indicator of MISC's future outlook on sustainability, MISC's has a net position of $224,931 in 2014, compared to a net position of $135,699 in 2013 and a net deficiency of $90,044 in 2012. The vast improvement in MISC's financial position from a net deficiency in 2012 to an increasing net position in 2013 and 2014 is a result of increases in revenue streams stemming from increases in charter trips in response to the ongoing relief efforts of the State of Drought Disaster originally issued in June – July 2013, along with the increases in field trips with the addition of the two shipping vessels donated by the government of Japan. Combined with management efforts and persistence to streamline its operational expenses and to continue to reduce its personnel costs in prior years, the rebounds achieved in generating additional revenue streams have been a success factor to MISC's current net asset position.

MISC's improved net position over the period 2012 to 2014 provides an indicator of MISC management's efforts to reduce its recurrent expenditures. This is a positive indicator that MISC has been able to recover from the loss of the landing craft in January 2011. However, at its current tariff rate structure, MISC will continue to have operational losses and rely on RepMar subsidies to minimize the operational losses. In order to revive the MISC operations for future sustainability, MISC must be able to obtain RepMar approval to increase its tariff rates or continue to rely on a steady flow of subsidy amounts as a community service obligation to absorb the operational losses of MISC to provide affordable sea-transport services to the people.

Historically, the operating revenue generated by MISC has never been sufficient to cover the related expenses necessary to operate the shipping vessels and provide sea-transportation services. With operating losses over $1M to 1.5M annually, MISC continues to be dependent on financial support from RepMar. Most importantly, MISC is not able to generate sufficient revenue through its operations due to its low tariff rate structure, which has been in place since the early 1980's and have not increased despite the increase in fuel costs and inflation rates. As a state owned entity, MISC does not have the authority to increase its tariff rates without the approval of RepMar. MISC has made numerous requests to RepMar but have yet to be successful.

It is the intention of MISC to continue its lobbying efforts for the authority and flexibility to increase its tariff rates to account for the rising fuel costs and inflation rates. MISC received Technical Assistance from ADB to develop a three-year strategic plan and needs further assistance to implement its strategic plan. In the absence of a tariff rate increase, the state owned enterprise reform bill that was introduced into Nitijela in September 2012 should recognize MISC as a community service obligation. As such, tariff rates will remain low and on-going financial support from RepMar will have to continue and may need to increase, as appropriate.

The future outlook on sustainability for MISC continues to be threatened by the deteriorating conditions of the shipping vessels and remain at risk of not being a recipient of a repairs and maintenance subsidy from RepMar. In 2011, RepMar passed the Shipping Vessel Repairs and Maintenance Act (R&M) to ensure that subsidy funding is made available on an annual basis to ensure that major repairs and services are performed regularly and for the procurement of safety equipment. The R&M Act provides a strong position for MISC to continue to advocate for and to receive subsidy for the sole purpose of repairs and maintenance needs of its aging fleet. Without the R&M subsidy, the continued deteriorating conditions of more than half of MISC's shipping fleet will have a negative impact on MISC's ability to provide safe and reliable shipping services. In 2014, MISC did not receive its R&M subsidy from RepMar .

To summarize, MISC's future outlook on sustainability is dependent but not limited to the following factors:

- Approval from RepMar to increase MISC's tariff rate structure towards full cost recovery;
- Ongoing recipient of RepMar subsidy to support both MISC operations and the Shipping Vessel Repairs and Maintenance Act;
- Develop and adhere to an ongoing annual repairs and maintenance schedule;
- Increase the number of vessels in its shipping fleet;
- Explore other grant financing opportunities (i.e. ADB, World Bank, RUS, etc.);
- Continue with budgetary controls to minimize operational expenses where possible;
- Improve financial and operational management reporting and streamline processes:
- Capacity building opportunities for MISC personnel (administration and technical).

MISC FOCUS IN THE COMING FISCAL YEAR

MISC's focus in the coming fiscal year includes but is not limited to the following:

- MISC, through its Board of Directors, will continue to lobby for the approval from Cabinet to increase the MISC tariff rates. In the event that MISC efforts to secure Cabinet approval are futile, the passing of the State Owned Enterprise Reform Bill that was introduced in Nitijela in September 2012 will be the guiding principle for MISC to operate as a community service obligation and retain its current low tariff structure.
- With the support of its Board of Directors, MISC will continue to implement and monitor activities laid out in its strategic plan addressing both the operational and financial goals of MISC. The strategic plans include but are not limited to the following:
  - Develop a tariff rate template to incorporate rising cost and fluctuation of fuel and inflation rates;
  - Review of operational processes (such as stevedoring, field trip scheduling, shipping vessel loading and unloading process to reduce downtime and turn ships around more frequently to increase its services to the outer island);
  - Develop and improve management and financial reporting;
  - Address capacity building weaknesses and provide or seek opportunities for capacity building;
  - Ensure adherence to the shipping repairs and maintenance schedule; and
  - Update the MISC strategic plan 2012 – 2015.

ADDITIONAL FINANCIAL INFORMATION

This discussion and analysis is designed to provide MISC's customers and other stakeholders with an overview of the company's operations and financial condition as at 30th September 2014. Should the reader have questions regarding the information included in this report, or wish to request additional financial information, please contact the Marshall Islands Shipping Corporation General Manager at P.O. Box 1198, Majuro, Marshall Islands, MH 96960.

MARSHALL ISLANDS SHIPPING CORPORATION

Statements of Net Position
September 30, 2014 and 2013

ASSETS	2014	2013
Current assets:		
Cash	$ 255,103	$ 187,951
Receivables:		
Affiliates	189,574	98,512
Trade	128,939	182,551
Employees	19,683	26,837
	338,196	307,900
Less allowance for doubtful accounts	(144,810)	(51,474)
Total receivables, net	193,386	256,426
Inventory	1,786	3,840
Total current assets	450,275	448,217
Equipment, net	242,444	69,295
	$ 692,719	$ 517,512
LIABILITIES AND NET POSITION		
Current liabilities:		
Accounts payable	$ 70,148	$ 64,448
Payable to affiliates	296,217	230,737
Accrued payroll liabilities	101,423	86,628
Total liabilities	467,788	381,813
Commitments and contingencies		
Net position:		
Net investment in capital assets	242,444	69,295
Unrestricted	(17,513)	66,404
Total net position	224,931	135,699
	$ 692,719	$ 517,512

See accompanying notes to financial statements.

MARSHALL ISLANDS SHIPPING CORPORATION

Statements of Revenues, Expenses and Changes in Net Position
Years Ended September 30, 2014 and 2013

	2014	2013
Operating revenues:		
Charter	$ 940,597	$ 150,551
Cargo	485,324	521,768
Ship sales	180,860	219,159
Passenger	116,863	101,401
Copra fee	10,584	29,537
Other	18,311	26,979
Total operating revenues	1,752,539	1,049,395
Provision for bad debts	(93,336)	(17,027)
Total net operating revenues	1,659,203	1,032,368
Operating expenses:		
Salaries, wages and benefits	1,050,583	770,188
Petroleum, oil and lube	735,569	396,540
Material and supplies	449,326	301,731
Foodstuffs	137,281	96,545
Cost of goods sold	133,459	162,063
Rent	80,929	37,857
Depreciation	71,938	61,174
Repairs and maintenance	60,810	71,985
Travel and entertainment	32,089	27,681
Freight	24,200	15,032
Professional fees	20,093	30,079
Utilities	20,007	24,345
Contributions	12,290	2,850
Communications	8,740	13,106
Miscellaneous	31,714	20,854
Total operating expenses	2,869,028	2,032,030
Operating loss	(1,209,825)	(999,662)
Nonoperating revenues:		
Operating subsidies	1,299,057	1,225,405
Change in net position	89,232	225,743
Net position at beginning of year	135,699	(90,044)
Net position at end of year	$ 224,931	$ 135,699

See accompanying notes to financial statements.

MARSHALL ISLANDS SHIPPING CORPORATION

Statements of Cash Flows
Years Ended September 30, 2014 and 2013

	2014	2013
Cash flows from operating activities:		
Cash received from customers	$ 1,722,243	$ 841,920
Cash payments to suppliers for goods and services	(1,673,273)	(1,187,099)
Cash payments to employees for services	(1,035,788)	(765,045)
Net cash used for operating activities	(986,818)	(1,110,224)
Cash flows from noncapital financing activities:		
RepMar subsidy received	1,299,057	1,225,405
Cash flows from capital and related financing activities:		
Acquisition of capital assets	(245,087)	(3,435)
Net change in cash	67,152	111,746
Cash at beginning of year	187,951	76,205
Cash at end of year	$ 255,103	$ 187,951
Reconciliation of operating loss to net cash used for operating activities:		
Operating loss	$ (1,209,825)	$ (999,662)
Adjustments to reconcile operating loss to net cash used for operating activities:		
Depreciation	71,938	61,174
Provision for bad debts	93,336	17,027
(Increase) decrease in assets:		
Receivables:		
Affiliates	(91,062)	(40,746)
Trade	53,612	(153,146)
Employees	7,154	(13,583)
Inventory	2,054	(333)
Prepayments	-	28,059
Increase (decrease) in liabilities:		
Accounts payable	5,700	16,439
Payable to affiliates	65,480	(30,596)
Accrued payroll liabilities	14,795	5,143
Net cash used for operating activities	$ (986,818)	$ (1,110,224)

See accompanying notes to financial statements.

(1) Organization

The Marshall Islands Shipping Corporation (MISC), a component unit of the Republic of the Marshall Islands (RepMar), was created under Public Law 2005-41, the Marshall Islands Shipping Corporation Act, 2004. MISC was established to manage and operate RepMar's shipping vessels. MISC's principal line of business is to provide sea transportation services; to carry on business as ship owners; and to build and maintain ships and vessels.

MISC is governed by a five-member Board of Directors, including one official each from the Ministry of Finance and the Marshall Islands Ports Authority and three members appointed by the Cabinet of RepMar.

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

(2) Summary of Significant Accounting Policies

The accounting policies of MISC conform to accounting principles generally accepted in the United States of America, as applicable to governmental entities, specifically proprietary funds.

GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, as amended by Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus*, and Statement No. 38, *Certain Financial Statement Note Disclosures*, establish financial reporting standards for governmental entities which require that management's discussion and analysis of the financial activities be included with the basic financial statements and notes and modifies certain other financial statement disclosure requirements.

To conform to the requirements of GASB 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.

- 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.

Basis of Accounting

Proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operation of the fund are included in the statement 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. MISC considers revenues and costs that are directly related to operations of shipping vessels to be operating revenues and expenses. Revenues and expenses related to financing and other activities are reflected as nonoperating.

(2) Summary of Significant Accounting Policies, Continued

Cash

Custodial credit risk is the risk that in the event of a bank failure, MISC's deposits may not be returned to it. Such deposits are not covered by depository insurance and are either uncollateralized or collateralized with securities held by the pledging financial institution or held by the pledging financial institution but not in the depositor-government's name. MISC 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, 2014 and 2013, the carrying amount of cash was $255,103 and $187,951, respectively, and the corresponding bank balances were $251,240 and $191,769, respectively, which were maintained in a financial institution subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2014 and 2013, bank deposits were fully FDIC insured.

Receivables

All receivables are uncollateralized and are due from affiliates or customers, located within the Republic of the Marshall Islands. The allowance for doubtful accounts is stated at an amount which management believes will be adequate to absorb possible losses on accounts receivable that may become uncollectible based on evaluation of the collectability of these accounts. The allowance is established through a provision for bad debts charged to expense.

Inventory

Inventory consists of items purchased for resale (on the ships) during outer islands voyages. Inventory is valued at the lower of cost (first-in, first out FIFO) or market value (net realized value).

Equipment

MISC has not adopted a formal capitalization policy for equipment; however, items with a cost that equals or exceeds $1,000 are generally capitalized. Depreciation is calculated using the straight-line method based on the estimated useful lives of the respective assets. The estimated useful lives of these assets are 5 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, deferred outflows of resources 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. MISC 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 receipts tax of 3% on revenues. MISC is specifically exempt from this tax.

(2) Summary of Significant Accounting Policies, Continued

Compensated Absences

Vested or accumulated vacation leave is recorded as an expense and liability as the benefits accrue to employees. No liability is recorded for non-vesting accumulating rights to receive sick pay benefits. As of September 30, 2014 and 2013, the accumulated vacation leave liability totals $54,686 and $51,764, respectively, and is included within the statements of net position as other liabilities and accruals.

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, deferred inflows of resources 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. MISC has no items that qualify for reporting in this category.

Revenue Recognition

Cargo, charter and passenger revenue are recognized when the transportation is provided. Other components of other operating revenue are recognized as revenue when the related goods and services are provided.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

New Accounting Standards

During the year ended September 30, 2014, MISC implemented the following pronouncements:

- GASB Statement No. 66, *Technical Corrections - 2012*, which enhances the usefulness of financial reports by resolving conflicting accounting and financial reporting guidance that could diminish the consistency of financial reporting. The implementation of this statement did not have a material effect on the accompanying financial statements.

- GASB Statement No. 67, *Financial Reporting for Pension Plans,* which revises existing guidance for the financial reports of most pension plans. The implementation of this statement did not have a material effect on the accompanying financial statements.

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

- GASB Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*, which requires a state or local government guarantor that offers a nonexchange financial guarantee to another organization or government to recognize a liability on its financial statements when it is more likely than not that the guarantor will be required to make a payment to the obligation holders under the agreement. The implementation of this statement did not have a material effect on the accompanying financial statements.

In June 2012, GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions,* which revises and establishes new financial reporting requirements for most governments that provide their employees with pension benefits. The provisions in Statement 68 are effective for fiscal years beginning after June 15, 2014. Management does not believe that the implementation of this statement will have a material effect on the financial statements of MISC.

In January 2013, GASB issued Statement No. 69, *Government Combinations and Disposals of Government Operations,* which improves accounting and financial reporting for state and local governments' combinations and disposals of government operations. Government combinations include mergers, acquisitions, and transfers of operations. A disposal of government operations can occur through a transfer to another government or a sale. The provisions in Statement 69 are effective for fiscal years beginning after December 15, 2013. Management has not yet determined the effect of implementation of this statement on the financial statements of MISC.

In November 2013, GASB issued Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date - an amendment of GASB Statement No. 68,* which addresses an issue regarding application of the transition provisions of Statement No. 68, *Accounting and Financial Reporting for Pensions*. The issue relates to amounts associated with contributions, if any, made by a state or local government employer or nonemployer contributing entity to a defined benefit pension plan after the measurement date of the government's beginning net pension liability. The provisions in Statement 71 are effective for fiscal years beginning after June 15, 2014. Management does not believe that the implementation of this statement will have a material effect on the financial statements of MISC.

(3) Risk Management

MISC 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. MISC has elected to purchase commercial automobile insurance from independent third parties for the risks of loss to which it is exposed with respect to the use of motor vehicles. Settled claims have not exceeded this commercial coverage for the last three years. MISC does not maintain general liability insurance; maritime insurance; and fire, lightning and typhoon insurance for its office building and contents. In the event of an insurable loss, MISC may be self-insured to a material extent.

(4) Equipment

Capital asset activity during the years ended September 30, 2014 and 2013 is as follows:

	2014			
	October 1, 2013	Additions	Retirements	September 30, 2014
Equipment	$ 286,863	$ 41,120	$ -	$ 327,983
Vehicles	149,630	163,967	-	313,597
Furniture	6,000	-	-	6,000
Motor boats	46,623	40,000	-	86,623
	489,116	245,087	-	734,203
Less accumulated depreciation	(419,821)	(71,938)	-	(491,759)
	$ 69,295	$ 173,149	$ -	$ 242,444

	2013			
	October 1, 2012	Additions	Retirements	September 30, 2013
Equipment	$ 286,863	$ -	$ -	$ 286,863
Vehicles	149,630	-	-	149,630
Furniture	6,000	-	-	6,000
Motor boats	43,188	3,435	-	46,623
	485,681	3,435	-	489,116
Less accumulated depreciation	(358,647)	(61,174)	-	(419,821)
	$ 127,034	$ (57,739)	$ -	$ 69,295

(5) Related Party Transactions

MISC was created by the Nitijela of RepMar under Public Law 2005-41 and is thus considered a component unit of RepMar. Accordingly, MISC is affiliated with all RepMar-owned and affiliated entities, including Tobolar Copra Processing Plant, Inc. (Tobolar).

A summary of related party transactions for the years ended September 30, 2014 and 2013 is as follows:

	2014			
	Revenues	Expenses	Receivables	Payables
Tobolar	$ 1,964,412	$ -	$ 106,342	$ -
Marshall Islands Social Security Administration	62	160,301	148	73,215
Marshalls Energy Company, Inc.	251,809	148,062	28,500	6,879
RMI Ports Authority	-	36,731	-	158,641
Republic of the Marshall Islands	1,462,555	100,136	54,484	47,773
Other	616	26,365	100	9,709
	$ 3,679,454	$ 471,595	$ 189,574	$ 296,217

(5) Related Party Transactions, Continued

	2013			
	Revenues	Expenses	Receivables	Payables
Tobolar	$ 345,459	$ -	$ 86,606	$ -
Marshall Islands Social Security Administration	-	135,695	-	53,323
Marshalls Energy Company, Inc.	62	160,334	-	5,978
RMI Ports Authority	-	35,770	-	115,976
Republic of the Marshall Islands	89,621	139,904	11,783	42,855
Other	643	20,725	123	12,605
	$ 435,785	$ 492,428	$ 98,512	$ 230,737

During the years ended September 30, 2014 and 2013, the operations of MISC were funded by appropriations, totaling $1,299,057 and $1,225,405, respectively, from the Nitijela of RepMar.

MISC occupies certain office space and utilizes five vessels belonging to RepMar at no cost. No lease agreements have been executed to formalize these arrangements. However, management is of the opinion that no rental payments for the use of these properties are anticipated. The fair value of these contributions is presently not determinable. Accordingly, the contributed use of facilities has not been recognized as revenue and expense in the accompanying financial statements.

As described in note 6, MISC leases space from a related party.

(6) Commitments and Contingencies

Commitments

MISC leased a warehouse for $2,905 per month, effective April 1, 2011, from the RMI Ports Authority, and which expired on July 31, 2014. The lease was renewed, effective August 1, 2014, for $2,557 per month and expires on July 31, 2016. In addition, MISC leases garage and storage space for $688 per month from a related party, and which expired on September 30, 2013. The lease was renewed, effective October 1, 2013, for $688 per month and expires on September 30, 2018. For the years ended September 30, 2014 and 2013, MISC recorded rent expense associated with these leases of $77,471 and $37,857, respectively.

Total minimum future rental payments for non-cancelable lease agreements for subsequent years ending September 30, are as follows:

Year ending September 30,	
2015	$ 38,928
2016	33,815
2017	8,250
2018	8,250
	$ 89,243

(6) Commitments and Contingencies, Continued

Contingencies

During the years ended September 30, 2014 and 2013, MISC incurred losses from operations of $1,209,825 and $999,662, respectively. For the years ended September 30, 2014 and 2013, MISC received operational subsidies of $1,299,057 and $1,225,405, respectively, from the Nitijela of RepMar. Although RepMar has provided funding in the past, MISC does not have a formal agreement with RepMar to provide future funding. A significant reduction in the level of budgetary support from RepMar, if this were to occur, may have an effect on MISC's programs and activities. For the year ended September 30, 2015, RepMar appropriated $1,270,247 to MISC for the purpose of funding operations.

MISC is party to certain legal proceedings arising from the ordinary course of its business. Management is of the opinion that the ultimate outcome of these proceedings is currently not determinable. Therefore, no provision has been recorded in the accompanying financial statements.

Deloitte & Touche LLP
361 South Marine Corps Drive
Tamuning, GU 96913-3911
USA

Tel: (671)646-3884
Fax: (671)649-4932
www.deloitte.com

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*

Chairman
Board of Directors
Marshall Islands Shipping Corporation:

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 the Marshall Islands Shipping Corporation (MISC), which comprise the statement of net position as September 30, 2014, 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 July 9, 2015.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered MISC'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 MISC's internal control. Accordingly, we do not express an opinion on the effectiveness of MISC'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 and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be significant deficiencies. We did identify certain deficiencies in internal control, described in the accompanying Schedule of Findings and Responses as items 2014-001 and 2014-002, which we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the MISC'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 instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Findings and Responses as items 2014-003 through 2014-005.

MISC's Responses to Findings

MISC's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Responses. MISC's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

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.

Deloitte + Touche LLP

July 9, 2015

Finding No. 2014-001

Fixed Assets

Criteria: Adequate internal control policies and procedures should be established to require that the subsidiary fixed assets register includes appropriate detail, a physical inventory of fixed assets is taken and reconciled with the fixed asset register, and fixed assets are adequately safeguarded and tagged. Furthermore, policies over actual estimated useful lives and capitalization thresholds should be adopted.

Condition: MISC has not established policies and procedures over fixed assets, specifically asset lives and capitalization thresholds. Furthermore, some fixed assets are not tagged.

Fixed assets should be included in the subsidiary register with accurate descriptions, acquisition dates and amounts. Also, capitalizable tax expenses related to the purchased fixed assets should capitalized. We also noted equipment that was damaged and non-operational but was not retired or assessed for impairment.

Cause: The cause of the above condition is the lack of established policies and procedures pertaining to fixed assets.

Effect: The effect of the above condition is a potential misstatement of fixed assets.

Recommendation: We recommend that MISC adopt policies and procedures pertaining to fixed assets.

Prior Year Status: Lack of policies and procedures pertaining to fixed assets was reported as a finding in the audits of MISC for fiscal years 2007 through 2013.

Auditee Response and Corrective Action Plan:

Who: Head Accounting Officer

What: MISC management will review the current draft policy to ensure it remains in line with the accounting needs of MISC, it addresses any possible internal control gaps, it provides specific guidelines for capitalization thresholds and depreciation method, it addresses proper acquisition and disposal of assets, it ensures proper procedures are well documented to including tagging of the fixed assets and updating the fixed assets subsidiary ledger. Upon completion of the updates, the MISC management will submit to the Board for approval in FY 2015.

In addition, the Accounting Department will review the fixed assets subsidiary ledger and address the issues of accurate descriptions and acquisition dates and perform timely fixed asset reconciliation, including proper recording of disposal assets. Furthermore, initial efforts to have fixed asset tags have been initiated and are part of the Fixed Asset policy and process as noted above.

Finding No. 2014-001, Continued

Fixed Assets

Auditee Response and Corrective Action Plan, Continued:

With technical assistance provided by the Asian Development Bank Development Coordination Office, the local consultant will support MISC in the fourth quarter of FY2015 to assist with finalization of the fixed asset policy and to assist the Accounting Department with capacity building and implementation of the fixed asset policy.

When: Fiscal Year 2015

Finding No. 2014-002

Revenues

Criteria: Adequate internal control policies and procedures should be established requiring that revenues be accurately supported, identified, recorded, and collected. Furthermore, pre-numbered forms should be utilized to facilitate the completeness of recorded revenue.

Condition: The following exceptions concerning revenue tests were noted:

1. Significant delays occur in preparation and completion of cargo and passenger manifests. As of March 20, 2015, cargo and passenger manifests for the fiscal year-ended September 30, 2014 could not be provided. Missing sequences in passenger tickets per passenger manifests were not investigated.

2. Cargo and passenger sales analyses per voyage (voyage report vs. recorded revenue) were not performed.

3. Timely reconciliation/recording of copra freight revenue was not performed.

4. One charter trip was provided with a charter fee discount with no written formal documentation supporting the authority to provide the discount.

Cause: The cause of the above condition is the lack of established policies and procedures that require that revenues be accurately supported, identified, recorded, and collected.

Effect: The effect of the above condition is a possible misstatement of revenues.

Recommendation: We recommend that MISC maintain and organize cargo and passenger manifests. Furthermore, we recommend that revenue analysis (cargo and passenger) be performed per voyage to verify the reasonableness of recorded revenues against voyage data provided by the booking staff. Also, we recommend that timely reconciliation or recording of revenues be performed throughout the year. Also, we recommend that all decisions, orders, rules and regulations relating to the financial operation of MISC shall be made by resolution of the Board of Directors at a meeting and shall be recorded in the minutes of such meeting of the Board.

Prior Year Status: Lack of established policies and procedures pertaining to revenues was reported as a finding in the audits of MISC for fiscal years 2007 through 2013.

Auditee Response and Corrective Action Plan:

Who: Head Accounting Officer

What: Management will establish MISC revenue policies and procedures to be in effect for FY 2015.

With technical assistance provided by the Asian Development Bank Development Coordination Office, the local consultant will support MISC in the fourth quarter of FY2015 to assist with establishment of MISC's revenue policies and procedures policy and to assist the Accounting Department with capacity building and implementation of the policy. In addition, support will be provided to address the findings.

Finding No. 2014-002, Continued

Revenues

Auditee Response and Corrective Action Plan, Continued:

It is highly likely this will be a repeat finding in FY2015.

When: Fiscal Year 2015

Finding No. 2014-003

Local Noncompliance

Criteria: Public Law 2005-41 established the Marshall Islands Shipping Corporation (MISC) and authorized all movable and immovable property of the shipping services under the Ministry of Transportation and Communication be vest absolutely in MISC. Furthermore, all assets and liabilities, rights, duties, and obligations, and all contracts and agreements relating to shipping services existing on the date of MISC's establishment shall stand transferred and vest in MISC.

Condition: No documentation was provided to indicate that all assets, liabilities, rights, duties and obligations, and all contracts and agreements relating to shipping services existing on the date of MISC's establishment have been transferred to MISC. Specifically, five vessels (Aemman, Langdrik, Ribuuk Ae, Majuro and Kwajalein) operated by MISC and vehicles previously with the Ministry of Transportation and Communications are not recorded by MISC.

Cause: The cause of the above condition is the lack of official documentation transferring all assets and liabilities, rights, duties and obligations, and all contracts and agreements of the relating to shipping services existing on the date of MISC's establishment.

Effect: The effect of the above condition is noncompliance with requirements of Public Law 2005-41.

Recommendation: We recommend that management comply with the requirements of Public Law 2005-41.

Prior Year Status: Noncompliance with Public Law 2005-41 was reported as a finding in the audits of MISC for fiscal years 2007 through 2013.

Auditee Response and Corrective Action Plan:

Who: Head Accounting Officer

What: The noncompliance issue with the Public law 2005-41 has been escalated to the MISC Board. Management's understanding of the progress to have the assets transferred to MISC, as appropriate is slow and at a standstill.

With technical assistance provided by the Asian Development Bank Development Coordination Office, the local consultant will support MISC in the fourth quarter of FY2015 to assist with addressing this issue, including preparing the supporting documentation and required documents for all relevant government stakeholders signatory to include Ministry of Finance and Ministry of Transportation & Communication.

When: Fiscal Year 2015

Finding No. 2014-004

Local Noncompliance

Criteria: RepMar's Procurement Code states the following:

(a) Section 124 – unless otherwise authorized by law, all Government contracts shall be awarded by competitive sealed bidding.

(b) Section 127 – procurement of goods and services not exceeding $25,000 may be made in accordance with small purchase procedures promulgated by RepMar's Policy Office. Small purchase procedures are those relatively simple and informal methods for securing services, supplies, or other property that do not cost more than $25,000. RepMar's Ministry of Finance has previously declared that if small purchase procedures are used, price or rate quotations shall be obtained from an adequate number of qualified sources.

(c) Section 128 – a contract may be awarded for supply, service, or construction item without completion when it is determined in writing that there is only one source for the required supply, service, or construction them.

Condition: MISC does not have a formal procurement policy requiring documentation indicating the history of procurement to be maintained on file.

Cause: The cause of the above condition is the lack of established policies and procedures requiring documentation of procurement procedures to ensure compliance with RepMar's Procurement Code.

Effect: The effect of the above condition noncompliance with RepMar's Procurement Code.

Recommendation: We recommend that management establish policies and procedures to be in compliance with RepMar's Procurement Code.

Prior Year Status: Noncompliance with RepMar's Procurement Code was reported as a finding in the audits of MISC for fiscal years 2007 through 2013.

Auditee Response and Corrective Action Plan:

Who: Head Accounting Officer

What: MISC will adopt the RepMar Procurement policy requiring a minimum of three quotes. In addition, MISC will tailor its Procurement policy to the specialized needs of MISC. In some case, MISC access to vendors in the shipping industry is limited for ordering shipping vessel parts. In the case where a minimum of three quotes cannot be met, the Accounting Department will ensure to clearly document the deviation and in compliance with the RepMar Procurement policy.

It is highly likely this will be a repeat finding in FY2015.

When: Fiscal Year 2015

Finding No. 2014-005

Local Noncompliance

Criteria: Section 426 of Marshall Islands Shipping Corporation Act, 2004 states the following:

(a) The Corporation may from time to time fix charges for services provided by the Corporation.

(b) In fixing the charges, the Corporation must follow the procedures set out in this section.

(c) Before fixing the charges, the Corporation must submit the proposed charges to Cabinet for approval.

(d) The Corporation must publish notice of charges in the local newspaper or the local radio station.

Condition: MISC charges are based on new rates which were not approved by the Cabinet.

Cause: The cause of the above condition is approval by the Cabinet has not been obtained.

Effect: Noncompliance with Marshall Islands Shipping Corporation Act, 2004 appears to have occurred.

Recommendation: We recommend that management obtain approval from the Cabinet to be in compliance with Marshall Islands Shipping Corporation Act, 2004.

Auditee Response and Corrective Action Plan:

Who: Head Accounting Officer

What: MISC currently operates based on tariff rates established back in 1983. With high fuel prices today, there is a critical need for MISC to review and increase its tariff rate. In September 2011, MISC had prepared a proposal for Cabinet to approve a minimal increase in rates for shipping services. As required, the new rates were published to the general public to foster awareness and as required by Section 426 of Marshall Islands Shipping Corporation Act, 2004. To date, Cabinet approval has not been obtained. In FY2014, new rates were applied erroneously. Immediate corrective action to revert back to the old rates is in effect as of 30 June 2015.

MISC and the Board of Directors will revive its lobbying efforts with Cabinet members to approve the proposed new rates. Given the sensitivity of the matter with increasing rates, MISC and Board of Director shall revise its current rate increase proposal. A different approach perhaps shall be to keep the same passenger and cargo rates but appeal to the Cabinet to consider allowing the rate increase for charter rates, thereby having a lesser impact on vulnerable groups in the outer island.

Given the timing of the new finding being presented to MISC, it is highly likely this will be a repeat finding in FY2015 but will be resolved in FY2016.

When: Fiscal Year 2015

MARSHALL ISLANDS SHIPPING CORPORATION

Unresolved Prior Year Findings
Year Ended September 30, 2014

The status of unresolved prior year findings is disclosed within the Schedule of Findings and Responses sections of this report.