MARSHALL ISLANDS SHIPPING CORPORATION

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

FINANCIAL STATEMENTS AND INDEPENDENT AUDITORS' REPORT

YEARS ENDED SEPTEMBER 30, 2018 and 2017

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

Years Ended September 30, 2018 and 2017
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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, 2018 and 2017, 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.

Deloitte.

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, 2018 and 2017, 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 April 29, 2019, 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 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 MISC'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 MISC's internal control over financial reporting and compliance.

Deloitte + Touche LLP

April 29, 2019

Marshall Islands Shipping Corporation (MISC) herewith presents a discussion and analysis of the company's financial performance for the financial year ended 30th September 2018. 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 2018 was $8,542,142 compared to net position of $1,437,797 in 2017. The increase in net position from 2017 to 2018 is a positive indicator of the stabilization of MISC operations and ongoing efforts by management to maintain its expenditure spending within its operational revenues, as well as nonoperational revenues in the form of government subsidies and government capital contributions of $7,307,061 representing the subsidy for purchase of a new ship and the transfer of three (3) ships - MV Aemman, MV Ribuuk Ae, and MV Kwajelein from RMI Finance.

MISC's total net operating revenue decreased by $615,792 (35%) from $1,744,994 in 2017 compared to $1,129,202 in 2018. The decrease in revenue for Charter, Cargo, Ships Sales and Passenger is caused by the decrease of the field trip services and charter trips to the Outer Islands with MISC's current fleet of four (4) vessels from 67 total field trips in 2018 compared to 74 total field trips in 2017. MISC's passenger revenue decreased significantly by $18,766 (19%) to $77,476 in 2018 compared to $96,242 in 2017. Cargo revenues decreased by $8,599 (2%) to $566,808 in 2018 compared to $575,407 in 2017. Fuel and other revenue increased by $113,969 (87%) to $245,576 in 2018 compared to $131,607 in 2017. MISC's ship sales revenue decreased by $41,380 (76%) to $12,760 in 2018 compared to $54,141 in 2017. Copra fee revenues decreased by $812 (2%) to $32,296 in 2018 compared to $33,108 in 2017. MISC's charter revenue increased significantly from 2014-2017 due to RepMar's drought disaster declaration to provide relief efforts to the drought affected islands. Unfortunately, MISC's charter revenue decreased by $548,182 (60%) from $908,070 in 2017 to $359,888 in 2018.

Total operating expenses increased from 2017 to 2018. Total operating expenses were $3,236,245 in 2018 compared to $3,030,549 in 2017. Overall, MISC increased its total operating expenses by $205,696 (7%). Personnel and petroleum, oil, and lube (POL) expenses continue to remain MISC's leading operational expenses. Salaries, wages and benefit expenses increased by $64,854 (5%) from $1,234,594 in 2017 to $1,299,448 in 2018. POL expenses increased by $59,236 to $932,848 in 2018 compared to $873,612 in 2017. Material and supplies continued to decrease by $22,739 (10%) to $210,402 in 2018 from $233,141 in 2017. Unfortunately, travel and entertainment increased by $50,853 (66%) to $128,057 in 2018 from $77,204 in 2017. Drydock expense increased by $45,275 (25%) to $228,752 in 2018 compared to $183,477 in 2017.

MISC's operating loss increased by $821,488 (64%) from an operating loss of $1,285,555 in 2017 compared to an operating loss of $2,107,043 in 2018. Although MISC has maintained its efforts to reduce certain operating expenses, MISC will continue to operate at a loss ranging from $1.2M to $2M annually based on the current tariff rate structure that has been in place since the early 1980's.

MISC continues to depend heavily on subsidies from RepMar, which accounts for approximately 64% of MISC's source of total operating and non-operating revenues during 2018. The subsidy from RepMar to support the Shipping Vessel Repairs and Maintenance Act resumed in 2016. In 2017 and 2018, MISC received a total of $1.3M in subsidies for a ship purchase. Without the approval of RepMar to allow 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 as a community service obligation.

FINANCIAL ANALYSIS OF MISC

The Statements of Net Position and 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 assets increased for the year ended 30th September 2018.

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

	2018	2017	2016
ASSETS:			
Current and other assets	$ 1,067,008	$ 1,826,457	$ 782,619
Capital assets	8,600,045	261,227	227,043
Total Assets	9,667,053	2,087,684	1,009,662
LIABILITIES:			
Current Liabilities	1,124,911	649,887	608,581
NET POSITION:			
Net Investment in capital assets	7,936,045	261,227	227,043
Restricted	300,552	622,418	82,047
Unrestricted	305,545	554,152	91,991
Total net position	$ 8,542,142	$ 1,437,797	$ 401,081

Total assets increased from $1,009,662 in 2016 to $2,087,684 in 2017 and increased further to $9,667,053 in 2018. The increase in total assets by $1,078,022 (107%) from 2016 to 2017 is driven primarily by the increase in the dry dock prepayment, receivables and cash balances. In 2018, total assets increased further by $7,579,369 (363%) primarily due to the dry dock prepayment and the capital contribution from RepMar for a ship purchase and transfer of three (3) shipping vessels. Capital asset acquisitions of $8,537,337 was offset by depreciation of $89,667 and by retirements/disposals/reclassifications of $116,451.

Net capital assets increased from $227,043 in 2016 to $261,227 in 2017 and further increased to $8,600,045 in 2018. In 2017, net capital assets increased slightly by $34,184 (15%) with capital asset acquisitions of $122,738 offset by retirements/disposal of $74,712 and annual depreciation of $61,340. In 2018, net capital assets increased further by $8,338,818 with capital asset acquisitions of $8,537,337 offset by retirements/disposals/reclassifications of $116,451 and annual depreciation of $89,667.

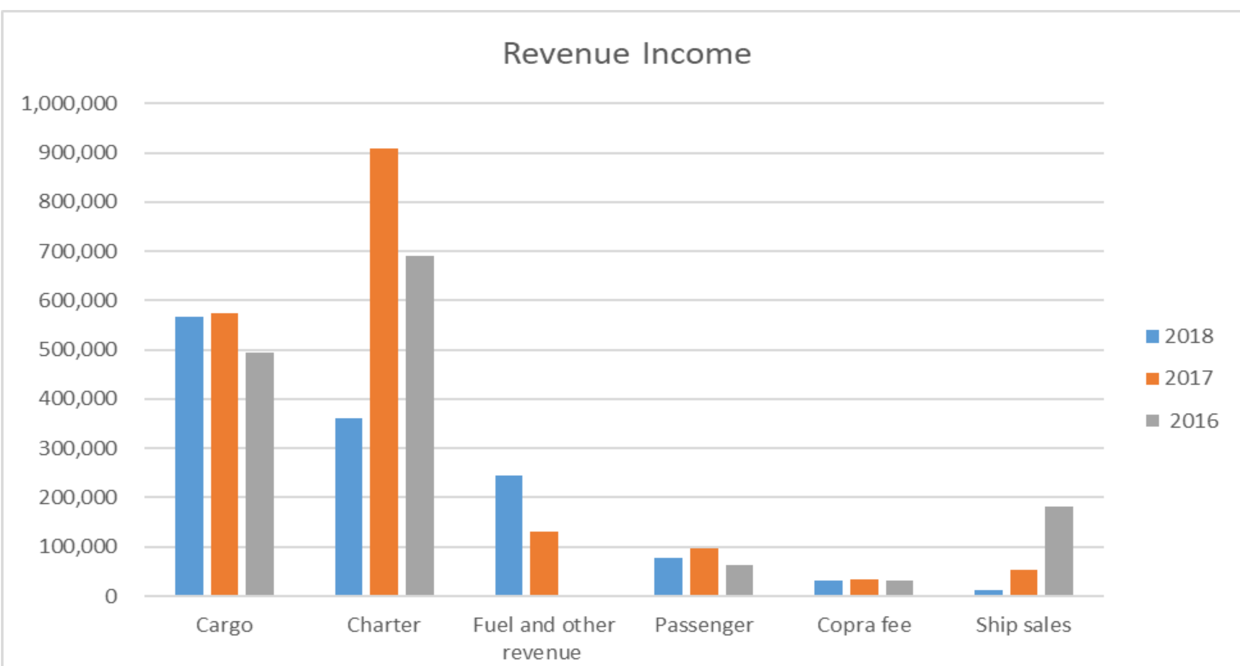
Total liabilities increased by $41,306 (7%) from $608,581 in 2016 to $649,887 in 2017 and further increased by $475,024 (73%) in 2018. In 2018, the significant increase in total liabilities is primarily driven by MISC's obligations due to ship contractor amounting to $664,000 and RepMar related parties, with RMI Ports Authority (RMIPA) being the highest. MISC rents warehouse and storage space from RMIPA but is not currently able to service the obligation due to cash flow constraints. MISC's total liabilities due to RepMar related parties were $384,588 in 2017, of which $180,619 was due to RMIPA, followed by $116,643 due to Marshall Islands Social Security Administration (MISSA). In 2018, MISC's total liabilities due to RepMar related parties were $219,654, down by $164,934 (43%) in comparison to 2017. Due to RMIPA decreased by $57,648 (32%) to $122,971. Payable to MISSA decreased by $49,083 (42%) to $67,560 and payable to Ministry of Finance decreased by $66,795 (80%).

The Summary Statements of Revenues, Expenses and Changes in Net Position for MISC is presented below:

	2018	2017	2016
REVENUES:			
Net operating revenues	$ 1,129,202	$ 1,744,994	$ 1,327,123
Nonoperating revenues – subsidies	1,906,227	1,894,720	1,737,237
Nonoperating revenues - other	-	-	5,354
Capital contributions	7,307,061	435,000	-
Total Revenues	10,342,490	4,074,714	3,069,714
EXPENSES:			
Operating expenses	3,236,245	3,030,549	2,948,603
Nonoperating expenses	1,900	7,449	-
Total Expenses	3,238,145	3,037,998	2,948,603
Change in Net Position	$ 7,104,345	$ 1,036,716	$ 121,111

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 net operating revenue increased by $417,871 (31%) to a total of $1,744,994 in 2017 compared to $1,327,123 in 2016. Unfortunately, in 2018, net operating revenue decreased by $615,792 (35%). 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 2016 and 2017. Charter revenue increased due to the delivery of goods and materials to rebuild houses that were damaged from heavy rough waves in 2017. Total trips decreased by 7 (9%) trips to 74 trips in 2017 compared to 67 trips in 2018.

The graphic below shows the major components of MISC's operating revenue from 2016 through 2018:



Total operating expenses increased by $81,946 (3%) from $2.94M in 2016 compared to $3.0M in 2017. In 2018, the total operating expenses slightly increased by $205,696 (7%) to $3.24M. For 2018, the top five components of operating expenses are: (1) Salaries, Wages and Benefits, (2) Petroleum, Oil & Lube (POL), (3) Drydock and Repairs and Maintenance Expense (4) Material and Supplies (5) Foodstuff.

Salaries, wages and benefits remain as the leading operational expense and increased by $159,455 (13%) from $1.07M in 2016 to $1.23M in 2017 and continued to increase by $64,854 (5%) to $1.30M in 2018. The Cabinet decision to transfer the MV Majuro to the Ministry of Works, Infrastructure & Utilities is not expected to impact the operational expenses as the crew will remain with MISC.

POL expenses increased by $300,460 (52%) from $573,152 in 2016 to $873,612 in 2017 and increased by $59,236 (7%) to $932,848 in 2018.

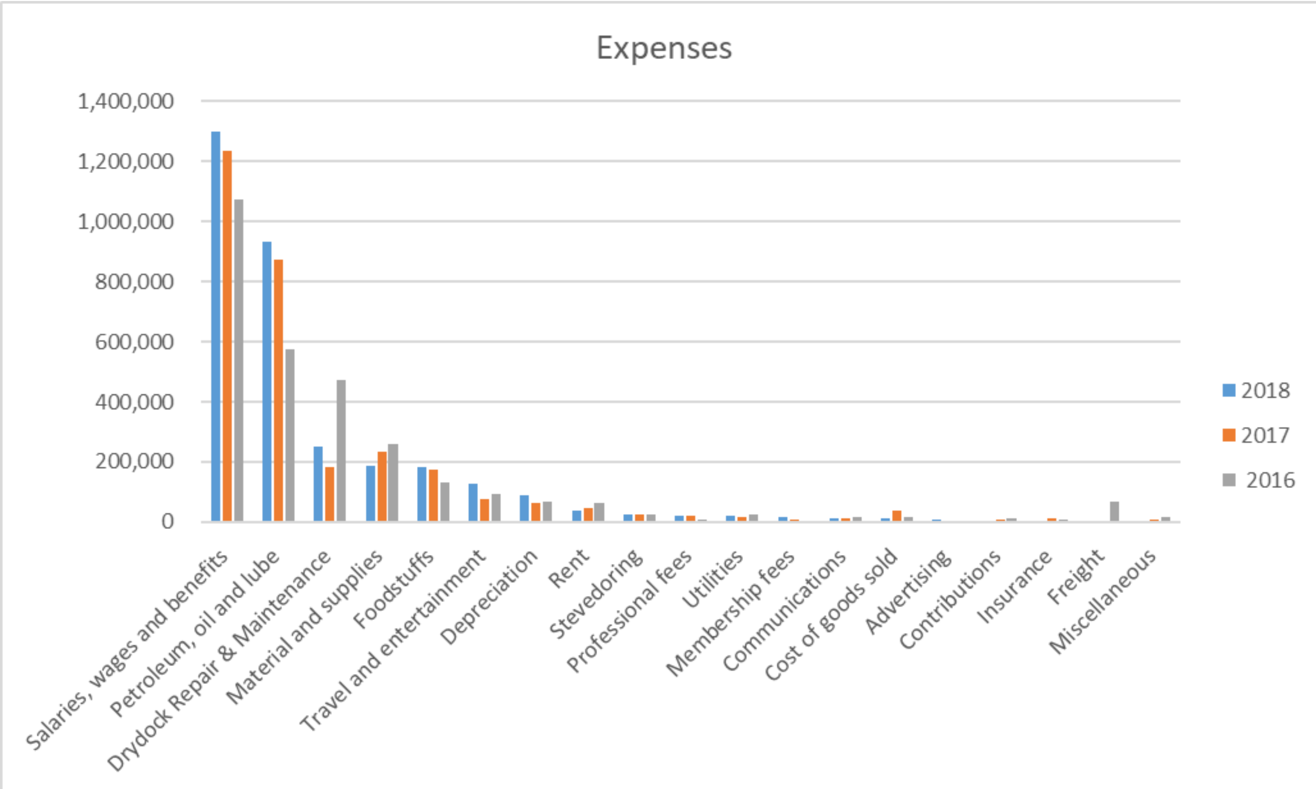
With the establishment of the Shipping Vessel Repairs and Maintenance Act in 2011, an annual subsidy is granted by RepMar for proper and timely dry docking, repairs and maintenance to be undertaken by MISC. This is to ensure the good and operable condition of the shipping fleet and for the safety and reliability of sea transportation services for the RMI outer island community. Drydock expense increased by $114,729 (167%) from $68,748 in 2016 to $183,477 in 2017 and further increased by $45,275 (25%) to $228,752 in 2018.

Materials and supplies expenses decreased by $240,880 (103%) from $474,021 in 2016 to $233,141 in 2017 and continued to decrease by $22,739 (11%) to $210,402 in 2018. This is in relation to Management's efforts to minimize expenses.

Foodstuff expenses decreased by $85,765 (33%) from $261,005 in 2016 to $175,240 in 2017 and increased by $8,386 (5%) to $183,626 in 2018. The significant increase in 2018 is expected due to the hired stevedoring (Okipade) crews to do copra stevedoring.

Ship sales services provide MISC an alternative source of income to subsidize it operations. Cost of goods sold (COGS) decreased by $97,640 (73%) from $133,160 in 2016 to $35,520 in 2017 and decreased further by $24,906 (70%) to $10,614 in 2018. The decrease in cost of goods sold for 2017 and 2018 is attributed primarily to the private vendors taking over the merchant services on the vessels through a claimed decision by the Cabinet to privatize such services. As such services were a major source of revenue for MISC, the Board had decided in 2018 to investigate whether there was a Cabinet Minute authorizing such services to be privatized; and if not, then return such to MISC. Since the office of the clerk of Cabinet had confirmed that there had not been any CM in this regard, merchandise or sales services are expected to return in 2019, but through a transitional or phase out period. Accordingly, MISCO, which had been the merchant on the three vessels, namely the MV Aemman, MV Kwajelein, and MV Ribuuk Ae, shall be notified.

The following graphic shows the major components of operating expenses from 2016 through to 2018:



The operating loss before non-operating revenues (i.e. RepMar subsidy) for 2018 was approximately $2.1M compared to $1.29M in 2017 and $1.62M in 2016, respectively. In 2016, operating loss decreased by $73,022 (4%) with dry-docking of MV Aemman and followed by MV Ribuuk Ae and loss of MV Landrik. In 2017, operating loss decreased by $335,925 (21%) with dry-docking of MV Ribuuk Ae and MV Kwajelein. In 2018, even though MISC was able to control and decrease some of the operating expenses for some of the areas, the operating loss increased by $821,488 (64%) to $2.1M with the drydocking of MV Ribuuk Ae in Solomon Islands.

Total subsidies, for operations and for repairs and maintenance, were $1.9M in 2018 compared to $1.8M in 2017 and $1.7M in 2016. RepMar's Appropriation Act for the 2014 budget had approved MISC to receive a total subsidy of $1.75M. MISC did not receive the appropriated funds earmarked for the repair and maintenance subsidy. In 2015 and 2016, receipt of the repair and maintenance subsidy resumed. 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. In 2016, MISC budgeted $1.7M for the purchase of a new vessel, which MISC also did not receive. In 2017, an additional $250,000 was appropriated on top of the initial appropriation amounting to $1.7M, as a down-payment to secure the ship purchase. Only $0.43M was used for the negotiations of said vessel. The new vessel is expected to be delivered in May 2019.

The operating subsidy received from RepMar in 2018 increased by $11,507 (1%). Expenses related to ship purchase is at $1,236,500 in 2018. 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.

Management's Discussion and Analysis for the year ended September 30, 2017 is set forth in MISC's report on the audit of financial statements, which is dated June 29, 2018. That Management's Discussion and Analysis explains the major factors impacting 2017 financial statements and can be obtained from MISC's General Manager via the contact information below.

CAPITAL ASSET AND DEBT

Net capital assets increased from $261,227 in 2017 to $8,600,045 in 2018. Capital asset acquisitions of $8,537,337 were offset by depreciation of $89,667 and by retirements/disposals/reclassifications of $116,451.

Refer to note 5 to the accompanying financial statements for additional information relating to capital assets.

CASH FLOWS

Net cash used for operating activities for 2018 was $2.1M compared to net cash used for operating activities of $1.2M in 2017 and $1.7M in 2016. The cash provided by operational activities was absorbed entirely by MISC's operational costs. Additionally, an injection of cash flow from RepMar subsidies was received in the amount of $2.7M, $2.3M and $1.7M during 2018, 2017, and 2016, respectively. In 2016, RepMar subsidies were utilized by MISC to cover its operational expenses in the amount of $1.26M; and for repairs and maintenance expenses in the amount of $0.48M. 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". In 2017, the RepMar subsidies were utilized by MISC to cover its operational expenses in the amount of $1.4M; and for repairs and maintenance expenses in the amount of $0.45M; and for new ship negotiation expenses in the amount of $0.43M. In 2018, the RepMar subsidies were utilized by MISC to cover operational expenses in the amount of $1.44M; and for drydocking repairs and maintenance expenses in the amount of $0.45M; and for New Ship negotiation travel expenses in the amount of $0.87M.

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.

FUTURE OUTLOOK ON SUSTAINABILITY, CONTINUED

As an indicator of MISC's future outlook on sustainability, MISC has continued to improve and increase its net position since 2012. MISC's net position increased to $8,542,142 in 2018, compared to a net position of $1,437,797 in 2017, $401,081 in 2016, $279,970 in 2015, $224,931 in 2014, $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 – 2017 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, 2016 climate change such as El Nino and 2017 climate change of heavy wave storm, 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 position. In addition to the subsidies received from RepMar, the three (3) vessels (MV Ribuuk Ae, MV Aemman, and MV Kwajelein) were formally transferred with NBV of $6,432,862.

MISC's improved trend on net position over the period 2016 to 2018 provides an indicator of MISC management's efforts to reduce its recurrent expenditures. 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 $1.2M to $2.1M 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's strategic plan will be expired in 2021. With tariff rates likely to remain low, on-going financial support from RepMar will have to continue and may need to increase, as appropriate to satisfy the community service obligation provided by MISC.

The future outlook on sustainability for MISC continues to be threatened by the deteriorating conditions of the shipping vessel. 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.

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 and New Ship;
- 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.
- 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:
    - Lobby and seek government and development partner opportunities to finance or co-finance procurement of additional shipping vessels to increase MISC's existing shipping fleet;
    - Seek assistance from donor partners opportunities to finance or co-finance procurement of additional equipment or trucks to improve or streamline loading and unloading processes of the vessels to ensure quicker turn-around of the vessels and improve the efficiency of their transport services.
    - Develop a tariff rate template to incorporate rising cost and fluctuation of fuel and inflation rates;
    - Streamline 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; and
    - Ensure adherence to the shipping repairs and maintenance schedule.

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 2018. 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, 2018 and 2017

ASSETS		2018		2017
Current assets:				
Cash	$	493,028	$	1,178,723
Receivables:				
Trade		152,158		136,922
Affiliates		400,593		292,627
Employees		268,922		308,943
		821,673		738,492
Less allowance for doubtful accounts		(604,605)		(439,003)
Total receivables, net		217,068		299,489
Inventory		2,379		3,801
Current portion of prepaid drydocking		211,659		195,083
Total current assets		924,134		1,677,096
Noncurrent assets:				
Prepaid drydocking, net of current portion		142,874		149,361
Capital assets:				
Nondepreciable capital assets		1,900,500		-
Capital assets, net of accumulated depreciation		6,699,545		261,227
Total noncurrent assets		8,742,919		410,588
	$	9,667,053	$	2,087,684
LIABILITIES AND NET POSITION				
Current liabilities:				
Accounts payable	$	117,606	$	152,783
Payable to affiliates		219,654		384,588
Contracts payable		664,000		-
Accruals and other liabilities		123,651		112,516
Total liabilities		1,124,911		649,887
Commitments and contingencies				
Net position:				
Net investment in capital assets		7,936,045		261,227
Restricted		300,552		622,418
Unrestricted		305,545		554,152
Total net position		8,542,142		1,437,797
	$	9,667,053	$	2,087,684

See accompanying notes to financial statements.

MARSHALL ISLANDS SHIPPING CORPORATION

Statements of Revenues, Expenses and Changes in Net Position
Years Ended September 30, 2018 and 2017

	2018	2017
Operating revenues:		
Cargo	$ 566,808	$ 575,407
Charter	359,888	908,070
Fuel and other revenue	245,576	131,607
Passenger	77,476	96,242
Copra fee	32,296	33,108
Ship sales	12,760	54,141
Total operating revenues	1,294,804	1,798,575
Provision for bad debts	(165,602)	(53,581)
Net operating revenues	1,129,202	1,744,994
Operating expenses:		
Salaries, wages and benefits	1,299,448	1,234,594
Petroleum, oil and lube	932,848	873,612
Drydock expense	228,752	183,477
Material and supplies	210,402	233,141
Foodstuffs	183,626	175,240
Travel and entertainment	128,057	77,204
Depreciation	89,667	61,340
Rent	37,443	44,553
Stevedoring	23,349	23,114
Professional fees	21,828	21,467
Utilities	19,486	18,002
Membership fees	16,550	7,700
Communications	11,780	11,999
Cost of goods sold	10,614	35,520
Advertising	6,829	318
Contributions	4,785	7,280
Insurance	3,628	12,991
Freight	3,130	2,500
Miscellaneous	4,023	6,497
Total operating expenses	3,236,245	3,030,549
Operating loss	(2,107,043)	(1,285,555)
Nonoperating revenues (expenses):		
Operating subsidies	1,906,227	1,894,720
Loss on disposal of fixed asset	(1,900)	(7,449)
Nonoperating revenues	1,904,327	1,887,271
Income (loss) before capital contributions	(202,716)	601,716
Capital contributions	7,307,061	435,000
Change in net position	7,104,345	1,036,716
Net position at beginning of year	1,437,797	401,081
Net position at end of year	$ 8,542,142	$ 1,437,797

See accompanying notes to financial statements.

MARSHALL ISLANDS SHIPPING CORPORATION

Statements of Cash Flows

Years Ended September 30, 2018 and 2017

	2018	2017
Cash flows from operating activities:		
Cash received from customers	$ 1,211,623	$ 1,675,823
Cash payments to suppliers for goods and services	(2,055,908)	(1,645,088)
Cash payments to employees for services	(1,288,313)	(1,240,048)
Net cash used for operating activities	(2,132,598)	(1,209,313)
Cash flows from noncapital financing activities:		
RepMar subsidy received	1,906,227	1,894,720
Cash flows from capital and related financing activities:		
Acquisition of capital assets	(1,333,524)	(122,736)
Capital contributions received	874,200	435,000
Proceeds from sale of capital assets	-	19,763
Net cash cash provided by (used for) capital and related financing activities	(459,324)	332,027
Net change in cash	(685,695)	1,017,434
Cash at beginning of year	1,178,723	161,289
Cash at end of year	$ 493,028	$ 1,178,723
Reconciliation of operating loss to net cash used for operating activities:		
Operating loss	$ (2,107,043)	$ (1,285,555)
Adjustments to reconcile operating loss to net cash used for operating activities:		
Depreciation	89,667	61,340
Provision for bad debts	165,602	53,581
(Increase) decrease in assets:		
Receivables:		
Affiliates	(107,966)	61,087
Trade	(15,236)	66,870
Employees	40,021	(250,709)
Inventory	1,422	4,046
Prepayments	(10,089)	38,721
Increase (decrease) in liabilities:		
Accounts payable	(35,177)	57,308
Payable to affiliates	(164,934)	(10,548)
Accruals and other liabilities	11,135	(5,454)
Net cash used for operating activities	$ (2,132,598)	$ (1,209,313)
Summary disclosure of noncash capital and related financing activities:		
Capital contribution from RepMar	$ 6,432,861	$ -
Additions to capital assets	(6,432,861)	-
	$ -	$ -

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 seven-member Board of Directors 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 (GAAP), 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 GASB Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus*, GASB Statement No. 38, *Certain Financial Statement Note Disclosures*, and GASB Statement No. 61, *The Financial Reporting Entity: Omnibus – an amendment of GASB Statements No. 14 and 34,* 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 Statement No. 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 that is constrained for specific purposes which are externally imposed by providers, such as creditors or amounts constrained due to constitutional provisions or enabling legislation. At September 30, 2018 and 2017, MISC has restricted net position of $300,552 and $622,418, respectively, relating to unexpended contributions from RepMar for dry-docking and new vessel.

- 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 deferred outflows of resources, and liabilities and deferred inflows of resources 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, 2018 and 2017, the carrying amount of cash was $493,028 and $1,178,723, respectively, and the corresponding bank balances were $534,817 and $1,202,452, respectively. Of the bank balance amounts, $524,814 and $1,202,452, respectively, were maintained in a financial institution subject to Federal Deposit Insurance Corporation (FDIC) insurance with the remaining amounts being maintained in a financial institution not subject to depository insurance. As of September 30, 2018 and 2017, bank deposits in the amount of $250,000 were FDIC insured. MISC does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk.

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 (moving average) or market value (net realized value).

Deferred Dry-dock Expenditures

Dry-dock expenditures have been recognized as an asset when the recognition criteria were met. The recognition is made when the dry-docking has been performed and is amortized over a period until the next scheduled dry-docking, which is usually two to three years. Ordinary repairs and maintenance expenses are charged to the income statement during the financial period in which they are incurred.

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 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.

(2) Summary of Significant Accounting Policies, Continued

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.

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, 2018 and 2017, the accumulated vacation leave liability totals $79,093 and $65,054, respectively, and is included within the statements of net position as accruals and other liabilities.

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. 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 accordance with GAAP 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.

New Accounting Standards

During the year ended September 30, 2018, MISC implemented the following pronouncements:

- GASB 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.

- GASB 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.

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

- GASB Statement No. 85, *Omnibus 2017*, which address 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).

- GASB Statement No. 86, *Certain Debt Extinguishment Issues*, which improves consistency in accounting and financial reporting for in-substance defeasance of debt.

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

In April 2018, GASB issued Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*, which improves the information that is disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements. The provisions in Statement No. 88 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 June 2018, GASB issued Statement No. 89, *Accounting for Interest Cost Incurred before the End of a Construction Period*, which requires that interest cost incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred for financial statements prepared using the economic resources measurement focus. The provisions in Statement No. 89 are effective for fiscal years beginning after December 15, 2019. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In August 2018, GASB issued Statement No. 90, *Majority Equity Interests – an Amendment of GASB Statements No. 14 and No. 61,* which improves the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and the relevance of financial statement information for certain component units. The provisions in Statement No. 90 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.

(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) Prepaid Drydocking

During the years ended September 30, 2018 and 2017, MISC incurred dry-dock expenditures of $238,841 and $144,756, respectively, for MV Ribuuk Ae and MV Kwajelein in Fiji and MV Ribuuk Ae in Solomon Islands, which is to be amortized over 3 years. As of September 30, 2018 and 2017, prepaid dry-docking amounted to $354,533 and $344,444, respectively.

An analysis of the change in prepaid drydocking costs during the years ended September 30, 2018 and 2017 is as follows:

	2018	2017
Beginning balance	$ 344,444	$ 383,165
Drydock costs incurred	238,841	144,756
Amortized drydock expense	(228,752)	(183,477)
Ending balance	$ 354,533	$ 344,444
Disclosed as follows:		
Current	$ 211,659	$ 195,083
Noncurrent	142,874	149,361
	$ 354,533	$ 344,444

(5) Capital Assets

Capital asset activity for the years ended September 30, 2018 and 2017 is as follows:

	2018			
	October 1, 2017	Additions	Disposals/ Reclassifications	September 30, 2018
Equipment	$ 360,843	$ 24,950	$ (116,451)	$ 269,342
Vehicles	306,723	116,749	-	423,472
Vessels	89,119	6,432,861	-	6,521,980
Motor boats	115,098	62,276	-	177,374
	871,783	6,636,836	(116,451)	7,392,168
Less accumulated depreciation	(610,556)	(89,667)	7,600	(692,623)
	261,227	6,547,169	(108,851)	6,699,545
Construction in progress	-	1,900,500	-	1,900,500
	$ 261,227	$ 8,447,169	$ (108,851)	$ 8,600,045

(5) Capital Assets, Continued

	2017			
	October 1, 2016	Additions	Retirements/Disposals	September 30, 2017
Equipment	$ 358,858	$ 1,985	$ -	$ 360,843
Vehicles	329,208	52,225	(74,710)	306,723
Vessels	36,566	52,553	-	89,119
Motor boats	99,123	15,975	-	115,098
	823,755	122,738	(74,710)	871,783
Less accumulated depreciation	(596,712)	(61,340)	47,496	(610,556)
	$ 227,043	$ 61,398	$ (21,214)	$ 261,227

Construction in progress additions of $1,900,500 during the year ended September 30, 2018, pertain to the MV Enekio vessel under construction.

During the year ended September 30, 2018, RepMar formally transferred MV Ribuuk Ae, MV Kwajelein and MV Aemman to MISC with an aggregate net book value of $6,432,861.

On November 14, 2018, the RepMar Cabinet approved the transfer of MV Tobolar from Tobolar Copra Processing Authority to MISC.

(6) Restricted Net Position

Restricted net position at September 30, 2018 and 2017, consists of the following:

	2018	2017
Republic of the Marshall Islands:		
Repairs and Maintenance	$ 300,552	$ 237,884
New Vessel	-	384,534
	$ 300,552	$ 622,418

(7) 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 the RMI Ports Authority.

A summary of related party transactions as of September 30, 2018 and 2017 and for the years then ended are as follows:

	2018			
	Revenues	Expenses	Receivables	Payables
Tobolar Copra Processing Authority	$ 307,570	$ 880	$ 161,122	$ -
Marshall Islands Social Security Administration	-	255,856	-	67,560
Marshalls Energy Company, Inc.	92,925	173,226	3,537	7,641
RMI Ports Authority	-	44,764	-	122,971
Republic of the Marshall Islands	220,951	119,302	189,987	16,882
Other	7,389	61,123	46,037	4,600
	$ 628,835	$ 655,151	$ 400,593	$ 219,654

(7) Related Party Transactions, Continued

	2017			
	Revenues	Expenses	Receivables	Payables
Tobolar Copra Processing Authority	$ 334,819	$ -	$ 29,876	$ -
Marshall Islands Social Security Administration	-	211,045	-	116,643
Marshalls Energy Company, Inc.	93,777	51,763	74,247	654
RMI Ports Authority	-	48,761	-	180,619
Republic of the Marshall Islands	172,177	121,124	80,103	83,677
Other	112,824	40,662	108,401	2,995
	$ 713,597	$ 473,355	$ 292,627	$ 384,588

During the years ended September 30, 2018 and 2017, the operations of MISC were funded by $1,449,907 and $1,438,400, respectively, of appropriations, from the Nitijela of RepMar. In addition, during each of the years ended September 30, 2018 and 2017, MISC received Nitijela appropriations of $456,320 that were restricted for dry-docking and related expenses. As of September 30, 2018 and 2017, MISC had $300,552 and $622,418, respectively, of these appropriations that had not been expended for the designated purpose. Accordingly, these amounts are restricted within net position.

During the years ended September 30, 2018 and 2017, MISC also received $874,200 and $435,000, respectively, from the Nitijela of RepMar for a vessel purchase.

MISC occupies certain RepMar office space at no cost. No lease agreement has been executed to formalize this arrangement. However, management is of the opinion that no rental payment for the use of this property is anticipated. The fair value of this contribution is presently not determinable. Accordingly, the contributed facility use has not been recognized as revenue and expenses in the accompanying financial statements.

As described in note 8, MISC leases space from a related party.

(8) Commitments and Contingencies

Commitments

MISC leases a warehouse for $2,557 per month, effective August 1, 2015, from the RMI Ports Authority, which lease expires on July 31, 2020. During the years ended September 30, 2018 and 2017, MISC's recorded associated rent expense was $30,678 per year.

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

Year ending September 30,	
2019	$ 30,678
2020	25,565
	$ 56,243

MISC entered into a January 2018 agreement for construction of a general cargo vessel. The contracted price is $1,900,000 and the expected time of completion is ten working months after full payment of a 40% deposit. During the year ended September 30, 2018, MISC paid a total of $1,236,500 against the contract price. As of September 30, 2018, the remaining unpaid contract price is $664,000.

(8) Commitments and Contingencies, Continued

Contingencies

During the years ended September 30, 2018 and 2017, MISC incurred losses from operations of $2,107,043 and $1,285,555, respectively. During the years ended September 30, 2018 and 2017, MISC received operational subsidies of $1,449,907 and $1,438,400, respectively, from the Nitijela of RepMar in conjunction with $456,320 per year for dry-docking expenses. During the years ended September 30, 2018 and 2017, MISC also received $874,200 and $435,000, respectively, from the Nitijela of RepMar for a vessel purchase. 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. During the year ended September 30, 2019, RepMar has appropriated $1,600,000 and $450,000, respectively, to fund MISC operations and dry-docking expenses.

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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 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, 2018, 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 April 29, 2019.

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.

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 have not been identified. We did identify certain deficiencies in internal control, described in the accompanying Schedule of Findings and Responses as item 2018-001 that 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 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.

Deloitte & Touche LLP

April 29, 2019

Finding No. 2018-001

Employee Income Tax Withholdings

Criteria: Adequate internal control policies and procedures requires timely reconciliation of general ledger account balances. Furthermore, section 103 of the Income Tax Act 1989 requires the employer to withhold income taxes from employee wages at the rate of 8 percent upon the first $10,400 and 12 percent upon the amount over $10,400.

Condition: At September 30, 2018, MISC recorded a $64,121 RMI Withholding Taxes payable liability, which included a $8,017 liability for employee withholding income taxes and a $17,739 liability for overwithheld income taxes from employee wages. MISC subsequently reconciled and corrected the general ledger account balances.

Cause: The cause of the above condition is the lack of established policies and procedures requiring timely reconciliation of general ledger account balances and an incorrect rate of 12 percent applied to the first $10,400 of employee wages, which commenced in April 2016 after an update was performed to the Quickbooks accounting software.

Effect: The effect of the above condition is the overstatement of withholding taxes payable and the overwithholding of income taxes from employee wages; however, this matter was corrected by management in April 2019.

Recommendation: We recommend management establish policies and procedures requiring timely reconciliation of general ledger account balances.

Auditee Response and Corrective Action Plan: MISC has subsequently reconciled and corrected the general ledger account balances. Moving forward, MISC will timely reconcile the general ledger accounts to prevent and detect any similar problem in the future. Liabilities for over withheld income taxes from employee wages will be offset against employee receivables, if any.

Auditee Response and Corrective Action Plan:

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