

MAJURO WATER AND SEWER COMPANY, INC.

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

**FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED SEPTEMBER 30, 2018 AND 2017

**MAJURO WATER AND SEWER COMPANY, INC.
(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
Majuro Water and Sewer Company, Inc.:

Report on the Financial Statements

We have audited the accompanying financial statements of Majuro Water and Sewer Company, Inc. (MWSC), a component unit of the Republic of the Marshall Islands, which comprise the statements of net position as of September 30, 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.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Majuro Water and Sewer Company, Inc. as of September 30, 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.

Emphasis-of-Matter

Going Concern

The accompanying financial statements have been prepared assuming that MWSC will continue as a going concern. As discussed in Note 10 to the financial statements, MWSC's recurring losses from operations raise substantial doubt about its ability to continue as a going concern. Management's plans concerning these matters are also discussed in Note 10 to the financial statements. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

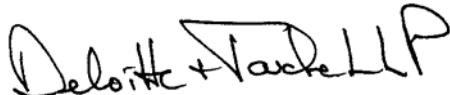
Other Matters

Required Supplementary Information

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

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated April 12, 2019, on our consideration of MWSC's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of MWSC's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering MWSC's internal control over financial reporting and compliance.



April 12, 2019

**MAJURO WATER AND SEWER COMPANY, INC.
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Management's Discussion and Analysis
Years Ended September 30, 2018 and 2017

FINANCIAL HIGHLIGHTS

Majuro Water and Sewer Company, Inc.'s (MWSC) net position decreased by \$260,432 in 2018 compared to a decrease of \$187,575 in 2017. The significant decrease is mainly due to a decrease in revenues and an increase in operational expenses.

Total operating revenues decreased by \$163,470 from \$1,400,891 in 2017 to \$1,237,421 in 2018. Within the operating revenues, utility billings decreased by \$133,451 from \$1,169,837 in 2017 to \$1,036,386 in 2018. Hook-ups and delivery billing decreased by \$36,346 from \$226,643 in 2017 to \$190,297 in 2018. The significant decrease in revenues is due to less demand in water utility and bulk water. Furthermore, there has been an additional \$212,306 allowance provided for uncollectable accounts in 2018 compared with \$332,104 in 2017.

Operating expenses increased by \$41,099 from \$1,900,503 in 2017 to \$1,941,602 in 2018. The main contributing factor for the increase in operating expenses is an increase in salaries, wages and benefits (\$34,934), electricity (\$45,822), depreciation and amortization (\$88,348), petroleum, oil and lubricants (\$5,822), insurance (\$14,134) and communications (\$2,332), offset by a decrease in spare parts (\$70,354), contractual services (\$9,184), entertainment and food (\$3,010), office supplies (\$4,972), licenses, fees and taxes (\$6,612), travel (\$23,711), chlorine (\$4,254), freight and handling (\$16,847) and repairs and maintenance (\$23,346).

The statement of cash flows net increase in cash was \$434,403 in 2018 compared to a net decrease of \$169,692 in 2017. The operating activities of MWSC resulted in a net cash outflow of \$36,329 in 2018 compared to a net cash inflow of \$9,866 for 2017. The decrease in net cash from operations in 2018 was offset to a degree by an increase in net cash from noncapital financial activities of \$29,052 and net cash from capital and related financing activities of \$441,680.

FINANCIAL ANALYSIS OF MWSC

The statement of net position and the statement of revenues, expenses and changes in net position provide an indication of MWSC's financial condition. MWSC's net position reflects the difference between assets and liabilities. An increase in net position over time typically indicates an improvement in financial condition.

A summary of MWSC's statements of net position is presented below:

	<u>2018</u>	<u>2017</u>	<u>2016</u>
Current assets	\$ 1,007,978	\$ 815,375	\$ 1,125,681
Capital assets, net	<u>1,532,746</u>	<u>1,666,504</u>	<u>1,138,340</u>
Total assets	<u>\$ 2,540,724</u>	<u>\$ 2,481,879</u>	<u>\$ 2,264,021</u>
Current liabilities	<u>\$ 3,124,700</u>	<u>\$ 2,805,423</u>	<u>\$ 2,399,990</u>
Net position:			
Net investment in capital assets	1,532,746	1,666,504	1,138,340
Restricted	604,242	85,300	155,083
Unrestricted	<u>(2,720,964)</u>	<u>(2,075,348)</u>	<u>(1,429,392)</u>
Total net position	<u>(583,976)</u>	<u>(323,544)</u>	<u>(135,969)</u>
Total liabilities and net position	<u>\$ 2,540,724</u>	<u>\$ 2,481,879</u>	<u>\$ 2,264,021</u>

As indicated above, total assets increased by \$58,845 from \$2,481,879 in 2017 to \$2,540,724 in 2018.

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Total liabilities reflects an increase of \$319,277 from \$2,805,423 in 2017 to \$3,124,700 in 2018. An increase in liabilities pertains to MWSC electricity bills to MEC. The net position decreased by \$260,432 from a net deficit of \$323,544 in 2017. There were no non-current liabilities at September 30, 2018 or 2017.

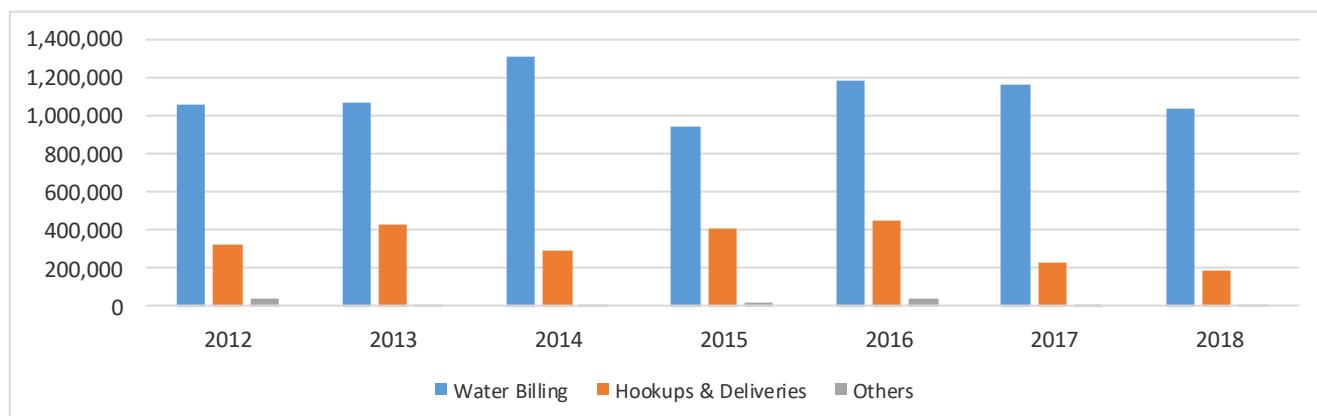
A summary of MWSC's statements of revenues, expenses, and changes in net position is presented below:

	<u>2018</u>	<u>2017</u>	<u>2016</u>
Revenues:			
Net operating revenues	\$ 1,025,115	\$ 1,068,787	\$ 1,302,161
Nonoperating revenues	<u>30,000</u>	<u>-</u>	<u>150,000</u>
Total revenues	<u>1,055,115</u>	<u>1,068,787</u>	<u>1,452,161</u>
Expenses:			
Operating expenses	1,941,602	1,900,503	1,860,720
Nonoperating expenses	<u>948</u>	<u>675</u>	<u>542</u>
Total expenses	<u>1,942,550</u>	<u>1,901,178</u>	<u>1,861,262</u>
Capital contributions	<u>627,003</u>	<u>644,816</u>	<u>103,249</u>
Change in net position	<u>\$ (260,432)</u>	<u>\$ (187,575)</u>	<u>\$ (305,852)</u>

The statement of revenue, expenses and changes in net position identifies that various revenue and expense items that impacted the change in net position. As indicated above, MWSC's operating revenues decreased by \$43,672 from \$1,068,787 in 2017 to \$1,025,115 in 2018. A decrease in revenue for 2018 consists of utility billings of \$133,451 and hook-up and deliveries of \$36,346, which is offset by an increase in others of \$6,327 and a decrease in bad debt expense of \$119,798.

Nonoperating revenues represent operating subsidies and grants received. The grants were received from RepMar in 2018 of \$208,325 to upgrade existing Saltwater and Sanitary Sewer Pump Stations, Water Treatment Plant C and Water Treatment Plant A. Upgrade includes mechanical, electrical overhaul and electrical replacement. The grant received from U.S. Government of \$327,000 to acquire and facilitate Airport Runway Cleaning Equipment and Efficiency Program. The grant received from Government of Japan of \$91,678 was to acquire a water truck and spare parts.

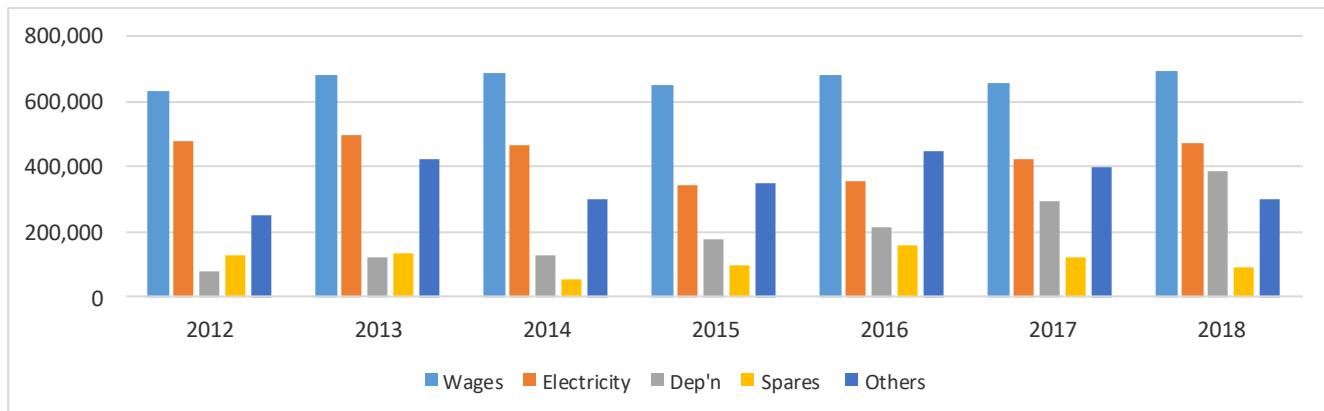
The graph below shows the major components of operating revenues for 2018 compared with the years 2012 through 2017.



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Operating expenses increased by \$41,099 to \$1,941,602 in 2018 from \$1,900,503 in 2017. The graph below shows the major components of operating expenses for 2018 compared with the years 2012 to 2017.



CAPITAL ASSETS

Net capital assets decreased by \$133,758 in 2018 as a result of the acquisition of machinery and equipment of \$243,925 and office equipment of \$6,200 less total depreciation and amortization for the year of \$383,883.

MWSC received capital contributions of \$627,003 in 2018. The contributions from U.S. Government Department of the Interior of \$327,000, Republic of the Marshall Islands – Compact of Free Association Public Infrastructure Sector of \$208,325 and Government of Japan of \$91,678. Please refer to note 4 to the financial statements for additional information on MWSC's capital assets.

Management's Discussion and Analysis for the ended September 30, 2017 is set forth in MWSC's report on the audit of financial statements, which is dated June 22, 2018. Such Management's Discussion and an Analysis explains the major factors impacting the 2017 financial statements and can be obtained from MWSC's General Manager via the contact information below.

FUTURE OUTLOOK ON SUSTAINABILITY

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

1. Increase in our customer base. Currently we have some 1,201 water customers and 2,491 sewer customers out of a possible 3,703. Increasing our customer base without having to major expansions to our assets will mean a significant increase in revenue without proportional increase in operating costs. Encouraging new customers will require a concerted long term community awareness and educational program to have them understand the value and benefits to connecting to our water and sewer system.
2. Renovate and repair our water, sewer and saltwater assets to improve reliability, and consequently, service to our customers.
3. Tariff reform to recognize the cost of operating the business and to recognize inflation since the last tariff adjustment was 12 years ago. MWSC will prepare tariff reform proposal based on present and future needs for Board approval.
4. Initiate survey of all services provided.

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Years Ended September 30, 2018 and 2017

MWSC'S FOCUS IN THE COMING YEAR

MWSC's focus in the coming year are the following:

1. Continued implementation of development goals under the guidance of the 20-Year Development Plan. Lift stations, saltwater stations and parts of the water treatment plants are being targeted for upgrades with leftover Department of Interior funding from the grant used to complete the 20 year development plan. These stations are also being examined for energy efficiency improvements from the Sustainable Energy Development Project (SEDeP) implemented by the World Bank on behalf of the RMI.
2. Submit application to USDA in regards to the replacement of the sewage outfall. A replacement outfall is provided at Delap which allows sewage to be dispersed and assimilated into the environment, away from the coastline. Public health is significantly improved along the coastline at Delap.
3. Utilize available funding from ADB to begin project preparation for the following projects:
 - a. MWSC's Non Revenue Water Improvement Plan. This plan will improve MWSC's capability to capture lost revenue in our water system and will provide MWSC with a water balance on the system.
 - b. Establishing an asset management and GIS system. With the objective of accurate and reliable information about the location, condition and performance of its assets.
 - c. Minceror Facility/Rehab of Pump Stations No. 1. This facility will provide a physical treatment of sewage streams and output to the newly rebuilt outfall in Delap. Large solids will macerated into smaller particles for easier/better dispersion of outfall.
4. Establishing a Statement of Corporate Intent that will cover current fiscal year and the next two fiscal years.
5. Establishing a Business Plan that will cover current fiscal year and the next two fiscal years.
6. Hire an Attorney to collect long outstanding debts and other legal issues.
7. Grant received from DOI to procure necessary equipment to improve our rainwater yield from the airport runway. These equipment include a sweeper, valve and basin maintenance equipment, pipe inspection equipment and a pipe cleaning equipment. These equipment has been awarded and MWSC plans to implement this project later this year.
8. TAP Grant awarded from DOI will be used to:
 - a. Procure professional services that will provide mapping and or to rectifying imagery and plan metrics for all of Majuro for GIS base map.
 - b. Acquisition of GIS Software, GPS Equipment and training.
 - c. Acquisition of large format printer to produce field maps.

ADDITIONAL FINANCE INFORMATION

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

**MAJURO WATER AND SEWER COMPANY, INC.
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Statements of Net Position
September 30, 2018 and 2017

	2018	2017
<u>ASSETS</u>		
Current assets:		
Cash	\$ 590,017	\$ 155,614
Receivables:		
Utility	1,861,380	1,650,277
Affiliates	96,682	185,316
Other	21,674	87,498
	1,979,736	1,923,091
Less allowance for doubtful accounts	(1,896,648)	(1,684,342)
	83,088	238,749
Inventory	329,587	410,742
Prepaid expenses	5,286	10,270
Total current assets	1,007,978	815,375
Capital assets, net	1,532,746	1,666,504
	\$ 2,540,724	\$ 2,481,879
<u>LIABILITIES AND NET POSITION</u>		
Current liabilities:		
Accounts payable	\$ 150,570	\$ 169,125
Payable to affiliates	2,919,902	2,582,355
Other accrued liabilities	54,228	53,943
Total current liabilities	3,124,700	2,805,423
Commitment and contingencies		
Net position:		
Net investment in capital assets	1,532,746	1,666,504
Restricted	604,242	85,300
Unrestricted	(2,720,964)	(2,075,348)
Total net position	(583,976)	(323,544)
	\$ 2,540,724	\$ 2,481,879

See accompanying notes to financial statements.

**MAJURO WATER AND SEWER COMPANY, INC.
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Statements of Revenues, Expenses and Changes in Net Position
Years Ended September 30, 2018 and 2017

	2018	2017
Operating revenues:		
Utility billings	\$ 1,036,386	\$ 1,169,837
Hook-up and deliveries	190,297	226,643
Other	10,738	4,411
Total operating revenues	1,237,421	1,400,891
Less uncollectable accounts	(212,306)	(332,104)
Total net operating revenues	1,025,115	1,068,787
Operating expenses:		
Salaries, wages and benefits	692,923	657,989
Electricity	471,207	425,385
Depreciation and amortization	383,883	295,535
Spare parts	90,979	161,333
Petroleum, oil and lubricants	53,507	47,685
Insurance	47,204	33,070
Communications	30,845	28,513
Contractual services	30,370	39,554
Entertainment and food	22,956	25,966
Office supplies	19,134	24,106
Licenses, fees and taxes	17,421	24,033
Travel	16,183	39,894
Chlorine	14,131	18,385
Rental	13,069	11,625
Freight and handling	5,200	22,047
Uniforms	4,090	909
Repairs and maintenance	2,000	25,346
Advertising	401	5,425
Miscellaneous	26,099	13,703
Total operating expenses	1,941,602	1,900,503
Operating loss	(916,487)	(831,716)
Nonoperating revenues (expenses), net:		
Operating grants	30,000	-
Penalties and interest	(948)	(675)
Total nonoperating revenues (expenses), net	29,052	(675)
Loss before capital contributions	(887,435)	(832,391)
Capital contributions		
Change in net position	627,003	644,816
Net position at beginning of year	(260,432)	(187,575)
Net position at end of year	\$ (583,976)	\$ (323,544)

See accompanying notes to financial statements.

MAJURO WATER AND SEWER COMPANY, INC.
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Statements of Cash Flows
Years Ended September 30, 2018 and 2017

	2018	2017
Cash flows from operating activities:		
Cash received from customers	\$ 1,180,776	\$ 1,116,901
Cash payments to suppliers for goods and services	(561,200)	(439,859)
Cash payments to employees for services	(655,905)	(667,176)
Net cash (used for) provided by operating activities	(36,329)	9,866
Cash flows from noncapital financing activities:		
Operating grants received	30,000	-
Penalties and interest paid	(948)	(675)
Net cash provided by (used for) noncapital financing activities	29,052	(675)
Cash flows from capital and related financing activities:		
Capital contributions received	535,325	90,800
Acquisition of capital assets	(93,645)	(269,683)
Net cash provided by (used for) capital and related financing activities	441,680	(178,883)
Net change in cash	434,403	(169,692)
Cash at beginning of year	155,614	325,306
Cash at end of year	\$ 590,017	\$ 155,614
Reconciliation of operating loss to net cash provided by (used for) operating activities:		
Operating loss	\$ (916,487)	\$ (831,716)
Adjustments to reconcile operating loss to net cash provided by (used for) operating activities:		
Depreciation and amortization	383,883	295,535
Uncollectable accounts	212,306	332,104
(Increase) decrease in assets:		
Receivables:		
Utility	(211,103)	(261,268)
Affiliates	88,634	(27,701)
Other	65,824	4,979
Inventory	16,353	26,579
Prepaid expenses	4,984	65,921
Increase (decrease) in liabilities:		
Accounts payable	(18,508)	26,272
Payable to affiliates	337,547	367,808
Other accrued liabilities	238	11,353
Net cash (used for) provided by operating activities	\$ (36,329)	\$ 9,866
Summary disclosure of noncash financing activities:		
Capital assets donated by a foreign donor:		
Capital assets	\$ (91,678)	\$ (554,016)
Capital contributions	91,678	554,016
	\$ -	\$ -
Transfer of inventory to capital assets:		
Inventory	\$ 64,802	-
Capital assets	(64,802)	-
	\$ -	\$ -

See accompanying notes to financial statements.

**MAJURO WATER AND SEWER COMPANY, INC.
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Notes to Financial Statements
September 30, 2018 and 2017

(1) Organization

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

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

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

MWSC is governed by a seven-member RMI Combined Utilities Board of Directors appointed by the Cabinet of RepMar. The RMI Combined Utilities Board of Directors also have governance over the Kwajalein Atoll Joint Utilities Resources, Inc. (KAJUR) and the Marshalls Energy Company, Inc. (MEC), which are component units of RepMar.

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

(2) Summary of Significant Accounting Policies

GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, 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 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.

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Notes to Financial Statements
September 30, 2018 and 2017

(2) Summary of Significant Accounting Policies, Continued

- Restricted net position - nonexpendable net position subject to externally imposed stipulations that require MWSC to maintain such permanently. As of September 30, 2018 and 2017, MWSC does not have nonexpendable restricted net position. Expendable net position whose use by MWSC is subject to externally imposed stipulations that can be fulfilled by actions of MWSC pursuant to those stipulations or that expire with the passage of time. As of September 30, 2018 and 2017, MWSC has expendable net position amounting to \$604,242 and \$85,300, respectively.
- 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 statements of net position. Proprietary fund operating statements present increases and decreases in net position. The accrual basis of accounting is utilized by proprietary funds. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. MWSC considers utility revenues and costs that are directly related to utility operations to be operating revenues and expenses. Revenues and expenses related to financing and other activities are reflected as nonoperating.

Operating and Non-Operating Revenue and Expenses

Operating revenues and expenses generally result directly from the operation and maintenance of MWSC. Non-operating revenues and expenses result from capital and related financing activities as well as certain other non-recurring income and expense items.

Cash

Custodial credit risk is the risk that in the event of a bank failure, MWSC's deposits may not be returned to it. Such deposits are not covered by depositor insurance and are either uncollateralized or collateralized with securities held by the pledging financial institution or held by the pledging financial institution but not in the depositor-government's name. MWSC does not have a deposit policy for custodial credit risk.

For purposes of the statements of net position and of cash flows, cash is defined as cash on hand and cash held in demand accounts. As of September 30, 2018 and 2017, cash was \$590,017 and \$155,614, respectively, and the corresponding bank balances were \$620,379 and \$211,373, respectively. Of the bank balances, \$612,296 and \$84,483, respectively, are maintained in a financial institution subject to Federal Deposit Insurance Corporation (FDIC) insurance with the remaining amounts of \$8,083 and \$126,890, respectively, being maintained in a financial institution not subject to depository insurance. As of September 30, 2018 and 2017, bank deposits in the amount \$250,000 and \$84,483, respectively, were FDIC insured. MWSC does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC coverage are uncollateralized. Accordingly, these deposits were exposed to custodial credit risk. MWSC has not experienced any losses in such accounts and management believes it is not exposed to any significant credit risk on its deposits.

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Notes to Financial Statements
September 30, 2018 and 2017

(2) Summary of Significant Accounting Policies, Continued

Receivables

All receivables are due from government agencies, businesses and individuals located within the Republic of the Marshall Islands and are interest free and uncollateralized. The allowance for doubtful accounts is stated at an amount which management believes will be adequate to absorb possible losses on accounts receivable that may become uncollectible based on evaluations of the collectibility of these accounts and prior collection experience. The allowance is established through a provision for bad debts charged to expense and accounts that are ultimately written-off are charged against the allowance.

Inventory

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

Capital Assets

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

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

Deferred Outflows of Resources

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

Deferred Inflows of Resources

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

Taxes

Corporate profits are not subject to income tax in the Republic of the Marshall Islands. The Government of the Republic of the Marshall Islands imposes a gross revenue tax of 3% on revenues. Pursuant to the Income Tax Act of 1989, as amended, sales of water and sewer services by public utility companies are exempt from gross revenue tax. Accordingly, MWSC is exempt from this tax relating to gross revenue from sales of water and sewer services.

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

Notes to Financial Statements
September 30, 2018 and 2017

(2) Summary of Significant Accounting Policies, Continued

Revenue Recognition

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

Estimates

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

Reclassifications

Certain balances in the 2017 presentation has been reclassified to conform to the 2018 presentation. These reclassifications had no impact on operating loss, net position or cash flows as previously reported.

New Accounting Standards

During the year ended September 30, 2018, MWSC 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.
- 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 statements did not have a material effect on the accompanying financial statements.

**MAJURO WATER AND SEWER COMPANY, INC.
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Notes to Financial Statements
September 30, 2018 and 2017

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

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) Inventory

Spare parts inventory at September 30, 2018 and 2017, consists of the following:

	<u>2018</u>	<u>2017</u>
Water	\$ 269,287	\$ 254,651
Sewer	59,871	127,539
Other	<u>429</u>	<u>28,552</u>
	<u>\$ 329,587</u>	<u>\$ 410,742</u>

**MAJURO WATER AND SEWER COMPANY, INC.
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Notes to Financial Statements
September 30, 2018 and 2017

(4) Capital Assets

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

	2018			
	October 1, 2017	Additions	Retirements	September 30, 2018
Vehicles	\$ 255,173	\$ -	\$ -	\$ 255,173
Machinery and equipment	1,340,594	243,925	-	1,584,519
Office equipment	224,655	6,200	-	230,855
Buildings and leasehold improvements	<u>952,501</u>	<u>-</u>	<u>-</u>	<u>952,501</u>
	2,772,923	250,125	-	3,023,048
Less accumulated depreciation and amortization	<u>(1,106,419)</u>	<u>(383,883)</u>	<u>-</u>	<u>(1,490,302)</u>
	<u>\$ 1,666,504</u>	<u>\$ (133,758)</u>	<u>\$ -</u>	<u>\$ 1,532,746</u>
	2017			
	October 1, 2016	Additions	Retirements	September 30, 2017
Vehicles	\$ 161,973	\$ 142,500	\$ (49,300)	\$ 255,173
Machinery and equipment	699,537	665,171	(24,114)	1,340,594
Office equipment	225,917	16,028	(17,290)	224,655
Buildings and leasehold improvements	<u>952,501</u>	<u>-</u>	<u>-</u>	<u>952,501</u>
	2,039,928	823,699	(90,704)	2,772,923
Less accumulated depreciation and amortization	<u>(901,588)</u>	<u>(295,535)</u>	<u>90,704</u>	<u>(1,106,419)</u>
	<u>\$ 1,138,340</u>	<u>\$ 528,164</u>	<u>\$ -</u>	<u>\$ 1,666,504</u>

During the years ended September 30, 2018 and 2017, MWSC was the beneficiary of certain donated capital assets of \$91,678 and \$554,016, respectively, from foreign donors.

(5) Restricted Net Position

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

	2018	2017
Republic of the Marshall Islands:		
Compact of Free Association Public Infrastructure Sector Grants:		
Majuro Water and Sewer Capital Upgrade Projects	\$ 277,242	\$ 85,300
U.S. Government:		
U.S. Department of the Interior:		
Airport Runway Cleanliness and Efficiency Program	<u>327,000</u>	<u>-</u>
	<u>\$ 604,242</u>	<u>\$ 85,300</u>

**MAJURO WATER AND SEWER COMPANY, INC.
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Notes to Financial Statements
September 30, 2018 and 2017

(6) Capital Contributions

Capital contributions for the years ended September 30, 2018 and 2017, consist of the following:

	<u>2018</u>	<u>2017</u>
U.S. Department of the Interior	\$ 327,000	\$ -
Republic of the Marshall Islands:		
Compact of Free Association Public Infrastructure Sector	208,325	-
Government of Japan	91,678	603,216
RMI Ports Authority	-	41,600
	<u>\$ 627,003</u>	<u>\$ 644,816</u>

(7) Employee Retirement Plan

MWSC together with KAJUR and MEC have implemented a RMI defined contribution retirement savings plan (the Plan) for their respective employees, whereby employees eighteen years and older are eligible to participate upon one year of employment. Plan participants may contribute any amount of their salaries to be matched 100% by their respective employers up to 10% of base salaries. Withdrawal from the Plan occurs upon termination of employment, death, or financial hardship. Plan assets are held in a trust fund administered by a trustee in accordance with the trust agreement. Management has the authority to establish or amend Plan provisions and contribution requirements. MWSC contributed \$13,917 and \$11,915 to Plan participant accounts during the years ended September 30, 2018 and 2017, respectively, and total combined plan assets were \$1,490,260 and \$1,163,871 as of September 30, 2018 and 2017, respectively.

(8) Related Party Transactions

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

During the years ended September 30, 2018 and 2017, RepMar made direct payments to a vendor of \$16,250 and \$1,350,850, respectively, on behalf of MWSC for a feasibility study for potential future capital improvements associated with the water reservoir. These payments were made from the Compact of Free Association Public Infrastructure Sector Grant. The total amount of the allocated grant amounted to \$1,800,000.

A summary of related party transactions for the years ended September 30, 2018 and 2017, and related receivable and payable balances as of September 30, 2018 and 2017, is as follows:

	<u>2018</u>			
	<u>Revenues</u>	<u>Expenses</u>	<u>Receivables</u>	<u>Payables</u>
RepMar	\$ 377,628	\$ 14,048	\$ 34,527	\$ 13,467
Marshalls Energy Company, Inc. (MEC)	14,230	471,207	49,751	2,841,192
Marshall Islands National Telecommunications Authority	1,483	25,850	1,155	1,740
Marshall Islands Social Security Administration	414	123,586	1,106	51,379
Majuro Resort, Inc.	44,666	10,665	6,553	2,168
Others	<u>65,399</u>	<u>12,187</u>	<u>3,590</u>	<u>9,956</u>
	<u>\$ 503,820</u>	<u>\$ 657,543</u>	<u>\$ 96,682</u>	<u>\$ 2,919,902</u>

**MAJURO WATER AND SEWER COMPANY, INC.
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Notes to Financial Statements
September 30, 2018 and 2017

(8) Related Party Transactions, Continued

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

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

(9) Commitment

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

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

As of September 30, 2018 and 2017, MWSC did not record the liability per the franchise agreement due to lack of capacity to make the payments in the foreseeable future. MWSC essentially depends on financing from RepMar and MEC to be able to continue as a going concern. Thus, management will negotiate the franchise terms with RepMar. If negotiations fail, MWSC may become liable for the above amounts but management does not believe that it will possess the ability to liquidate that liability.

(10) Contingencies

Going Concern

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplates the continuation of MWSC as a going concern. MWSC has incurred losses from operations of \$916,487 and \$831,716 during the years ended September 30, 2018 and 2017, respectively, and used substantial amount of working capital in its operations resulting in a working capital deficiency of \$2,116,722 at September 30, 2018. Furthermore, at September 30, 2018, total liabilities exceeded total assets by \$583,976.

In view of these matters, realization of a major portion of the assets in the accompanying statement of net position at September 30, 2018, is dependent upon continued operations of MWSC, which, in turn, is dependent upon MWSC's ability to collect and distribute fresh water and wastewater. Management acknowledges that the continuation of MWSC's operations is dependent upon the future financial support of RepMar, compensation by RepMar for the cost of actual utility service provided, the collection of long outstanding utility receivables, and/or significant improvements in operations, among other matters. Additionally, in order for MWSC to continue as a going concern, it may need to delay payments to the Marshalls Energy Company, Inc., a related party, for electricity usage.

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Notes to Financial Statements
September 30, 2018 and 2017

(10) Contingencies, Continued

Going Concern, Continued

At September 30, 2018, MWSC has an outstanding liability to MEC amounting to \$2,841,192, of which \$97,018 is under dispute and anticipated by management to be reversed. At September 30, 2018, the accompanying financial statements do not include any adjustments that might result from the outcome of this uncertainty. Management is currently negotiating the settlement of electricity charges with MEC.

Federal Grants

MWSC participates in a number of federally assisted grant programs. These programs are subject to financial and compliance audits to ascertain if Federal laws and guidelines have been followed. MWSC's management believes that liabilities, if any, for reimbursement which may arise as a result of these audits will not be material to the financial position of MWSC.

(11) Risk Management

MWSC is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. MWSC has elected to purchase commercial insurance from independent third parties for the risks of loss to which it is exposed. However, as of September 30, 2018 and 2017, respectively, MWSC is self-insured for any losses that could befall its buildings, equipment and inventory. Claims expenses and liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. No losses as a result of these risks have occurred in any of the past three years.

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

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

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Majuro Water and Sewer Company, Inc. (MWSC), which comprise the statement of net position as of September 30, 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 12, 2019. Our report included an emphasis-of-matter paragraph regarding going concern.

Internal Control Over Financial Reporting

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

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

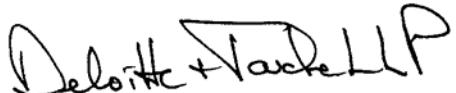
Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not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

Compliance and Other Matters

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

Purpose of this Report

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



April 12, 2019

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

Unresolved Prior Year Findings
Year Ended September 30, 2018

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