MARSHALL ISLANDS SHIPPING CORPORATION

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

FINANCIAL STATEMENTS AND INDEPENDENT AUDITORS' REPORT

YEARS ENDED SEPTEMBER 30, 2017 AND 2016

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

Years Ended September 30, 2017 and 2016
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INDEPENDENT AUDITORS' REPORT

Board of Directors
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, 2017 and 2016, and the related statements of revenues, expenses and changes in net position and of cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

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, 2017 and 2016, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

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

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated June 29, 2018, 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

June 29, 2018

Marshalls Islands Shipping Corporation (MISC) herewith presents a discussion and analysis of the company's financial performance for the financial year ended 30th September 2017. 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 2017 was $1,437,797 compared to net position of $401,081 in 2016. The increase in net position from 2016 to 2017 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.

MISC's total net operating revenue was increased by $417,871 (31%) from $1,327,123 in 2016 compared to $1,744,994 in 2017. The increase in revenue for Charter, Cargo, Passenger and Other revenue are driven by two factors. First, MISC managed to increase the operating revenue by increasing of field trip services and charter trip to the Outer Islands even though MISC's current fleet was reduced to four (4) vessels in FY17 and FY16. The second factor is based on prior year's extraordinary circumstances in the form of a natural disaster, which provided a revenue generating opportunity for MISC. MISC's charter revenue increased significantly in 2014, 2015, 2016 and 2017 due to RepMar's drought disaster declaration. The charter service demands to provide relief efforts to the drought affected islands resulted in an increased revenue stream in 2014-2017, and should be treated as extraordinary circumstances. MISC's charter revenue increased significantly by $218,000 (32%) from $690,070 in 2016 to $908,070 in 2017. All other revenue sources, on the other hand, increased in 2017, except for ship sales. MISC's passenger revenue increased significantly by $33,451 (53%) to $96,242 in 2017 compared to $62,791 in 2016. Cargo revenues increased by $82,129 (17%) to $575,407 in 2017 compared to $493,278 in 2016. MISC's ship sales revenue decreased by $127,108 (70%) to $54,141 in 2017 compared to $181,249 in 2016. There is an increasing trend with copra fee revenues. Copra fee revenues increased by $1,493 (5%) to $33,108 in 2017 compared to $31,615 in 2016. This increase in copra fee revenue is an indicator of MISC's support to assist Tobolar copra purchases and is authorized at the discretion of the ship vessels captain.

Total operating expenses increased marginally from 2016 to 2017. Total operating expenses were $3,030,549 in 2017 compared to $2,948,603 in 2016. Overall, MISC increased its total operating expenses by $81,946 (3%). Personnel and petroleum, oil, and lube (POL) expenses continue to remain as MISC's leading operational expenses. Salaries, wages and benefit expenses increased by $159,455 (15%) from $1,075,139 in 2016 to $1,234,594 in 2017. In line with changing global fuel prices and the increasing in MISC's shipping fleet, POL expenses increased by $300,460 (52%) from $573,152 in 2016 to $873,612 in 2017.

MISC's operating loss decreased by $335,925 (21%) from an operating loss of $1,621,480 in 2016 compared to an operating loss of $1,285,555 in 2017. Although MISC has maintained its efforts to reduce its operating expenses, MISC will continue to operate at a loss of ranging from $1.2M to $1.8M 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 56% of MISC's source of total operating and non-operating revenues during 2017. The subsidy from RepMar to support the Shipping Vessel Repairs and Maintenance Act resumed in 2016. Although it was appropriated in the national budget, MISC did not receive the 2014 subsidy for the Shipping Vessel Repairs Act. In 2016, RepMar appropriated $1.7M for ship purchase which was not received by MISC. As a result, the subsidies from RepMar accounted for approximately 54% of MISC's source of total operating and non-operating revenues in 2016. 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 Statement of Net Position and the Statement of Revenues, Expenses and Changes in Net Position provide an indication of MISC's financial condition. MISC's net position reflects the difference between total assets and total liabilities. An increase in net position over time normally indicates an improvement in financial condition. As illustrated in the figures below MISC's net assets increased for the year ended 30th September 2017.

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

	2017	2016	2015
ASSETS:			
Current and other assets	$ 1,826,457	$ 782,619	$ 506,717
Capital assets	261,227	227,043	238,474
Total Assets	2,087,684	1,009,662	745,191
LIABILITIES:			
Current Liabilities	649,887	608,581	465,221
NET POSITION:			
Net investment in capital assets	261,227	227,043	238,474
Restricted	622,418	82,047	190,641
Unrestricted	554,152	91,991	(149,145)
Total net position	$ 1,437,797	$ 401,081	$ 279,970

Total assets increased from $745,191 in 2015 to $1,009,662 in 2016 and increased further to $2,087,684 in 2017. The increase in total assets by $264,471 (35%) from 2015 to 2016 is driven primarily by a significant increase in capital assets with the acquisition of vehicles including utility flatbeds. In 2017, total assets increased further by $1,078,022 (107%) primarily due to the dry dock prepayment, increase in receivables and increase in cash balances. Capital asset acquisition of $122,738 was offset by accumulated depreciation of $61,340 and by retirements/disposals of $74,712.

Net capital assets decreased from $238,474 in 2015 to $227,043 in 2016 and increased to $261,227 in 2017. In 2016, net capital assets decreased slightly by $11,431 (5%) with capital asset acquisition of $112,229 offset by retirements of $97,499 and annual depreciation of $94,478. In 2017, net capital assets increased slightly by $34,184 (15%) with capital asset acquisition of $122,738 offset by the annual depreciation amount of $61,340 and by retirements/disposals of $74,712. The dry dock repairs extending the life span of the vessels are currently being treated as a direct expense provided the shipping vessel asset have yet to be transferred to MISC as required under the Public Law 2005-41. Public Law 2005-41, established the MISC and authorized all movable and immovable property of the shipping services under the Ministry of Transportation and Communication be vest absolutely in MISC.

Total liabilities increased by $143,360 (31%) from $465,221 in 2015 to $608,581 in 2016 and further increased by $41,306 (7%) in 2017. In 2016, the significant increase in total liabilities is primarily driven by MISC's obligations due to 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 $395,136 in 2016, of which $240,342 was due to RMIPA, followed by $93,960 due to Marshall Islands Social Security Administration (MISSA). In 2017, MISC's total liabilities due to RepMar related parties were $384,588, down by $10,548 (3%) in comparison to 2016. Although, MISC's total liabilities due to RMIPA decreased by $59,723 (25%) for 180,619, it was offset by the increase of the payable to MISSA by $22,683 (24%) and payable to Ministry of Finance by $38,924 (87%).

A summary of MISC's operating losses is presented below:

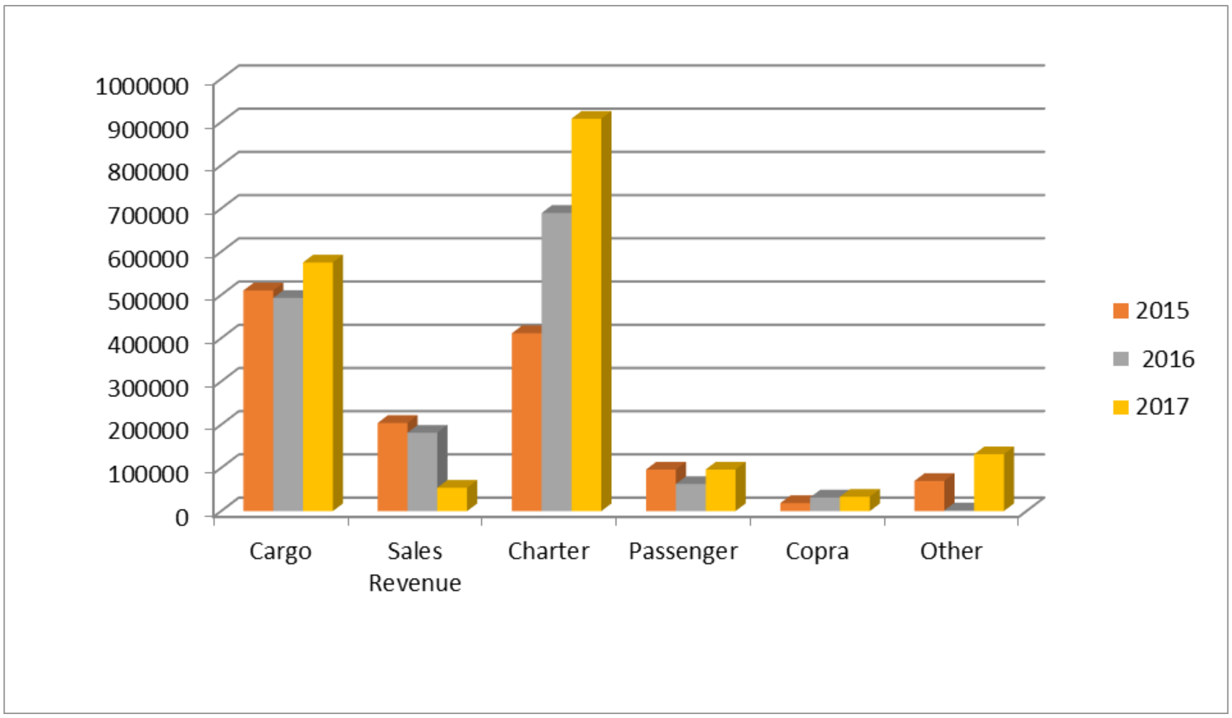
	2017	2016	2015
REVENUES:			
Net operating revenue	$ 1,744,994	$1,327,123	$1,204,281
EXPENSES:			
Operating expenses	3,030,549	2,948,603	2,898,783
Operating loss	$ (1,285,555)	$(1,621,480)	$(1,694,502)

MISC's total net operating revenue increased by $122,842 (10%) to a total of $1,327,123 in 2016 compared to $1,204,281 in 2015. In 2017, net operating revenue increased by $417,871 (31%). 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. Charter increased due to deliver goods and materials to rebuild houses that were damage from heavy rough wave.

Charter revenue increased significantly by $218,000 (32%) from $690,070 in 2016 to $908,070 in 2017; cargo sales increased by $82,129 (17%) from $493,278 in 2016 to $575,407 in 2017; ship sales decreased by $127,108 (70%) from $181,249 in 2016 to $54,141 in 2017, because of allowing MISCO/BOMI merchant on three vessels in 2017; passenger sales increased by $33,451 (53%) from $62,791 in 2016 to $96,242 in 2017; copra fee increased by $1,493 (5%) from $31,615 in 2016 to $33,108 in 2017.

There appears to be a growing trend with copra fee revenues as an indicator of MISC's assistance to pay the copra farmers due to possible cash flow constraints experienced by Tobolar at times. Revenue recognized from ship sales have reversed from a declining trend to a positive upward trend in 2016 and 2017. Ship sales service aboard the shipping vessels to the outer island consumers has been one of MISC's alternative sources of income and cash flow to subsidize its operations and was initiated in 2009. It is crucial that MISC continues to review its ship sales process to identify and remediate any internal control gaps in order to maximize the revenue generation opportunity. As a constraint on the RepMar's national budget, ship sales provide a viable business solution for MISC as an alternative source of revenue for cross subsidization opportunities for MISC while continuing to operate with low tariff rates.

The graphic below shows the major components of MISC's operating revenue from 2015 through to 2017:



Total operating expenses increased by $49,820 (2%) from $2.89M in 2015 compared to $2.94M in 2016. In 2017, the total operating expenses slightly increase by $81,946 (3%) to $3.0M. For 2017, the top five components of operating expenses are: (1) salaries, wages and benefits, (2) petroleum, oil & lube (POL), (3) material and supplies (4) foodstuff and (5) drydock repair & maintenance expense.

Salaries, wages and benefits remain as the leading operational expense and decreased by $9,940 (1%) from $1.08M in 2015 to $1.07M in 2016 and increased by $159,455 (15%) to $1.2M in 2017. 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 as crew of the new vessel currently under construction.

POL expenses decreased by $76,195 (12%) from $649,347 in 2015 to $573,152 in 2016 and increased by $300,460 (52%) to $873,612 in 2017. This increase was the result of the increase in the frequency of trips by the remaining four vessels.

Materials and supplies expenses increased by $8,579 (2%) from $465,442 in 2015 to $474,021 in 2016 and decreased by $233,141 (51%) to $233,141 in 2017. This is in relation to Management's efforts to minimize expenses.

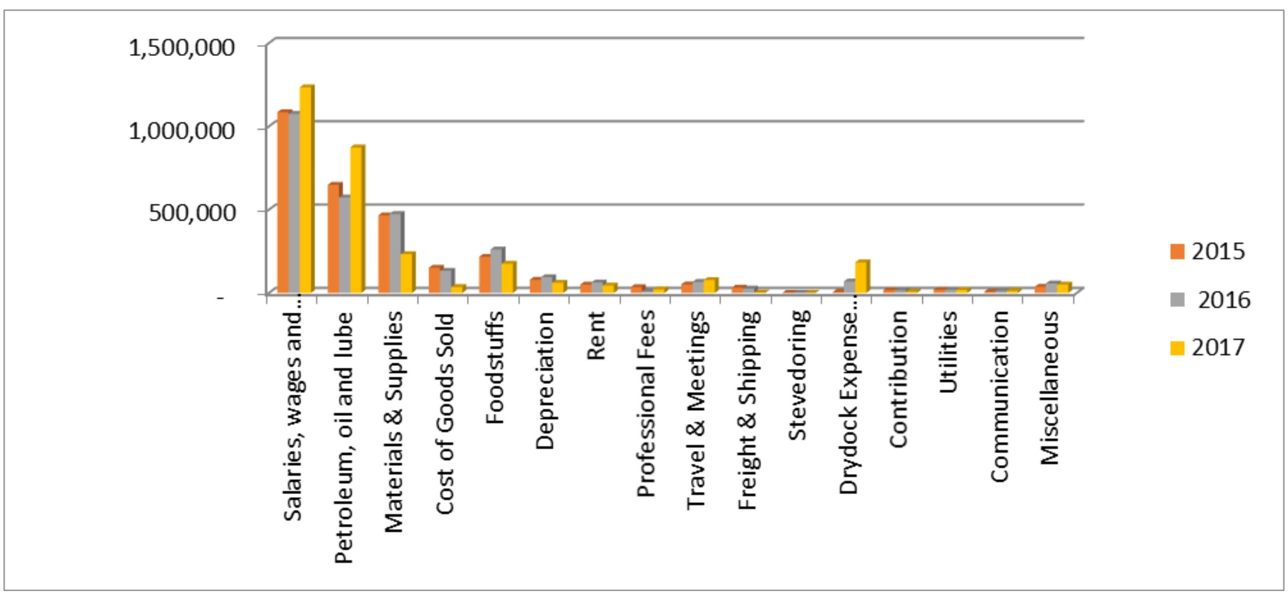
Foodstuff expenses increased by $44,295 (17%) from $216,710 in 2015 to $261,005 in 2016 and decreased by $85,765 (33%) to $175,240 in 2017. The significant decreased in 2017 is expected by Management to control purchasing the provisions for the vessels shipping fleet.

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

Ship sales services provide MISC an alternative source of income to subsidize it operations. Cost of goods sold (COGS) decreased by $17,817 (12%) from $150,977 in 2015 to $133,160 in 2016 and decreased further by $97,640 (73%) to $35,520 in 2017. The decrease in cost of goods sold for 2017 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 back to be handled by MISC. Since the office of the clerk of Cabinet had confirmed that there had not been any CP to this regard, merchandise or sales services is expected to return in 2018, but through a transitional or phase out period. Accordingly, MISCO/BOMI, which had been the merchant on the three vessels, namely the MV Aemman, MV Kwajelein, and MV Ribuuk Ae, shall be notified.

Other expenses decreased by $68,413 (19%) from $363,378 in 2016 to $294,965 in 2017. The freight component, followed by depreciation and rent expense were the main drivers for the decrease in other expenses in 2017.

The following graphic shows the major components of operating expenses from 2015 through to 2017:



The operating loss before non-operating revenues/expenses (i.e. RepMar subsidy) for 2017 was approximately $1.29M compared to $1.62M in 2016 and $1.69M in 2015, respectively. In 2015, operating loss increased with re-establishment of the repairs and maintenance subsidy, allowing MISC to incur additional expenditures to prolong the lifetime of its most critical asset, the shipping vessels. 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 (25%) with dry-docking of MV Ribuuk Ae and MV Kwajelein.

Total subsidies, for operations and for repairs and maintenance, were $1.9M in 2017 compared to $1.74M in 2016 and $1.75M in 2015. The subsidy amount of $1.30M received from RepMar in 2014 represents MISC's operating subsidy only. 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 purchase for the ship. Only $0.43M was used for the negotiations of said vessel. The new vessel is expected to be delivered in November 2018.

The operating subsidy received from RepMar in 2017 increased by $157,483 (9%). Subsidy related to ship purchase is at $435,000 in 2017. 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, 2016 is set forth in MISC's report on the audit of financial statements, which is dated June 5, 2017. That Management's Discussion and Analysis explains the major factors impacting 2016 financial statements and can be obtained from MISC's General Manager via the contact information below.

CAPITAL ASSET

Net capital assets increased from $227,043 in 2016 to $261,227 in 2017. Capital asset acquisition of $122,738 was offset by accumulated depreciation of $61,340 and by retirements/disposals of $74,712.

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 2017 was $1.2M compared to net cash used for operating activities of $1.71M in 2016 and $1.72M in 2015. The cash provided by operational activities was absorbed entirely by MISC's operational costs. Additionally, injection of cash flow from the RepMar subsidies were received in the amount of $2.3M, $1.74M and $1.75M during 2017, 2016, and 2015, respectively. In 2015, RepMar subsidies were utilized by MISC to cover its operational expenses in the amount of $1.27M; 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 2016, the 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. In 2017, the RepMar subsidies were utilized by MISC to cover its operational expense in the amount of $1.4M; and for drydocking repairs and maintenance expenses in the amount of $0.45M; and for the new ship negotiation expenses in the amount of $0.43M.

FUTURE OUTLOOK ON SUSTAINABILITY

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

As an indicator of MISC's future outlook on sustainability, MISC's has continued to improve and increase its net position since 2012. MISC's net position increased to $1,507,797 in 2017, compared to a net position of $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.

MISC's improved trend on net postion over the period 2015 to 2017 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 1.7M 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 expired in 2015; and will therefore need Technical Assistance to update its three-year strategic plan. In the absence of a tariff rate increase, the state owned enterprise reform act that was passed into Nitijela in September 2015 is a key legislation to support reform efforts for MISC together with all other state own enterprises. 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.
- Update MISC strategic plan 2016-2019
- 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 2017. 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, 2017 and 2016

ASSETS	2017	2016
Current assets:		
Cash	$ 1,178,723	$ 161,289
Receivables:		
Trade	136,922	203,792
Affiliates	292,627	353,714
Employees	308,943	58,234
	738,492	615,740
Less allowance for doubtful accounts	(439,003)	(385,422)
Total receivables, net	299,489	230,318
Inventory	3,801	7,847
Current portion of prepaid drydocking	195,083	152,541
Total current assets	1,677,096	551,995
Noncurrent assets:		
Prepaid drydocking, net of current portion	149,361	230,624
Equipment, net	261,227	227,043
	$ 2,087,684	$ 1,009,662
LIABILITIES AND NET POSITION		
Current liabilities:		
Accounts payable	$ 152,783	$ 95,475
Payable to affiliates	384,588	395,136
Accruals and other liabilities	112,516	117,970
Total liabilities	649,887	608,581
Commitments and contingencies		
Net position:		
Net investment in capital assets	261,227	227,043
Restricted	622,418	82,047
Unrestricted	554,152	91,991
Total net position	1,437,797	401,081
	$ 2,087,684	$ 1,009,662

See accompanying notes to financial statements.

MARSHALL ISLANDS SHIPPING CORPORATION

Statements of Revenues, Expenses and Changes in Net Position
Years Ended September 30, 2017 and 2016

	2017	2016
Operating revenues:		
Charter	$ 908,070	$ 690,070
Cargo	575,407	493,278
Fuel and other sales	131,607	1,860
Passenger	96,242	62,791
Ship sales	54,141	181,249
Copra fee	33,108	31,615
Total operating revenues	1,798,575	1,460,863
Provision for bad debts	(53,581)	(133,740)
Net operating revenues	1,744,994	1,327,123
Operating expenses:		
Salaries, wages and benefits	1,234,594	1,075,139
Petroleum, oil and lube	873,612	573,152
Material and supplies	233,141	474,021
Drydock expense	183,477	68,748
Foodstuffs	175,240	261,005
Travel and entertainment	77,204	66,326
Depreciation	61,340	94,478
Rent	44,553	63,170
Cost of goods sold	35,520	133,160
Professional fees	21,467	9,868
Utilities	18,002	18,454
Communications	11,999	12,049
Contributions	7,280	16,425
Freight	2,500	25,873
Miscellaneous	50,620	56,735
Total operating expenses	3,030,549	2,948,603
Operating loss	(1,285,555)	(1,621,480)
Nonoperating revenues (expenses):		
Operating subsidies	1,894,720	1,737,237
Gain (loss) on disposal of fixed asset	(7,449)	5,354
Nonoperating revenues	1,887,271	1,742,591
Capital contributions	435,000	-
Change in net position	1,036,716	121,111
Net position at beginning of year	401,081	279,970
Net position at end of year	$ 1,437,797	$ 401,081

See accompanying notes to financial statements.

MARSHALL ISLANDS SHIPPING CORPORATION

Statements of Cash Flows

Years Ended September 30, 2017 and 2016

	2017	2016
Cash flows from operating activities:		
Cash received from customers	$ 1,675,825	$ 1,278,558
Cash payments to suppliers for goods and services	(1,645,088)	(1,888,815)
Cash payments to employees for services	(1,240,048)	(1,102,421)
Net cash used for operating activities	(1,209,311)	(1,712,678)
Cash flows from noncapital financing activities:		
RepMar subsidy received	1,894,720	1,737,237
Cash flows from capital and related financing activities:		
Acquisition of capital assets	(122,738)	(112,299)
Capital contributions received	435,000	-
Sale of capital assets	19,763	34,606
Net cash cash provided by (used for) capital and related financing activities	332,025	(77,693)
Net change in cash	1,017,434	(53,134)
Cash at beginning of year	161,289	214,423
Cash at end of year	$ 1,178,723	$ 161,289
Reconciliation of operating loss to net cash used for operating activities:		
Operating loss	$ (1,285,555)	$ (1,621,480)
Adjustments to reconcile operating loss to net cash used for operating activities:		
Depreciation	61,340	94,478
Provision for bad debts	53,581	133,740
(Increase) decrease in assets:		
Receivables:		
Affiliates	61,088	(130,686)
Trade	66,871	(36,688)
Employees	(250,709)	(14,931)
Inventory	4,046	9,961
Prepayments	38,721	(290,432)
Increase (decrease) in liabilities:		
Accounts payable	57,308	26,463
Payable to affiliates	(10,548)	118,572
Accruals and other liabilities	(5,454)	(1,675)
Net cash used for operating activities	$ (1,209,311)	$ (1,712,678)

See accompanying notes to financial statements.

(1) Organization

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

MISC is governed by a five-member Board of Directors 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, 2017 and 2016, MISC has restricted net position of $622,418 and $82,047, respectively, relating to unexpended contributions from RepMar for dry-docking and vessel purchase.

- 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, 2017 and 2016, the carrying amount of cash was $1,178,723 and $161,289, respectively, and the corresponding bank balances were $1,202,452 and $220,791, respectively, which were maintained in a financial institution subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2017 and 2016, bank deposits in the amount of $250,000 and $220,791, respectively, 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 the period until the next scheduled dry-docking usually 2 to 3 years. Any remaining carrying amount of the cost of the previous inspection is de-recognized. 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, 2017 and 2016, the accumulated vacation leave liability totals $65,054 and $70,465, 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.

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards

During the year ended September 30, 2017, MISC implemented the following pronouncements:

- GASB Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not Within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*, which aligns the reporting requirements for pensions and pension plans not covered in GASB Statements 67 and 68 with the reporting requirements in Statement 68.

- GASB Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which replaces Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans, as amended,* and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and addresses financial reporting requirements for governments whose employees are provided with postemployment benefits other than pensions (other postemployment benefits or OPEB).

- GASB Statement No. 77, *Tax Abatement Disclosures,* which requires governments that enter into tax abatement agreements to disclose certain information about the agreements.

- GASB Statement No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans,* which addresses a practice issue regarding the scope and applicability of Statement No. 68, Accounting and Financial Reporting for Pensions.

- GASB Statement No. 80, *Blending Requirements for Certain Component Units - an amendment of GASB Statement No. 14,* which improves financial reporting by clarifying the financial statement presentation requirements for certain component units.

- GASB Statement No. 82, *Pension Issues - an amendment of GASB Statements No. 67, No. 68, and No. 73,* which addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements.

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

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

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

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

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

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

In March 2017, GASB issued Statement No. 85, *Omnibus 2017*, which 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. The provisions in Statement No. 85 are effective for fiscal years beginning after June 15, 2017. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In May 2017, GASB issued Statement No. 86, *Certain Debt Extinguishment Issues*, which improves consistency in accounting and financial reporting for in-substance defeasance of debt. The provisions in Statement No. 86 are effective for fiscal years beginning after June 15, 2017. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In June 2017, GASB issued Statement No. 87, *Leases*, which establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. The provisions in Statement No. 87 are effective for fiscal years beginning after December 15, 2019. Management has yet to determine whether the implementation of this statement will have a material effect on the financial statements.

(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, 2017 and 2016, MISC incurred dry-dock expenditures of $300,483 and $359,180, respectively, for the MV Aemman and MV Ribuuk Ae ships in Fiji, which is to be amortized for 3 years. In 2017 and 2016, amortized dry-dock expense amounted to $183,477 and $68,748, respectively. As of September 30, 2017 and 2016, prepaid dry-docking amounted to $344,444 and $383,165, respectively.

(5) Equipment

Capital asset activity for the years ended September 30, 2017 and 2016 is as follows:

	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
Vessel	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

	2016			
	October 1, 2015	Additions	Retirements/Disposals	September 30, 2016
Equipment	$ 350,125	$ 38,340	$ (29,607)	$ 358,858
Vehicles	322,097	31,200	(24,089)	329,208
Vessel	50,110	30,259	(43,803)	36,566
Motor boats	86,623	12,500	-	99,123
	808,955	112,299	(97,499)	823,755
Less accumulated depreciation	(570,481)	(94,478)	68,247	(596,712)
	$ 238,474	$ 17,821	$ (29,252)	$ 227,043

(6) 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.

A summary of related party transactions as of September 30, 2017 and 2016 and for the years then ended are as follows:

	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

	2016			
	Revenues	Expenses	Receivables	Payables
Tobolar Copra Processing Authority	$ 313,778	$ -	$ 254,856	$ -
Marshall Islands Social Security Administration	-	98,143	-	93,960
Marshalls Energy Company, Inc.	113,827	75,604	2,527	1,812
RMI Ports Authority	-	59,263	-	240,342
Republic of the Marshall Islands	178,674	10,471	81,449	44,753
Other	40,385	63,379	14,882	14,269
	$ 646,664	$ 306,860	$ 353,714	$ 395,136

During the years ended September 30, 2017 and 2016, the operations of MISC were funded by appropriations, of $1,438,400 and $1,260,085, respectively, from the Nitijela of RepMar. In addition, during the years ended September 30, 2017 and 2016, MISC received Nitijela appropriations of $456,320 and $477,152, respectively, restricted for dry-docking and related expenses. MISC also received a $435,000 appropriation for a vessel purchase during the year ended September 30, 2017. As of September 30, 2017 and 2016, MISC had yet to expend $622,418 and $82,047, respectively, of these appropriations. Accordingly, these amounts are restricted within net position.

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

As described in note 7, MISC leases space from a related party.

(7) Commitments and Contingencies

Commitments

MISC leased a warehouse for $2,557 per month, effective August 1, 2015, from the RMI Ports Authority, and expires on July 31, 2020. For the years ended September 30, 2017 and 2016, MISC recorded rent expense associated with this lease of $30,678 and $33,462, respectively.

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

Year ending September 30,	
2018	$ 30,678
2019	30,678
2020	25,565
	$ 86,921

MISC entered into an agreement on January 2018 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.

Contingencies

During the years ended September 30, 2017 and 2016, MISC incurred losses from operations of $1,285,555 and $1,621,480, respectively. For the years ended September 30, 2017 and 2016, MISC received operational subsidies of $1,438,400 and $1,260,085, respectively, from the Nitijela of RepMar in conjunction with $456,320 and $477,152, respectively, for dry-docking expenses. Although RepMar has provided funding in the past, MISC does not have a formal agreement with RepMar to provide future funding. A significant reduction in the level of budgetary support from RepMar, if this were to occur, may have an effect on MISC's programs and activities. For the year ended September 30, 2018, RepMar appropriated $1,461,600 and $460,000 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, 2017, and the related statements of revenues, expenses and changes in net position and of cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated June 29, 2018.

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.

Our consideration of internal control was for the limited purpose described in the preceding paragraph 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. However, as described in the accompanying Schedule of Findings and Responses, we did identify certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

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. We consider the deficiencies described in the accompanying Schedule of Findings and Responses as item 2017-001 to be material weaknesses.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying Schedule of Findings and Responses as items 2017-002 and 2017-006 to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the MISC's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Findings and Responses as items 2017-003 through 2017-005.

MISC's Response to Findings

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

Purpose of this Report

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

Deloitte & Touche LLP

June 29, 2018

Finding No. 2017-001

Revenues

Criteria: Adequate internal control policies and procedures should be established requiring that revenues be accurately supported, identified, and recorded.

Condition: The following exceptions concerning revenue tests were noted:

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

2. MISC reported $34,008 of copra revenue in FY2017 but such revenue pertains to transactions that occurred in PY2015 and PY2016. Tobolar was not able to submit reports on time which is MISC's basis for recording the revenue.

3. MISC does not have formal policies in setting selling price for the sale of fuel to third parties

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

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

Recommendation: We recommend that MISC maintain and organize cargo and passenger manifests. Furthermore, we recommend that revenue analysis (cargo and passenger) be performed per voyage to verify the reasonableness of recorded revenues against voyage data provided by the booking staff. Also, we recommend that management implement formal procedures to ensure that all revenues are accurately and timely supported, identified, and recorded.

Prior Year Status: Lack of established policies and procedures pertaining to revenues was reported as a finding in the audits of MISC for fiscal years 2007 through 2016.

Auditee Response and Corrective Action Plan:

1. A complete report for the day, that will include unpaid bills of lading or passenger bills, will be reflected or recorded on the same day's manifest and transmitted to the appropriate accounting personnel.
2. Tobolar has already agreed to an MOU to address this, specifically to ensure that report for particular trip/voyage will be submitted promptly to MISC.
3. MISC will set formal policies in setting fuel price immediately after the next Board Meeting.

Finding No. 2017-002

Capital Assets

Criteria: Adequate internal control policies and procedures should be established requiring proper authorization, approval and recordation of sale of capital assets. Also, policies over proper turn-over of assets, policies over actual estimated useful lives and proper tagging should be adopted and implemented.

Condition: The following exceptions concerning capital assets were noted:

1. Disposals of two capital assets were incorrectly recorded.

2. Two assets were not tagged.

3. Two malfunctioning assets were not retired/derecognized.

4. MISC has no established policies and procedures governing determination of estimated useful lives of capital assets.

5. Turn-over of the following assets was not performed by the previous General Manager:

Asset Description	Amount / Net Book Value
2007 Dodge Ram Pickup Truck	$ 14,333
35FT Boat	$ 14,000
Welding Aluminum Boat Square Bow	$ 8,750
2000 Dodge Ram 2500 SLT, Diesel	$ 5,888
1997 Dodge Ram 2500, Diesel	$ 5,740
Planner Machine	$ 3,502
Miller Welder Trailblazer	$ 2,921
Makita Table Saw 10''	$ 1,654
1999 Dodge Laramie	$ -
2005 Dodge Ram 2500, Diesel	$ -
2011 Hyundai Porter Vin	$ -

Cause: The cause of the above condition is the lack of established policies and procedures governing capital assets.

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

Recommendation: We recommend that material decisions, orders, rules and regulations relating to the financial operations of MISC be made by resolution of the Board of Directors and be recorded in the minutes of such meetings. Also, we recommend that MISC establish internal control policies and procedures governing capital assets.

Finding No. 2017-002, Continued

Capital Assets

Auditee Response and Corrective Action Plan:

1. At its meeting on February 19, 2018, Meeting 004/18, the Board approved the disposal of all the old and unusable vehicles, including the same mentioned vehicles.
2. The vehicle was issued the proper tag.
3. MISC uses or follows the Government's policy in the absence of its own written policies.
4. The matter regarding these assets is with the AG's Office.

Finding No. 2017-003

Local Noncompliance

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

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

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

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

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

Prior Year Status: Noncompliance with Public Law 2005-41 was reported as a finding in the audits of MISC for fiscal years 2007 through 2016.

Auditee Response and Corrective Action Plan: An MOU is currently with the AG, pending his signature to formalize the transfer of the assets, specifically the 4 vessels mentioned.

Finding No. 2017-004

Local Noncompliance

Criteria: RepMar's Procurement Code states the following:

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

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

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

Condition: Competitive sealed bidding did not occur in relation to a $1,900,000 ship purchase contract.

Additionally, MISC obtained at least 3 quotations for purchases of more than $25,000, but does not have a formal evaluation process for a vendor selection. The following payments were not adequately documented to evidence compliance with the criteria:

1) Purchase of vehicles ($52,225)
2) Purchase of life rafts ($27,483)
3) Purchase of rebuilt twin disk ($25,070)
4) Travel expenses of $25,986

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

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

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

Prior Year Status: Noncompliance with RepMar's Procurement Code was reported as a finding in the audits of MISC for fiscal years 2007 through 2016.

Finding No. 2017-004, Continued

Local Noncompliance

Auditee Response and Corrective Action Plan:

1) Basically in our opinion, after obtaining the quotations, and after obtaining the Cabinet blessing to proceed with the negotiations relating to the purchase of the new vessel, through a Cabinet Minute, we were of the view that we were complying with the procurement requirement/process.
2) Purchased because of the lowest quotation by the seller
3) There were 7 life rafts each priced at $3,977.57, much lower than the minimum $25,000 for competitive bidding.
4) The previous management was compelled to go single sources because of the emergency nature of the need to bring the twin disk (gear box) for the MV Ribuuk Ae which was berthing idle and not doing any of its required transport services, supporting the fleet. Hence getting this from a local source who was available and had been doing similar services was urgently needed.

With the newly hired Deputy Manager, we shall be able to promulgate policies on this and other issues that will require written policies. He is already engaging in the reviewing of the Board Minutes to help determine what issues that will need written policies.

Finding No. 2017-005

Local Noncompliance

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

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

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

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

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

Condition: MISC is charging based on charter rates without Cabinet approval.

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

Effect: The effect of the above condition is noncompliance with the Marshall Islands Shipping Corporation Act, 2004 appears to have occurred.

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

Prior Year Status: Noncompliance with the Marshall Islands Shipping Corporation Act, 2004 was reported as a finding in the audits of MISC for fiscal years 2014 through 2016.

Auditee Response and Corrective Action Plan: A Cabinet Paper was in 2011 for the purpose of addressing the issue. Current management is unsure of how the current rates had been adopted and used up until now. Obviously the rates should have been first approved by the Cabinet prior to being used. A Cabinet Paper is being prepared to address this very issue as instructed by the Board.

Finding No. 2017-006

Dry-dock expenditures

Criteria: Dry-dock expenditures are recognized as an asset when the recognition criteria has been met.

Condition:

MISC records dry-dock expenses when third party service providers deliver the final billing. As a result, some dry-dock expenses that should have been recorded in one accounting period are improperly recorded and amortized in the next accounting period, such as the following:

Vessel	Amount	Date recorded	Correct accounting year
Ribuuk Ae	$57,586	10/7/2016	2016
Kwajelein	$21,762	10/6/2017	2017

Cause: The cause of the above condition is the non-accrual of incurred dry-docking expenses.

Effect: The effect of the above condition is the misstatement of account balances associated with dry-dock activities.

Recommendation: We recommend that management verify the percentage of completion of dry-dock activities and timely record accruals, dry-dock assets and expenses.

Auditee Response and Corrective Action Plan: MISC will comply with this.

Unresolved Prior Year Findings
Year Ended September 30, 2017

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