

*Financial Statements, Required Supplementary
Information, and Report on Internal Control and
Compliance*

Marshall Islands Shipping Corporation
(A Component Unit of the Republic of the Marshall Islands)

*Year ended September 30, 2022
with Report of Independent Auditors*



Marshall Islands Shipping Corporation
(A Component Unit of the Republic of the Marshall Islands)

Financial Statements, Required Supplementary Information,
and Report on Internal Control and Compliance

Year ended September 30, 2022

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Report of Independent Auditors

Board of Directors
Marshall Islands Shipping Corporation

Report on the Audit of the Financial Statements

Qualified Opinion

We have audited the financial statements of the business-type activities of Marshall Islands Shipping Corporation (MISC), a component unit of the Republic of the Marshall Islands, as of and for the year ended September 30, 2022, and the related notes to the financial statements, which collectively comprise MISC's basic financial statements as listed in the table of contents.

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion section of our report, the accompanying financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities of MISC as of September 30, 2022, and the changes in financial position, and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Qualified Opinion

As discussed in note 1 to the financial statements, MISC has not implemented GASB Statement No. 87, *Leases*, which requires the recognition of certain lease assets and liabilities for leases that previously were classified as operating leases. The amount of which the departure would affect the assets and liabilities of the business-type activities of MISC has not been determined.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS) and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States (*Government Auditing Standards*). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of MISC and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about MISC's ability to continue as a going concern for twelve months beyond the financial statement date, including any currently known information that may raise substantial doubt shortly thereafter.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS and *Government Auditing Standards* will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS and *Government Auditing Standards*, we

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit 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 MISC's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about MISC's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

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 4 through 14 be presented to supplement the financial statements. Such information is the responsibility of management and, 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 basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with GAAS, 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 basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated July 26, 2024, 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.

Ernst + Young LLP

July 26, 2024

Marshall Islands Shipping Corporation
(A Component Unit of the Republic of the Marshall Islands)

Management's Discussion and Analysis

Year Ended September 30, 2022

Marshall Islands Shipping Corporation (MISC) herewith presents a discussion and analysis of the company's financial performance for the financial year ended 30th September 2022. 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 2022 decreased by \$812,664 (or 9%) to \$8,000,274 in 2022 compared to a net position of \$8,812,938 in 2021. The decrease in net position from 2021 to 2022 of \$812,664 is a negative indicator of the results of operations, and ongoing struggles by management to maintain expenses within operational revenues as well as nonoperational revenues in the form of RMI government subsidies. MISC was the recipient of RMI government subsidies of \$2,041,262 in 2022 compared with \$1,814,824 received in 2021. No capital contributions were received in 2022 compared with \$819,787 received in 2021.

MISC's total net operating revenues increased by \$1,171,563 (or 101%) from \$1,163,258 in 2021 to \$2,334,821 in 2022. The increase in revenues from cargo, charter, ship sales, fuel and other revenue, offset by the decrease in revenues from passenger revenue, was driven by two factors. The increase in cargo, charter, ship sales, fuel and other revenues correspond to the increase in frequency of field trips from 36 trips in 2021 to 38 field trips in 2022. The decrease in passenger revenues was due to extraordinary circumstances in the form of the COVID-19, with fewer people traveling to the outer islands but, instead, traveling to the U.S. mainland for better opportunities in getting medical treatment, job opportunities, and education and other needs for a better life.

MISC's total operating expenses increased by \$1,399,427 (or 37%) from \$3,789,320 in 2021 to \$5,188,747 in 2022. MISC's leading operational expenses in 2022 were salaries, wages and benefits expense; petroleum, oil and lube expense; depreciation expense; dry-dock repair and maintenance expense; and cost of goods sold expense. Salaries, wages and benefits expense increased by \$576,416 (or 35%) from \$1,657,537 in 2021 to \$2,233,953 in 2022. Petroleum, oil and lube expense increased by \$573,356 (or 141%) from \$406,512 in 2021 to \$979,868 in 2022. Depreciation expense decreased marginally by \$2,187 (or 0.4%) from \$621,394 in 2021 to \$619,207 in 2022. Dry-dock repair and maintenance expense increased by \$18,689 (or 16%) from \$114,278 in 2021 to \$132,967 in 2022. Cost of goods sold expense increased by \$146,759 (or 101%) from \$145,945 in 2021 to \$292,704 in 2022.

MISC's operating loss increased by \$227,864 (or 9%) from \$2,626,026 in 2021 to \$2,853,926 in 2022. MISC's operating losses were funded by cash subsidies from RepMar. In line with MISC's operating losses, operating subsidies received from RepMar increased by \$226,438 (or 12%) from \$1,814,824 in 2021 to \$2,041,262 in 2022. The RepMar subsidy for 2022 included \$446,400 earmarked for Dry-dock Repairs and Maintenance whilst no similar earmark was received in 2021.

Marshall Islands Shipping Corporation
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Management's Discussion and Analysis, continued

FINANCIAL HIGHLIGHTS, CONTINUED

MISC's change in net position decreased by \$1,373,438 (or 245%) from a positive \$560,774 in 2021 to a negative \$812,664 in 2022. One of the drivers associated with this negative change was the recognition of a one-time gain on forgiveness of debt of \$588,069 together with capital contributions of \$819,787 in 2021. No similar transactions occurred in 2022.

Without the approval of RepMar to allow management of MISC to increase tariffs, it is expected that MISC will always operate at a loss and MISC's future sustainability will continue to be a burden on RepMar as a community service obligation.

FINANCIAL ANALYSIS OF MISC

The Statements of Net Position and the Statements 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. A decrease in net position over time normally indicates a deterioration in financial condition. As illustrated in the figures below, MISC's net position decreased for the year ended 30th September 2022. A summary of MISC's Statements of Net Position is presented below:

Net Position

A summary of MISC's Statements of Net Position is presented below:

Summary Statements of Net Position
As of September 30

	<u>2022</u>	<u>2021</u>	<u>\$ Change 2022-2021</u>	<u>% Change 2022-2021</u>	<u>2020</u>
Assets:					
Current and other assets	\$ 560,155	\$ 658,232	\$ (98,077)	(14.9)%	\$ 602,837
Capital assets	<u>8,383,028</u>	<u>8,774,440</u>	<u>(391,412)</u>	(4.5)%	<u>8,652,543</u>
Total assets	<u>8,943,183</u>	<u>9,432,672</u>	<u>(489,489)</u>	(5.2)%	<u>9,255,380</u>
Liabilities:					
Current and other liabilities	<u>942,909</u>	<u>619,734</u>	<u>323,175</u>	52.1%	<u>1,003,216</u>
Net position:					
Net investment in capital assets	8,383,028	8,774,440	(391,412)	(4.5)%	8,652,543
Restricted	9,797	283,626	(273,829)	(96.5)%	195,388
Unrestricted	<u>(392,551)</u>	<u>(245,128)</u>	<u>(147,423)</u>	60.1%	<u>(595,767)</u>
Total net position	<u>\$ 8,000,274</u>	<u>\$ 8,812,938</u>	<u>\$ (812,664)</u>	(9.2)%	<u>\$ 8,252,164</u>

Marshall Islands Shipping Corporation
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Management's Discussion and Analysis, continued

FINANCIAL ANALYSIS OF MISC, CONTINUED

Total assets decreased by \$489,489 (or 5%) from \$9,432,672 in 2021 to \$8,943,183 in 2022. The decrease was due to a decrease in capital assets, net of accumulated depreciation, of \$391,412 (or 4%) and a decrease in current and other assets of \$98,077 (or 15%). The decrease in capital assets was due to acquisitions of \$227,795 offset by depreciation of \$619,207. The decrease in current and other assets was due to a decrease in cash balances and net receivables of \$126,206 (or 52%) and \$122,262 (or 45%).

Total liabilities increased by \$323,175 (or 52%) from \$619,734 in 2021 to \$942,909 in 2022. The increase in liabilities was primarily driven by the increase in MISC's obligations due to RepMar and affiliates, including the Marshalls Energy Company, Inc. (MEC). Payables to affiliates increased by \$172,387 (or 59%) from \$293,205 in 2021 to \$465,592 in 2022 primarily because of an increase in liabilities due to MEC for fuel purchases.

Total net position decreased by \$812,664 (or 9%) from \$8,812,938 in 2021 to \$8,000,274 in 2022. In 2022, MISC incurred a loss from operations of \$2,853,926, which was principally funded by contributions received from RepMar of \$2,041,262. In comparison, MISC incurred a loss from operation of \$2,626,062 in 2021, which was principally funded by RepMar contributions of \$1,814,824.

Change in Net Position

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

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

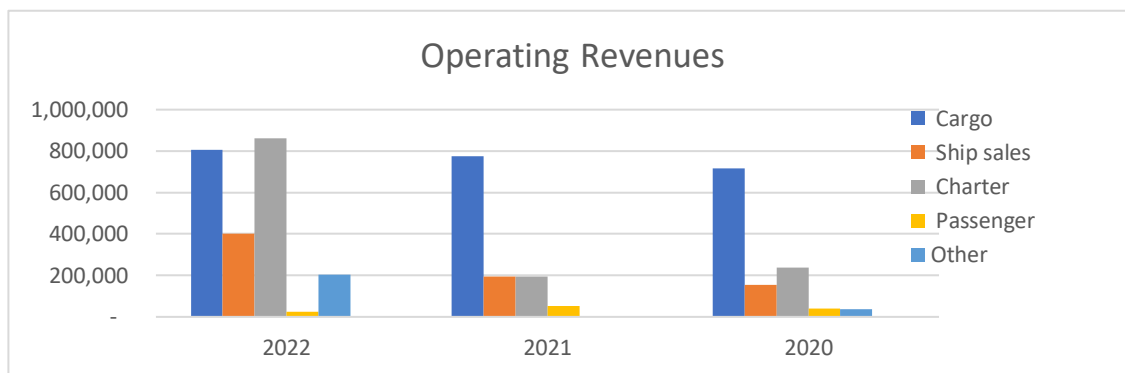
	<u>2022</u>	<u>2021</u>	<u>\$ Change</u> <u>2022-2021</u>	<u>% Change</u> <u>2022-2021</u>	<u>2020</u>
Operating:					
Operating revenues	\$ 2,334,821	\$ 1,163,258	\$ 1,171,563	100.7%	\$ 1,059,105
Operating expenses	<u>5,188,747</u>	<u>3,789,320</u>	<u>1,399,427</u>	36.9%	<u>4,488,371</u>
Operating loss	<u>(2,853,926)</u>	<u>(2,626,062)</u>	<u>(227,864)</u>	8.7%	<u>(3,429,266)</u>
Nonoperating:					
Nonoperating revenues	2,041,262	2,402,893	(361,631)	(15.0)%	2,348,075
Nonoperating expenses	<u>-</u>	<u>35,844</u>	<u>(35,844)</u>	(100.0)%	<u>8,400</u>
	<u>2,041,262</u>	<u>2,367,049</u>	<u>(325,787)</u>	(13.8)%	<u>2,339,675</u>
	(812,664)	(259,013)	(553,651)	213.8%	(1,089,591)
Capital contributions	<u>-</u>	<u>819,787</u>	<u>(819,787)</u>	(100.0)%	<u>993,845</u>
Change in net position	<u>\$ (812,664)</u>	<u>\$ 560,774</u>	<u>\$ (1,373,438)</u>	(244.9)%	<u>\$ (95,746)</u>

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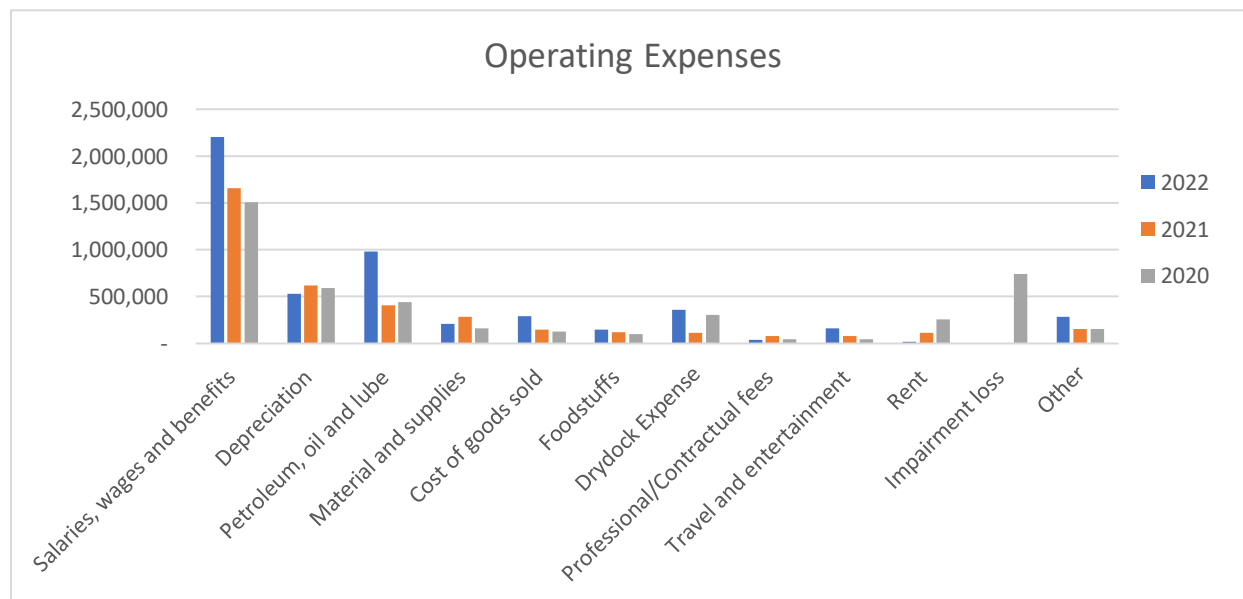
Management’s Discussion and Analysis, continued

FINANCIAL ANALYSIS OF MISC, CONTINUED

The Statements of Revenues, Expenses and Changes in Net Position identify the various revenue and expense items that contributed to the change in net position. MISC’s total net operating revenues increased by \$1,171,563 (or 101%) to a total of \$2,334,821 in 2022 compared to \$1,163,258 in 2021. In 2022, MISC benefitted from increased revenues through the charter of the SV Kwai vessel by Ocean Voyages Institute, in partnership with Island Ventures Limited, to assist with the continued cleanup efforts of the world’s oceans. Charter revenues increased by \$668,074 (or 344%) from \$194,041 in 2021 to \$862,115 in 2022. The graph below presents the major components of MISC’s operating revenues from 2020 through 2022:



Total operating expenses increased by \$1,399,427 (or 37%) from \$3,789,320 in 2021 to \$5,188,747 in 2022. For 2022, the top five components of operating expenses were: (1) Salaries, Wages and Benefits, (2) Petroleum, Oil and Lube (POL), (3) Depreciation, (4) Dry-dock Repair & Maintenance Expense, and (5) Cost of goods sold. The graph below presents the major components of MISC’s operating expenses from 2020 through 2022:



Marshall Islands Shipping Corporation
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Management's Discussion and Analysis, continued

FINANCIAL ANALYSIS OF MISC, CONTINUED

Salaries, wages and benefits remain as the leading operational expense and increased by \$576,416 (or 35%) from \$1,657,537 in 2021 to \$2,233,953 in 2022. Increase in salaries, wages and benefits is due to new hires and recruitment of employees for the new vessels SV Kwai and MV Ribuuk Meto, respectively, and salary increase for certain employees.

POL expenses increased by \$573,356 (or 141%) from \$406,512 in 2021 to \$979,868 in 2022. In 2022, the POL expense was severely impacted by the increase in global fuel costs as a result of the ongoing Russia/Ukraine war with the increase in frequency of field trips from 36 in 2021 to 38 also increasing POL expenses.

Depreciation expense decreased marginally by \$2,187 (or 0.3%) from \$621,394 in 2021 to \$619,207 in 2022. This marginal decrease is the result of acquisitions offset by the write-off of certain assets associated with MV Tobolar in 2021.

Dry-dock repair and maintenance expense increased by \$18,689 (or 16%) from \$114,278 in 2021 to \$132,967 in 2022 is due primarily to ancillary costs incurred by MISC on minor repairs and maintenance of MISC vessels in addition to the amortization of prepaid dry-dock expense.

Ship sales services provide MISC an alternative source of income to subsidize operations. The increase in COGS by \$146,759 (or 101%) from \$145,945 in 2021 to \$292,704 in 2022 corresponds with the increase in ship sales to customers from the outer islands during field trips.

With the establishment of the Shipping Vessel Repairs and Maintenance Act in 2011, an annual subsidy is granted by RepMar for proper and timely dry-docking, repairs and maintenance to be undertaken by MISC. This is to ensure the good and operable conditions of MISC's fleet and for the safety and reliability of sea transportation services for the RMI outer island community. Dry-dock expense decreased by \$187,814 (or 62%) from \$302,092 in 2020 to \$114,278 in 2021, with no dry-docking activities taking place in 2020 or 2021 due to the lack of dry-dock funding being made available by RepMar. Funding recommenced in 2022 in the amount of \$446,400.

The operating loss before nonoperating revenues and expenses (i.e., RepMar subsidy) increased by \$227,864 (or 9%) from \$2,626,062 in 2021 to \$2,853,926 in 2022. At the same time, change in net position decreased from a positive balance of \$560,774 in 2021 to a negative balance of \$812,664 in 2022, a difference of \$1,373,438 from 2021 to 2022. In 2021, although with control and the reduction of some expense categories, positive balance in 2021 included gain on forgiveness of debt of \$588,069 for MV Tobolar as well as capital contributions of \$819,787 from RepMar relative to vessel purchases.

Marshall Islands Shipping Corporation
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Management's Discussion and Analysis, continued

FINANCIAL ANALYSIS OF MISC, CONTINUED

Total subsidies for operations were \$2,041,262 in 2022 compared to \$1,814,824 in 2021. In 2018, 2019 and 2022, MISC was the recipient of subsidies associated with the Shipping Vessel Repairs and Maintenance Act, but MISC did not receive such in 2020 and 2021. 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.

As noted above, the operating subsidy received from RepMar in 2022 increased by \$226,438 (or 12%) from \$1,814,824 in 2021 to \$2,041,262 in 2022, with no dry-dock subsidy being received in 2021. In addition, MISC did not receive any capital contributions in 2022 compared to \$819,787 received in 2021. The amount received in 2021 represented contributions from RepMar associated with the acquisition of MV Ribuuk Meto (\$369,787) and SV Kwai (\$450,000). With current fare rates unchanged since 1980 and no available landing craft for charter, MISC is not able to achieve full cost recovery to cover 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 fleet will continue to depend on sufficient financial support from RepMar.

Management's Discussion and Analysis for the year ended September 30, 2021 is set forth in MISC's report on the audit of financial statements, which is dated December 29, 2022. Such Management Discussion and Analysis explains the major factors impacting the FY2021 financial statements and can be obtained from MISC's General Manager via the contact information on page 14.

CAPITAL ASSETS AND DEBT

Net capital assets decreased by \$391,412 (or 4%) from \$8,774,440 in 2021 to \$8,383,028 in 2022. Capital asset acquisitions in 2022 of \$227,795 were offset by depreciation of \$619,207.

During the year ended September 30, 2022, the vessel namely MV Aemman, previously under dry-dock repair and maintenance, was completed and returned at a cost of \$895,852 from \$451,171 in 2021 to \$444,681 in 2022.

Marshall Islands Shipping Corporation
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Management’s Discussion and Analysis, continued

CAPITAL ASSETS AND DEBT, CONTINUED

A summary of MISC’s capital assets is presented below:

Summary Schedules of Capital Assets
As of September 30

	2022	2021	\$ Change 2022-2021	% Change 2022-2021	2020
Vessels	\$ 9,878,861	\$ 9,878,861	\$ -	0.0%	\$ 8,239,074
Vehicles	564,365	508,870	55,495	10.9%	502,870
Equipment	511,028	345,128	165,900	48.1%	397,586
Motorboats	229,874	223,474	6,400	2.9%	223,924
	11,184,128	10,956,333	227,795	2.1%	9,363,454
Accumulated depreciation	(2,801,100)	(2,181,893)	(619,207)	28.4%	(1,680,911)
	8,383,028	8,774,440	(391,412)		7,682,543
Vessels under CIP	-	-	-		970,000
	<u>\$ 8,383,028</u>	<u>\$ 8,774,440</u>	<u>\$ (391,412)</u>	(4.5)%	<u>\$ 8,652,543</u>

Capital assets are summarized in note to the financial statements. Please refer to Note 4 for additional information concerning capital assets. At this time, MISC has no long-term debt.

CASH FLOWS

Net cash used for operating activities for 2022 was \$1,939,673 compared to net cash used for operating activities of \$1,727,843 in 2021. The cash provided by operational activities was absorbed entirely by MISC’s operational costs. Additionally, cash flow injections from RepMar to subsidize MISC’s operations were received in the amount of \$2,041,262 and \$1,814,824 during 2022 and 2021, respectively. Available subsidies for vessel repairs and maintenance were received in 2022 of \$446,400 and no subsidies in 2021. The repair and maintenance subsidy amounts are determined by a schedule developed in January 2011 under the JICA Preparatory Study for the “Project for Improvement of Domestic Shipping Services in the Marshall Islands”.

FUTURE OUTLOOK ON SUSTAINABILITY

MISC plays an important role in the lives of people living in the outer islands. The regular fieldtrip services are essential to transfer people and basic needs from the capital city to the outer islands and vice versa. As an indicator of MISC’s future outlook on sustainability, MISC’s has continued to improve and increase its net position since 2012; In 2022, MISC’s net position decreased by \$812,664 from \$8,812,938 in 2021 to \$8,000,274 in 2022. This is in comparison to the increase in MISC’s net position in 2021 of \$560,774 from \$8,252,164 in 2020 to \$8,812,938 in 2021. Prior to that, MISC’s net position decreased in 2020 by \$95,746 from \$8,347,910 in 2019 to \$8,252,164 in 2020 and increased to \$8,542,142 in 2018, \$1,437,797 in 2017, \$401,081 in 2016, and \$279,970 in 2015.

Marshall Islands Shipping Corporation
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Management's Discussion and Analysis, continued

FUTURE OUTLOOK ON SUSTAINABILITY, CONTINUED

MISC's improved trend in net position overall provided an indicator of MISC management's efforts to reduce its recurrent expenses. However, at the current tariff rates such as the passenger and freight rate structures together with the limitation in vessel numbers or fleet size capacity, MISC will continue to have operational losses and rely on RepMar subsidies to minimize operational losses. In order to revive MISC operations for future sustainability, MISC must be able to obtain RepMar approval to increase tariff rates for passengers and freight, or continue to rely on a steady flow of subsidy amounts through community service obligations, enough to absorb the operational losses of MISC and to be able to provide affordable sea-transport services to the people in the Neighboring Islands.

Historically, operating revenues 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 \$3.4M annually, MISC continues to be dependent on financial support from RepMar. Most importantly, MISC has not been able to generate sufficient amount of revenue through its operations due to the current passenger and freight rate structures, which has been in place since the early 1980's, despite the increase in fuel costs and inflation rates. As a state-owned enterprise governed under the State-Owned Enterprise Act, MISC has no authority to stand alone and make decision on tariff increases without further consultation and approval by the RepMar Cabinet. In this effort, and on a meeting of MISC's Board of Directors, it was approved to increase freight rates to a median amount of \$117 per tonnage. However, this action was deferred by the former David Kabua administration. The current freight rate, which remains unchanged, was approved on April 25, 2019 from \$56.50 per ton to \$66.50 per ton as reflected in the FY19 and FY20 audit reports.

With the fluctuation and inflation, especially increases of fuel and goods around the world, MISC will continue all its effort to approach the Government for either a CSO or increasing tariff rates to an affordable amount that will be accounted to offset the amount of MISC's operating deficit every year. MISC continues to work closely with the RepMar Government and the relevant government agencies for the sustainability of the sea transport services to the Neighboring Islands, as mandated, but will continue to rely on RepMar's continued subsidies to meet its goal and objectives as stated in the business plan. MISC's business plan was renewed and modified through the year of 2027.

Marshall Islands Shipping Corporation
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Management's Discussion and Analysis, continued

FUTURE OUTLOOK ON SUSTAINABILITY, CONTINUED

The future outlook on sustainability for MISC continues to be threatened by the deteriorating conditions of the shipping vessels. 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 and parts. 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. Furthermore, the operations of MISC are further hampered with the loss of MV Ribuuk Ae, which ran aground on Ujae Atoll and later sunk in December 2019 followed by MV Tobolar in April 2021 and the transfer of MV Majuro to the Ministry of Public Works. With this current maintenance fund compared to the number of the current fleet, MISC's management feels that for the sustainability of the vessel, management of RepMar should increase annual contributions to the R&M maintenance fund in order to maintain and prolong the lifespan of the vessels.

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)
- Implementation of community services obligation (CSO) to comply with the SOE Act.

Marshall Islands Shipping Corporation
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Management's Discussion and Analysis, continued

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 MISC tariff rates, and to negotiate CSO agreements for identified commercial rates.
- With the support of its Board of Directors, MISC will continue to implement and monitor activities laid out in its business plan addressing both the operational and financial goals of MISC. The business 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 partner's 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.

The Marshall Islands was not directly impacted by the COVID-19 pandemic being experienced elsewhere worldwide. No cases of COVID-19 were experienced in the Marshall Islands for the majority of 2022 and, as such, MISC was able to continue operations as usual subject to the continued support from RepMar. However, community transmission occurred in August 2022 that temporarily disrupted operations resulting in delays in MISC's field trip operations.

Marshall Islands Shipping Corporation
(A Component Unit of the Republic of the Marshall Islands)

Management's Discussion and Analysis, continued

ADDITIONAL FINANCIAL INFORMATION

This discussion and analysis are designed to provide MISC's customers and other stakeholders with an overview of the company's operations and financial condition as at 30th September 2022. 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
(A Component Unit of the Republic of the Marshall Islands)

Statement of Net Position

September 30, 2022

ASSETS

Current assets:	
Cash	\$ <u>117,401</u>
Receivables:	
Trade	165,462
Due from affiliates	502,936
Employees	<u>305,617</u>
	974,015
Less allowance for doubtful accounts	(<u>826,207</u>)
Total receivables, net	<u>147,808</u>
Inventories	48,048
Current portion of prepaid dry-docking	<u>82,299</u>
Total current assets	<u>395,556</u>
Noncurrent assets:	
Prepaid dry-docking, net of current portion	164,599
Capital assets, net of accumulated depreciation	<u>8,383,028</u>
Total noncurrent assets	<u>8,547,627</u>
	<u>\$ 8,943,183</u>

LIABILITIES AND NET POSITION

Current liabilities:	
Accounts payable	\$ 262,772
Payable to affiliates	465,592
Accruals and other liabilities	186,692
Unearned revenue	<u>27,853</u>
Total liabilities	<u>942,909</u>
Commitments and contingencies	
Net position:	
Net investment in capital assets	8,383,028
Restricted	9,797
Unrestricted	(<u>392,551</u>)
Total net position	<u>8,000,274</u>
	<u>\$ 8,943,183</u>

See accompanying notes.

Marshall Islands Shipping Corporation
(A Component Unit of the Republic of the Marshall Islands)

Statement of Revenues, Expenses and Changes in Net Position

Year ended September 30, 2022

Operating revenues:	
Charter	\$ 862,115
Cargo	807,602
Ship sales	383,715
Passenger	23,249
Fuel and other revenue	220,425
Total operating revenues	<u>2,297,106</u>
Recovery of bad debts	37,715
Net operating revenues	<u>2,334,821</u>
Operating expenses:	
Salaries, wages and benefits	2,233,953
Petroleum, oil and lube	979,868
Depreciation	619,207
Cost of goods sold	292,704
Material and supplies	276,220
Travel and entertainment	159,391
Foodstuffs	150,592
Dry-dock expense	132,967
Insurance	61,447
Copra claim	56,431
Utilities	43,606
Professional fees	38,424
Sitting fees	34,569
Contributions	33,581
Communications	22,752
Rent	18,734
Freight	15,741
Stevedoring	986
Miscellaneous	17,574
Total operating expenses	<u>5,188,747</u>
Operating loss	(2,853,926)
Nonoperating revenues:	
Operating subsidies	<u>2,041,262</u>
Change in net position	(812,664)
Net position at beginning of year	<u>8,812,938</u>
Net position at end of year	<u><u>\$ 8,000,274</u></u>

See accompanying notes.

Marshall Islands Shipping Corporation
(A Component Unit of the Republic of the Marshall Islands)

Statement of Cash Flows

Year ended September 30, 2022

Cash flows from operating activities:	
Cash received from customers	\$ 2,467,905
Cash payments to suppliers for goods and services	(2,198,969)
Cash payments to employees for services	(2,208,609)
Net cash used for operating activities	(1,939,673)
Cash flows from noncapital financing activities:	
Operating subsidies received	<u>2,041,262</u>
Cash flows from capital and related financing activities:	
Acquisition of capital assets	(227,795)
Net change in cash	(126,206)
Cash at beginning of year	<u>243,607</u>
Cash at end of year	\$ <u><u>117,401</u></u>
Reconciliation of operating loss to net cash used for operating activities:	
Operating loss	\$ (2,853,926)
Adjustments to reconcile operating loss to net cash used for operating activities:	
Depreciation	619,207
Dry-dock	98,861
Recovery of bad debts	(37,715)
Change in assets and liabilities:	
Receivables:	
Due from affiliates	185,466
Trade	38,455
Employees	(63,944)
Inventories	11,952
Prepaid Dry-docking	(261,204)
Accounts payable	114,622
Payable to affiliates	172,387
Accruals and other liabilities	25,344
Unearned revenue	<u>10,822</u>
Net cash used for operating activities	\$ (<u><u>1,939,673</u></u>)

See accompanying notes.

Marshall Islands Shipping Corporation
(A Component Unit of the Republic of the Marshall Islands)

Notes to Financial Statements

Year ended September 30, 2022

1. Organization

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 including the MV Aemman, the MV Enen Kio, the MV Kwajalein, the MV Ribuuk Ae, the MV Ribuuk Meto, the MV Tobolar, and the SV Kwai. In 2020, the MV Ribuuk Ae and the MV Tobolar were decommissioned and taken out of service. 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 an eight-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. The Governmental Accounting Standards Board (GASB) is the recognized standard-setting body for establishing governmental accounting and financial reporting principles.

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 - 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 No. 34*, establish standards for external financial reporting for state and local governments and requires that resources be classified for accounting and reporting purposes into the following three net position categories:

- Net investment in capital assets - capital assets, net of accumulated depreciation and related debt, plus construction or improvement of those assets.
- Restricted - net position whose use by MISC is subject to externally imposed stipulations that can be fulfilled by actions of the MISC pursuant to those stipulations or that expire with the passage of time. As of September 30, 2022, MISC has restricted net position for unexpended contributions from RepMar of \$9,797 for vessel repairs and maintenance.

Marshall Islands Shipping Corporation
(A Component Unit of the Republic of the Marshall Islands)

Notes to Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

- 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.

When both restricted and unrestricted resources are available for use for the same purpose, it is MISC's policy to use unrestricted resources first, then restricted resources as they are needed.

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.

Revenue Recognition

MISC's revenues are derived primarily from the operation of shipping vessels. Capital grants, financing or investing related transactions are reported as non-operating revenues. Revenue is recognized on the accrual basis and is recorded upon billing when services have been completed. Specifically, 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. All expenses related to operating MISC are reported as operating expenses. Operating subsidies from RepMar is the primary component of non-operating revenues.

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 and savings accounts. As of September 30, 2022, the carrying amount of cash was \$117,401 and the corresponding bank balance was \$139,017. Of the bank balance amount, \$129,714, was maintained in a financial institution subject to Federal Deposit Insurance Corporation (FDIC) insurance. The remaining amount of \$9,303 was maintained in a financial institution not subject to depository insurance.

Marshall Islands Shipping Corporation
(A Component Unit of the Republic of the Marshall Islands)

Notes to Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

Cash, continued

As of September 30, 2022, bank deposits in the amount of \$129,714 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, employees, or customers located within the Republic of the Marshall Islands. The allowance for uncollectible 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 collectability of these accounts and prior collection experience. Management determines the adequacy of the allowance for uncollectible accounts based upon review of the aged accounts receivable. The allowance is established through a provision for bad debts charged to revenue. Bad debts are written off against the allowance on the specific identification method.

Inventories

Inventories consist of items purchased for resale (on the ships) during outer islands voyages and are 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 derecognized. Ordinary repairs and maintenance expenses are charged to the income statement during the financial period in which they are incurred.

Marshall Islands Shipping Corporation
(A Component Unit of the Republic of the Marshall Islands)

Notes to Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

Capital Assets

MISC has not adopted a formal capitalization policy for capital assets; however, items with a cost that equals or exceeds \$1,000 and have an estimated life of more than one year are generally capitalized. Such assets are stated at cost. Depreciation is calculated on the straight-line method based on the estimated useful lives of the respective assets. The estimated useful lives of these assets are as follows:

	<u>Estimated Useful Lives</u>
Equipment	5 - 10 year
Vehicles	5 year
Vessels	25 year
Motorboats	5 year

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.

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, 2022, the accumulated vacation leave liability totals \$114,420 and is included within the statement of net position as accruals and other liabilities.

Unearned Revenue

Unearned revenue represents cash received in advance for revenue to be earned in a future period.

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.

Marshall Islands Shipping Corporation
(A Component Unit of the Republic of the Marshall Islands)

Notes to Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

Recently Adopted Accounting Pronouncements

In 2020, GASB issued Statement No. 95, *Postponement of the Effective Dates of Certain Authoritative Guidance*, which postponed the effective dates of GASB Statement No. 84, 89, 90, 91, 92 and 93 by one year and GASB Statement No. 87 by 18 months; however, earlier application of the provisions addressed in GASB Statement No. 95 is encouraged and is permitted to the extent specified in each pronouncement as originally issued. In accordance with GASB Statement No. 95, MISC's management has elected to postpone implementation of these Statements.

During the year ended September 30, 2022, MISC implemented the following pronouncements:

- GASB Statement No. 89, *Accounting for Interest Cost Incurred Before the End of a Construction Period*, which enhances the relevance and comparability of information about capital assets and the cost of borrowing for a reporting period and simplifies accounting for interest cost incurred before the end of a construction period. The implementation of this Statement did not have a material effect on the accompanying financial statements.
- GASB Statement No. 92, *Omnibus 2020*, which enhances comparability in accounting and financial reporting and improves the consistency of authoritative literature by addressing practice issues that have been identified during implementation and application of certain GASB Statements. The implementation of this Statement did not have a material effect on the accompanying financial statements.
- GASB Statement No. 97, *Certain Component Unit Criteria, and Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans - an amendment of GASB Statements No. 14 and No. 84, and a supersession of GASB Statement No. 32*, which increases consistency and comparability related to the reporting of fiduciary component units; mitigates costs associated with the reporting of certain pension plans and other postemployment benefit (OPEB) plans as fiduciary component units; and enhances the relevance, consistency, and comparability of the accounting and financial reporting for Internal Revenue Code (IRC) Section 457 deferred compensation plans (Section 457 plans) that meet the definition of a pension plan and for benefits provided through those plans. The implementation of this Statement did not have a material effect on the accompanying financial statements.
- GASB Statement No. 98, *The Annual Comprehensive Financial Report*, which establishes the term annual comprehensive financial report and its acronym ACFR. That new term and acronym replace instances of comprehensive annual financial report and its acronym in generally accepted accounting principles for state and local governments. The implementation of this Statement did not have a material effect on the accompanying financial statements.

Marshall Islands Shipping Corporation
(A Component Unit of the Republic of the Marshall Islands)

Notes to Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

Recently Adopted Accounting Pronouncements, continued

- GASB Statement No. 99, *Omnibus 2022*, which provides clarification guidance on several of its recent statements that addresses different accounting and financial reporting issues identified during implementation of the new standards and during the GASB's review of recent pronouncements. GASB Statement No. 99:
 - 1) Amends guidance in GASB Statement No. 24, *Accounting and Financial Reporting for Certain Grants and Other Financial Assistance*, requiring that the accounting and financial reporting of Supplemental Nutrition Assistance Program (SNAP) transactions should follow the provisions of GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, as amended. These provisions were effective upon issuance and implementation did not have a material effect on the accompanying financial statements.
 - 2) Requires disclosures related to nonmonetary transactions, in the notes to financial statements, of the measurement attribute(s) applied to the assets transferred rather than the basis of accounting for those assets. These provisions were effective upon issuance and implementation did not have a material effect on the accompanying financial statements.
 - 3) Provides guidance on accounting for pledges of future revenues when resources are not received by the pledging government. The guidance addresses the process of blending a component unit created to issue debt on behalf of a primary government when that component unit is required to be presented as a blended component unit. This guidance was effective upon issuance and implementation did not have a material effect on the accompanying financial statements.
 - 4) Provides clarification of provisions in GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, as amended, related to the focus of the government-wide financial statements. This guidance was effective upon issuance and implementation did not have a material effect on the accompanying financial statements.
 - 5) Provides terminology updates related to certain provisions of GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, and terminology used in GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. These updates were effective upon issuance and implementation did not have a material effect on the accompanying financial statements.

Marshall Islands Shipping Corporation
(A Component Unit of the Republic of the Marshall Islands)

Notes to Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

Recently Adopted Accounting Pronouncements, continued

- 6) GASB Statement No. 93, *Replacement of Interbank Offered Rates*, which amended GASB Statement No. 53 to address transition away from the London Interbank Offered Rate (LIBOR). GASB Statement No. 99 extends the period during which the LIBOR is considered an appropriate benchmark interest rate to when LIBOR ceases to be determined using methodology in place as of December 31, 2021. This guidance was effective upon issuance and implementation did not have a material effect on the accompanying financial statements.

MISC has not implemented GASB Statement No. 87, *Leases*, which increases the usefulness of governments' financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and as inflows of resources or outflows of resources recognized based on the payment provisions of the contract. Management is unable to ascertain the impact, if any, on the accompanying financial statements.

Upcoming Accounting Pronouncements

In May 2019, GASB issued Statement No. 91, *Conduit Debt Obligations*. The primary objectives of this Statement are to provide a single method of reporting conduit debt obligations by issuers and eliminate diversity in practice associated with (1) commitments extended by issuers, (2) arrangements associated with conduit debt obligations, and (3) related note disclosures. This Statement achieves those objectives by clarifying the existing definition of a conduit debt obligation; establishing that a conduit debt obligation is not a liability of the issuer; establishing standards for accounting and financial reporting of additional commitments and voluntary commitments extended by issuers and arrangements associated with conduit debt obligations; and improving required note disclosures. Management does not believe that this Statement, upon implementation, will have a material effect on the financial statements. In accordance with GASB Statement No. 95, GASB Statement No. 91 will be effective for fiscal year ending September 30, 2023.

In March 2020, GASB issued Statement No. 94, *Public-Private and Public-Public Partnerships and Availability Payment Arrangements*. The primary objective of this Statement is to improve financial reporting by addressing issues related to public-private and public-public partnership arrangements. This Statement also provides guidance for accounting and financial reporting for availability payment arrangements. Management does not believe that this Statement, upon implementation, will have a material effect on the financial statements. GASB Statement No. 94 will be effective for fiscal year ending September 30, 2023.

Marshall Islands Shipping Corporation
(A Component Unit of the Republic of the Marshall Islands)

Notes to Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

Upcoming Accounting Pronouncements, continued

In May 2020, GASB issued Statement No. 96, *Subscription-Based Information Technology Arrangements*. This Statement provides guidance on the accounting and financial reporting for subscription-based information technology arrangements (SBITAs) for government end users (governments). This Statement (1) defines a SBITA; (2) establishes that a SBITA results in a right-to-use subscription asset - an intangible asset - and a corresponding subscription liability; (3) provides the capitalization criteria for outlays other than subscription payments, including implementation costs of a SBITA; and (4) requires note disclosures regarding a SBITA. Management does not believe that this Statement, upon implementation, will have a material effect on the financial statements. GASB Statement No. 96 will be effective for fiscal year ending September 30, 2023.

In April 2022, GASB issued Statement No. 99, *Omnibus 2022*. This Statement contains guidance whose effective dates are in future periods. Management is evaluating the effect that this Statement, upon implementation, will have on the financial statements. GASB Statement No. 99:

- 1) Modifies guidance in GASB Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*, to bring all guarantees under the same financial reporting requirements and disclosures effective for fiscal year ending September 30, 2024.
- 2) Provides guidance on classification and reporting of derivative instruments within the scope of GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, effective for fiscal year ending September 30, 2024.
- 3) Provides clarification of provisions in GASB Statement No. 87 related to the determination of the lease term, classification of a lease as a short-term lease, recognition and measurement of a lease liability and a lease asset, and identification of lease incentives effective for fiscal year ending September 30, 2023.
- 4) Provides clarification of provisions in GASB Statement No. 94, *Public-Private and Public-Public Partnerships and Availability Payment Arrangements*, related to (a) the determination of the public-private and public-public partnership (PPP) term and (b) recognition and measurement of installment payments and the transfer of the underlying PPP asset. Effective for fiscal year ending September 30, 2023.

Marshall Islands Shipping Corporation
(A Component Unit of the Republic of the Marshall Islands)

Notes to Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

Upcoming Accounting Pronouncements, continued

- 5) Provides clarification of provisions in GASB Statement No. 96, *Subscription-Based Information Technology Arrangements*, related to the subscription-based information technology arrangement (SBITA) term, classification of a SBITA as a short-term SBITA, and recognition and measurement of a subscription liability. Effective for fiscal year ending September 30, 2023.
- 6) Modifies accounting and reporting guidance in GASB Statement No. 53 related to termination of hedge. Guidance is effective for fiscal year ending September 30, 2023.

In June 2022, GASB issued Statement No. 100, *Accounting Changes and Error Corrections - An Amendment of GASB Statement No. 62*. This Statement enhances accounting and financial reporting requirements for accounting changes and error corrections and requires that (a) changes in accounting principles and error corrections be reported retroactively by restating prior periods, (b) changes to or within the financial reporting entity be reported by adjusting beginning balances of the current period, and (c) changes in accounting estimates be reported prospectively by recognizing the change in the current period. Requirements applicable to changes in accounting principles apply to the implementation of a new pronouncement if there is no specific transition guidance in the new pronouncement. The Statement also requires that aggregate amounts of adjustments to, and restatements of, beginning net position, fund balance, or fund net position, as applicable, be displayed by reporting unit in the financial statements. Management is evaluating the effect that this Statement, upon implementation, will have on the financial statements. GASB Statement No. 100 will be effective for fiscal year ending September 30, 2024.

In June 2022, GASB issued Statement No. 101, *Compensated Absences*. The primary objective of the Statement is to better meet the information needs of financial statement users by updating the recognition and measurement guidance for compensated absences. This Statement requires that liabilities for compensated absences be recognized for leave that has not been used and leave that has been used but not yet paid, provided the services have occurred, the leave accumulates, and the leave is more likely than not to be used for time off or otherwise paid in cash or noncash means. In estimating the leave that is more likely than not to be used or otherwise paid or settled, a government should consider relevant factors such as employment policies related to compensated absences and historical information about the use or payment of compensated absences. Leave that is more likely than not to be settled through conversion to defined benefit postemployment benefits should not be included in a liability for compensated absences. Management is evaluating the effect that this Statement, upon implementation, will have on the financial statements. GASB Statement No. 101 will be effective for fiscal year ending September 30, 2025.

Marshall Islands Shipping Corporation
(A Component Unit of the Republic of the Marshall Islands)

Notes to Financial Statements, continued

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.

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 disclosures 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.

3. Prepaid Dry-docking

During the year ended September 30, 2022, MISC incurred dry-dock expenditures of \$261,204 for MV Aemman and SV KWAI in Fiji, which is to be amortized over the period of 3 years. As of September 30, 2022, prepaid dry-dock costs amounted to \$246,898.

An analysis of the change in prepaid dry-dock costs during the year ended September 30, 2022, is as follows:

Beginning balance	\$ 84,555
Dry-dock capitalized	261,204
Amortized dry-dock expense	<u>(98,861)</u>
Ending balance	<u>\$246,898</u>
Disclosed as follows:	
Current	\$ 82,299
Noncurrent	<u>164,599</u>
	<u>\$246,898</u>

Marshall Islands Shipping Corporation
(A Component Unit of the Republic of the Marshall Islands)

Notes to Financial Statements, continued

4. Capital Assets

Capital asset activities for the year ended September 30, 2022, were as follows:

	<u>October 1, 2021</u>	<u>Additions</u>	<u>Transfers and Disposals</u>	<u>September 30, 2022</u>
Depreciable capital assets:				
Vessels	\$ 9,878,861	\$ ---	\$ ---	\$ 9,878,861
Vehicles	508,870	55,495	---	564,365
Equipment	345,128	165,900	---	511,028
Motorboats	<u>223,474</u>	<u>6,400</u>	<u>---</u>	<u>229,874</u>
	10,956,333	227,795	---	11,184,128
Less accumulated depreciation	(<u>2,181,893</u>)	(<u>619,207</u>)	<u>---</u>	(<u>2,801,100</u>)
	<u>\$ 8,774,440</u>	<u>\$ (391,412)</u>	<u>\$ ---</u>	<u>\$ 8,383,028</u>

5. Related Party Transactions

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

A summary of related party transactions as of September 30, 2022 and for the year then ended are as follows:

	<u>Revenues</u>	<u>Expenses</u>	<u>Receivables</u>	<u>Payables</u>
Tobolar Copra Processing Authority	\$413,746	\$ 252	\$265,881	\$ ---
Marshall Islands Social Security Administration	---	397,457	---	92,896
Marshalls Energy Company, Inc.	141,380	689,433	---	270,148
RMI Ports Authority	---	41,973	---	29,880
RepMar	40,460	198,140	44,059	28,396
Other	<u>241,679</u>	<u>70,286</u>	<u>192,996</u>	<u>44,272</u>
	<u>\$837,265</u>	<u>\$1,397,541</u>	<u>\$502,936</u>	<u>\$465,592</u>

During the year ended September 30, 2022, the operations of MISC were funded by appropriations from the Nitijela of RepMar of \$2,041,262.

Marshall Islands Shipping Corporation
(A Component Unit of the Republic of the Marshall Islands)

Notes to Financial Statements, continued

5. Related Party Transactions, continued

In 2018, MISC entered into an agreement with the Ministry of Works, Infrastructure and Utilities (MWIU) whereby the MV Majuro vessel was transferred to MWIU. In return, MWIU agreed to operate the vessel and that any revenue generated by MWIU from the vessel more than \$300,000 per annum would be remitted to MISC. During the year ended September 30, 2022, vessel revenues did not exceed the \$300,000 threshold.

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

As described in note 7, MISC leases space from RMI Ports Authority.

6. 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 year. MISC does not maintain general liability insurance; maritime insurance including marine hull 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.

7. Commitments and Contingencies

Commitments

MISC leases a warehouse for \$2,297 per month, effective August 1 2020, from the RMI Ports Authority, which expires on July 31, 2025. During the year ended September 30, 2022, MISC recorded associated rent expense of \$27,558. Total minimum future rental payments under this non-cancelable lease agreement are as follows:

Year ending <u>September 30,</u>	
2023	\$ 27,558
2024	27,558
2025	<u>22,965</u>
	\$ <u>78,081</u>

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Notes to Financial Statements, continued

7. Commitments and Contingencies, continued

Going Concern

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America, which contemplates the continuation of MISC as a going concern. During the year ended September 30, 2022, MISC incurred losses from operations of \$2,853,926. During the year ended September 30, 2022, the operations of MISC were funded by appropriations from the Nitijela of RepMar of \$2,041,262. Management acknowledges that it is currently dependent on RepMar for cash funding to maintain MISC as a going concern. Although RepMar has provided funding in the past, MISC does not have a formal agreement with RepMar to provide future funding. Management believes that the continuation of MISC's operations is dependent upon the future financial support of RepMar, deferment of payment of certain liabilities, and/or significant improvements in operations.

In view of these matters, realization of the related assets in the accompanying statement of net position as of September 30, 2022, is dependent upon continued operations of MISC, which, in turn, is dependent upon MISC's ability to provide service to its customers and the success of future operations. Management believes that actions presently being undertaken to revise MISC's operating requirements, including the generation of positive cash flows from operations by increasing the number of field trips and operation of the new MV Ribuuk Meto and SV Kwai vessels, provide the opportunity for MISC to continue as a going concern. For the year ending September 30, 2023, RepMar has appropriated \$2,029,750 to fund MISC operations and \$450,000 to fund dry-docking costs.

Report of Independent Auditors 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
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 business-type activities of Marshall Islands Shipping Corporation (MISC), which comprise the statement of net position as September 30, 2022, and the related statements of revenues, expenses and changes in net position and of cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated July 26, 2024, which report was qualified due to the lack of implementation of GASB Statement No. 87, *Leases*.

Report on 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) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of MISC's internal control. Accordingly, we do not express an opinion on the effectiveness of MISC's internal control.

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We identified certain deficiencies in internal control, described in the accompanying Schedule of Findings and Responses as items 2022-001 and 2022-002 that we consider to be material weaknesses.

Report on Compliance and Other Matters

As part of obtaining reasonable assurance about whether 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 financial statements. 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*.

MISC's Response to Findings

Government Auditing Standards requires the auditor to perform limited procedures on MISC's response to the findings identified in our audit and described in the accompanying Schedule of Findings and Responses. MISC's response was not subjected to the other auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the response.

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.

Ernst + Young LLP

July 26, 2024

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Schedule of Findings and Responses

Year ended September 30, 2022

Finding No. 2022-001

GASB Statement No. 87, Leases

Criteria: GASB Statement No. 87 requires the recognition of certain lease assets and liabilities for leases that previously classified as operating leases, effective October 1, 2021.

Condition: During the year ended September 30, 2022, MISC did not evaluate their operating leases under GASB Statement No. 87 to determine whether the recognition of certain lease assets and liabilities for leases was required.

Cause: MISC lacks the necessary staffing resources to implement GASB Statement No. 87 effectively.

Effect: MISC's financial statements may not accurately reflect lease obligations and related expenses impacting the credibility of financial statements and resulting in an audit opinion modification.

Recommendation: We recommend management provide training and education for relevant staff to ensure they understand the requirements of GASB Statement No. 87 and can effectively implement the new processes.

Auditee Response and Corrective Action Plan: MISC regrettably understands that this response would not undo the finding as alluded to by the auditors. More regrettable is the fact that the GASB Statement No. 87 had not been strongly and widely pushed towards full implementation as it is a new process and MISC lacks full awareness and understanding of it. MISC takes the recommendation seriously and shall ensure that proper training or education relating to the GASB Statement No. 87 is provided to the relevant staff.

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Schedule of Findings and Responses, Continued

Finding No. 2022-002

Employee Receivables

Criteria: Effective internal control policies and procedures requires that employee receivables be properly authorized and documented and incorporate policies outlining terms under which employee receivables are incurred and procedures for collection.

Condition: At September 30, 2022, MISC recorded receivables from employees and former employees totaling \$305,617, which included one balance totaling \$53,779 representing cash and inventory shortages from various field trips made in 2022. In addition, employee receivables included numerous balances for which collection was not apparent.

Cause: Lack of defined policies and procedures requiring monitoring and follow-up of outstanding receivable balances for collection.

Effect: Unpaid employee receivables may disrupt cash flow, potentially affecting MISC's ability to meet financial obligations such as paying vendors or covering operating expenses. Persistent non-collection of receivables may lead to write-offs or increased provisions for bad debts.

Recommendation: We recommend management establish internal control policies and procedures requiring employee receivables be properly authorized and documented and be collected in accordance with agreed upon terms.

Auditee Response and Corrective Action Plan: MISC had not intentionally permitted credit charges to employees, except for freighting essential cargoes to families or relatives, specifically food/rice up to 5 bags and maybe a limited number of canned foods according to their net pay. Costs of such are deducted from paychecks.

These are the authorized accounts receivables, which are controllable. The unauthorized accounts receivables are, as reported previously, the unauthorized cash payments of unused annual leaves from the previous administration, which are still shown on the total accounts receivable accumulated or added to the current receivables caused mostly by merchants' short on returned or unsold inventories, and short on cash receipts. All such shortages are charged to a particular merchant and accumulated with previous receivables.

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Schedule of Findings and Responses, Continued

Finding No. 2022-002, continued

Employee Receivables, continued

Auditee Response and Corrective Action Plan, continued: MISC has delegated a supervisory role to a staff previously with the accounting department under the Finance Manager. The supervisor has been assigned the duty to work closely with the merchants to ensure they fully fill up sales forms that show or itemize the goods sold, remaining inventories, pick up cash from sales upon return of the ships, reconciles these, and have the Finance Manager verify them before deposit. The supervisor is responsible to take accurate accounts of returning inventories, and new inventories of goods prior to loading them. Work under the supervision and guidance of the fleet manager and deputy CEO for operations.

Additionally, MISC has hired a Fleet Manager, who in addition to assisting the Deputy CEO for Operations of the vessels, is responsible to guide and supervise the Merchants Supervisor, specifically on the inventories of all merchandise before they are loaded on the ships and after the returns of the ships; and to ensure that all the merchants fully comply with policies and requirements handed down by Management, including accurate reconciliations of inventories of returned merchandise with beginning inventories, accurate reconciliations of cash sales before review by the Finance Manager before deposit.