MARSHALL ISLANDS SHIPPING CORPORATION

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

FINANCIAL STATEMENTS AND INDEPENDENT AUDITORS' REPORT

YEARS ENDED SEPTEMBER 30, 2009 AND 2008

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INDEPENDENT AUDITORS' REPORT

Board of Directors
Marshall Islands Shipping Corporation:

We have audited the accompanying statements of net assets of the Marshall Islands Shipping Corporation (MISC), a component unit of the Republic of the Marshall Islands (RepMar), as of September 30, 2009 and 2008, and the related statements of revenues, expenses, and changes in net assets and of cash flows for the years then ended. These financial statements are the responsibility of MISC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

Except as discussed in the following paragraph, 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 of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing 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 over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

Because of the inadequacy of accounting records, we were unable to form an opinion regarding the amount at which copra purchases payable (stated at $200,637) is recorded in the accompanying statement of net assets at September 30, 2009, and the validity of other revenues, cost of goods sold expense, and materials and supplies expense (stated at $336,590, $218,989 and $404,381, respectively) that are recorded in the accompanying statement of revenues, expenses and changes in net assets for the year ended September 30, 2009.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had the accounting records concerning copra purchases payable, other revenues, cost of goods sold expense, and materials and supplies expense been adequate, such financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of MISC as of September 30, 2009 and 2008, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Member of
Deloitte Touche Tohmatsu

The Management's Discussion and Analysis on pages 3 through 7 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of MISC's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit such information and we do not express an opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 24, 2011, on our consideration of internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Deloitte + Touche LLP

January 24, 2011

MARSHALL ISLANDS SHIPPING CORPORATION

Management's Discussion and Analysis
September 30, 2009

As management of the Marshall Islands Shipping Corporation (MISC), we offer readers of MISC's financial statements this narrative overview and analysis of the financial activities of MISC for the fiscal year ending September 30th, 2009. We encourage the readers to consider the information presented here in conjunction with additional information that we have furnished in the MISC's financial statements, which follow this narrative.

Financial Highlights

<u>Fiscal Year 2009:</u>

- The assets of MISC exceeded its liabilities at the close of business for the year by \$0.126M (Net Assets), decreasing by \$0.239M (or 65%) from \$0.365M in the prior year.
- As of the close of business on September 30th, 2009, MISC earned \$1.27M in revenues; this represents a decrease of \$0.237M or 16% in comparison with the prior year. This decrease is a result of decreasing major revenue sources (Charter and Cargo) which went down from \$0.726M and \$0.603M in prior year to \$0.363M and \$0.504M at the end of FY2009 or about 50% and 16%, respectively. On the other hand, MISC incurred various expenses which are directly and indirectly related to provision to sea-transport services to the outer islands, totaled \$2.60M, a decrease of \$0.082M or 3% over the previous year. These expenses were funded by income generated from Charter, Freight and Passenger fees of \$1.27M and by an operating subsidy from the RMI Government of \$1.09M.

Overview of Financial Statements

This discussion and analysis is intended to serve as an introduction to MISC's basic financial statements. MISC's financial statements are comprised of four (4) components: 1) Statement of Net Assets, 2) Statement of Revenues, Expenses and Changes in Net Assets, 3) Statement of Cash Flows, and 4) Notes to the financial statements.

MISC, like other government agencies, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. MISC is comprised of a single proprietary fund. A proprietary fund operates by charging its customers a fee for the service provided *(operating revenue)*, like a typical business enterprise. A proprietary fund may also receive revenue from governmental agencies as grants or support *(non-operating revenue)*. These basic financial statements are designed to provide readers with a broad overview of MISC's finances, in a manner similar to a private-sector business.

The *Statement of Net Assets* presents information on all of MISC's assets and liabilities, with the difference between the two reported as *net assets*. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of MISC is improving or deteriorating. The statement of net assets can be found on page 8 of this report.

The *Statement of Revenues, Expenses, and Changes in Net Assets* presents information showing how MISC's net assets changed during the fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, *regardless of the timing of the related cash flows*. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g. accounts receivable and accounts payable). The statement of revenues, expenses, and changes in net assets can be found on page 9 of this report.

The *Statement of Cash Flows* presents information showing how MISC's cash increased or decreased during the year. Cash is received and used in three ways: operating activities, capital and non-capital financing activities, and investing activities. The statement of cash flows can be found on page 10 of this report.

The *Notes to the financial statements* provide additional information that is essential to a full understanding of the data provided in the basic financial statements. The notes to the financial statements can be found on pages 11-16 of this report.

Financial Analysis

Net Assets

Net Assets may serve over time as a useful indicator of a government's financial position. The Summary of Statement of Net Assets below was prepared to give insight on the MISC's resources, liabilities, and net assets compared with previous year. At the close of business on September 3oth, 2009, MISC's assets exceeded liabilities by $0.126M. However, $0.284M or 225% of these represent its investment in capital assets (mostly equipment); consequently, these assets are not available for future spending.

Marshall Islands Shipping Corporation
Summary of Statements of Net Assets

	2009	2008	2007
Assets:			
Cash	$ 226,780	$ 190,543	$ 236,498
Receivables, net	61,796	79,563	400,740
Inventory	8,972	0	0
Equipment, net	283,767	298,020	91,830
Other	0	0	72,000
Total Assets	$ 581,315	$ 568,126	$ 801,068
Current Liabilities:			
Accounts payable	$ 79,827	$ 22,300	$ 93,883
Payable to affiliates	70,338	81,143	105,333
Copra purchases payable	200,637	0	0
Other liabilities and accruals	104,509	99,410	62,662
Total Liabilities	455,311	202,853	261,878
Net Assets:			
Invested in capital assets	283,767	298,020	91,830
Unrestricted	(157,763)	67,253	447,360
Total Net Assets	126,004	365,273	539,190
	$ 581,315	$ 568,126	$ 801,068

Changes in Net Assets

Current year activities decreased MISC's net assets by $0.239M. The Summary of Statement of Revenues, Expenses, and Changes in Net Assets below was prepared to show the net asset calculation for the year.

Marshall Islands Shipping Corporation
Summary of Statements of Revenues, Expenses,
and Changes in Net Assets

	2009	2008	2007
Revenues:			
Operating revenues	$ 1,274,096	$ 1,511,398	$ 1,045,562
Non-operating revenues	1,091,847	1,008,150	1,467,466
Total Revenues	2,365,943	2,519,548	2,513,028
Expenses:			
Operating expenses	2,600,523	2,682,755	1,960,011
Provision for doubtful accounts	4,689	10,710	13,827
Total Expenses	2,605,212	2,693,465	1,973,838
Change in net assets	(239,269)	(173,917)	539,190
Net assets at the beginning of the year	365,273	539,190	0
Net Assets at the end of the year	$ 126,004	$ 365,273	$ 539,190

MISC's total revenues (excluding Non-operating revenues) reported in the current year decreased in comparison to previous financial year. Charter and Freight (Cargo fees) continue to be MISC's two top revenue sources, which account for approximately $.867M of total revenue earned during the year. Charter and Cargo, respectively, account for 29% and 40% or 69% of total revenue earned during the year. The chart below was prepared to describe MISC's revenue sources with comparison with previous year.

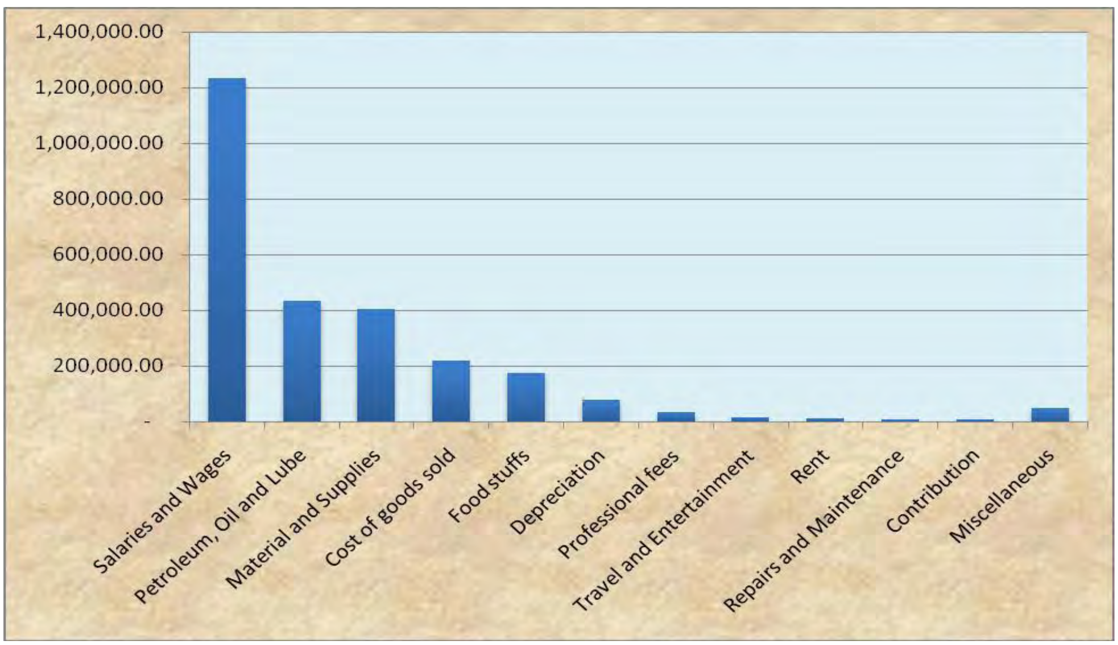
Revenue Sources

Other revenues increased by $0.25M in comparison with the prior year due to the commencement retail sales on board the ships operated by MISC. Operating revenue realized from these sales amounted to $0.23M for the year ended September 30th, 2009.

The total cost incurred by MISC as of the close of business on September 30th, 2009, amounted to $2.60M, a decrease of $0.82M or about 3% in comparison with the previous financial year. The main cause of this decrease is primarily due to significant drop in petroleum, oil and lube, which is a result of recent decreases in the cost of fuel worldwide. Aside from fuel costs, all other expense line items increased marginally. Finally, MISC's decision to purchase and sell goods (merchants) on the ships in 2009 resulted in MISC recording cost of goods sold in the amount of $0.22M.

The payroll, fuel, and supplies continue to be top three expense line items, which accounted for $2.18M, or 84%, of total expenses incurred during the year. The graph below was prepared to describe the itemized expenses and spending activities of MISC during the current year.

Expenses distribution



Management's Discussion and Analysis for the year ended September 30, 2008 is set forth in MISC's report on the audit of financial statements, which is dated October 5, 2009. That Discussion and Analysis explains the major factors impacting the 2008 financial statements and can be obtained from MISC's General Manager via the contact information below.

Capital Asset and Debt

During the year, MISC purchased several equipment and vehicles at a cost of approximately $29,000 and $30,000, respectively. For additional information concerning capital assets, please refer to Note 4 to the financial statements.

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

ECONOMIC OUTLOOK

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 Capitol city to the Outer Islands and vice versa.

The recent decreases in cost imported fuel have affected the operation of MISC positively during the year. That is, fuel consumption significantly dropped by $0.356M or 45% from $0.790M in the prior year. Although fuel expenses dropped, other expense line items such as food and material and supplies increased during the year, which is a result of expansion of the operations of MISC. MISC has been dependent on the cash infusion from the RMI Government to subsidize these costs.

With the recent decreases in cost of fuel worldwide and current commitment from the RMI Government to subsidize the cost associated with providing sea-transport services, management intends to maintain and increase the number of fieldtrip services in the near future. In line with this, the RMI Government has included within its FY 2010 budget an appropriation of $975,000 for the purpose of subsidizing the 2010 operations of MISC.

Request for Information

The financial report is designed to provide a general overview of MISC's finances for all those with an interest in the corporation's finances. Questions concerning any of the information provided in this report or request for additional financial information should be addressed to the Manager of Marshall Islands Shipping Corporation, **P.O. Box 1198, Majuro, MH 96960.**

MARSHALL ISLANDS SHIPPING CORPORATION

Statements of Net Assets
September 30, 2009 and 2008

ASSETS	2009	2008
Current assets:		
Cash	$ 226,780	$ 190,543
Receivables:		
Affiliates	37,454	57,042
Trade	50,401	41,016
Employees	3,167	6,042
	91,022	104,100
Less allowance for doubtful accounts	(29,226)	(24,537)
Total receivables, net	61,796	79,563
Inventory	8,972	-
Total current assets	297,548	270,106
Equipment, net	283,767	298,020
	$ 581,315	$ 568,126
LIABILITIES AND NET ASSETS		
Current liabilities:		
Accounts payable	$ 79,827	$ 22,300
Payable to affiliates	70,338	81,143
Copra purchases payable	200,637	-
Other liabilities and accruals	104,509	99,410
Total liabilities	455,311	202,853
Contingency		
Net assets:		
Invested in capital assets	283,767	298,020
Unrestricted	(157,763)	67,253
Total net assets	126,004	365,273
	$ 581,315	$ 568,126

See accompanying notes to financial statements.

MARSHALL ISLANDS SHIPPING CORPORATION

Statements of Revenues, Expenses and Changes in Net Assets
Years Ended September 30, 2009 and 2008

	2009	2008
Operating revenues:		
Cargo	$ 504,114	$ 603,138
Charter	363,427	726,658
Passenger	69,965	97,819
Other	336,590	83,783
	1,274,096	1,511,398
Less provision for doubtful accounts	(4,689)	(10,710)
Total operating revenues	1,269,407	1,500,688
Operating expenses:		
Salaries, wages and benefits	1,168,962	1,185,996
Petroleum, oil and lube	434,422	790,470
Material and supplies	404,381	363,932
Cost of goods sold	218,989	-
Foodstuffs	173,083	198,431
Depreciation	78,597	60,253
Professional fees	32,014	23,419
Travel and entertainment	16,554	13,556
Rent	9,924	7,386
Repairs and maintenance	8,159	3,468
Contributions	7,515	16,680
Miscellaneous	47,923	19,164
Total operating expenses	2,600,523	2,682,755
Operating loss	(1,331,116)	(1,182,067)
Nonoperating revenues:		
Operating subsidies	1,091,847	1,008,150
Change in net assets	(239,269)	(173,917)
Net assets at beginning of year	365,273	539,190
Net assets at end of year	$ 126,004	$ 365,273

See accompanying notes to financial statements.

MARSHALL ISLANDS SHIPPING CORPORATION

Statements of Cash Flows
Years Ended September 30, 2009 and 2008

	2009	2008
Cash flows from operating activities:		
Cash received from customers	$ 1,287,174	$ 1,771,805
Cash payments to suppliers for goods and services	(1,114,577)	(1,532,279)
Cash payments to employees for services	(1,163,863)	(1,149,248)
Net cash used for operating activities	(991,266)	(909,722)
Cash flows from noncapital financing activities:		
RepMar subsidy received	1,091,847	1,058,210
Cash flows from capital and related financing activities:		
Acquisition of capital assets	(64,344)	(194,443)
Net change in cash	36,237	(45,955)
Cash at beginning of year	190,543	236,498
Cash at end of year	$ 226,780	$ 190,543
Reconciliation of operating loss to net cash used for operating activities:		
Operating loss	$ (1,331,116)	$ (1,182,067)
Adjustments to reconcile operating loss to net cash used for operating activities:		
Depreciation	78,597	60,253
Bad debts	4,689	10,710
(Increase) decrease in assets:		
Receivables:		
Affiliates	19,588	207,355
Trade	(9,385)	58,352
Employees	2,875	(5,300)
Inventory	(8,972)	-
Increase (decrease) in liabilities:		
Accounts payable	57,527	(71,583)
Payable to affiliates	(10,805)	(24,190)
Copra purchases payable	200,637	-
Other liabilities and accruals	5,099	36,748
Net cash used for operating activities	$ (991,266)	$ (909,722)

See accompanying notes to financial statements.

(1) Organization

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

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

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

(2) Summary of Significant Accounting Policies

The accounting policies of MISC conform to accounting principles generally accepted in the United States of America, as applicable to governmental entities, specifically proprietary funds. Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, requires that proprietary activities apply all applicable GASB pronouncements as well as Statements and Interpretations issued by the Financial Accounting Standards Board (FASB), Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989. MISC has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

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

To conform to the requirements of GASB 34, equity is presented in the following net asset categories:

- Invested in capital assets; capital assets, net of accumulated depreciation, plus construction or improvement of those assets.

- Unrestricted; net assets that are not subject to externally imposed stipulations. Unrestricted net assets 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.

Estimates

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

(2) Summary of Significant Accounting Policies, Continued

Basis of Accounting

Proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operation of the fund are included in the statement of net assets. Proprietary fund operating statements present increases and decreases in net total assets. 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.

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 assets and cash flows, cash is defined as cash on hand and cash held in demand accounts. As of September 30, 2009 and 2008, the carrying amount of cash was $226,780 and $190,543, respectively, and the corresponding bank balances were $56,801 and $208,526, respectively, which were maintained in a financial institution subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2009 and 2008, bank deposits in the amount of $56,801 and $100,000, 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 (first-in, first out FIFO) or market value (net realized value).

Equipment

MISC has not adopted a formal capitalization policy for equipment; however, items with a cost that equals or exceeds $1,000 are generally capitalized. Depreciation is calculated using the straight-line method based on the estimated useful lives of the respective assets. The estimated useful lives of these assets is 5 years.

(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, 2009 and 2008, the accumulated vacation leave liability totals $68,658 and $69,033, respectively, and is included within the statements of net assets as other liabilities and accruals.

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.

New Accounting Standards

During fiscal year 2009, MISC implemented the following pronouncements:

- GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, which establishes standards for the measurement, recognition, and display of other postemployment benefits expense/expenditures and related liabilities, note disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employers.

- GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, which provides guidance and consistency under which a governmental entity would be required to report a liability related to pollution remediation.

- GASB Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*, which improves the quality of financial reporting by requiring endowments to report their land and other real estate investments at fair value, creating consistency in reporting among similar entities that exist to invest resources for the purpose of generating income.

- GASB Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, which improves financial reporting by contributing to the GASB's efforts to codify all GAAP for state and local governments so that they derive from a single source.

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

- GASB Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*, which incorporates accounting and financial reporting guidance previously only contained in the American Institute of Certified Public Accountants (AICPA) auditing literature into the GASB's accounting and financial reporting literature for state and local governments, and addresses three issues from the AICPA's literature - related party transactions, going concern considerations, and subsequent events.

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

In June 2007, GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets.* GASB Statement No. 51 addresses whether and when intangible assets should be considered capital assets for financial reporting purposes. The provisions of this statement are effective for periods beginning after June 15, 2009. Management does not believe that the implementation of this statement will have a material effect on the financial statements of MISC.

In June 2008, GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments.* GASB Statement No. 53 is intended to improve how state and local governments report information about derivative instruments – financial arrangements used by governments to manage specific risks or make investments – in their financial statements. The provisions of this statement are effective for periods beginning after June 15, 2009. Management does not believe that the implementation of this statement will have a material effect on the financial statements of MISC.

In December 2008, GASB issued Technical Bulletin No. 2008-1, *Determining the Annual Required Contribution Adjustment for Postemployment Benefits*, which clarifies the requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers,* and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions,* for calculating the annual required contribution (ARC) adjustment. The provisions of this statement are effective for periods beginning after December 15, 2008. Management does not believe that the implementation of this statement will have a material effect on the financial statements of MISC.

In March 2009, GASB issued Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, which enhances the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. The provisions of this statement are effective for periods beginning after June 15, 2010. Management does not believe that the implementation of this statement will have a material effect on the financial statements of MISC.

(3) Risk Management

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

(4) Equipment

Capital asset activity during the years ended September 30, 2009 and 2008 is as follows:

	2009			
	October 1, 2008	Additions	Retirements	September 30, 2009
Equipment	$ 271,525	$ 28,844	$ -	$ 300,369
Vehicles	78,949	30,000	-	108,949
Furniture	8,495	-	-	8,495
Motor boats	8,500	5,500	-	14,000
	367,469	64,344	-	431,813
Less accumulated depreciation	(69,449)	(78,597)	-	(148,046)
	$ 298,020	$ (14,253)	$ -	$ 283,767

	2008			
	October 1, 2007	Additions	Retirements	September 30, 2008
Equipment	$ 56,153	$ 215,372	$ -	$ 271,525
Vehicles	28,995	49,954	-	78,949
Furniture	7,378	1,117	-	8,495
Motor boats	8,500	-	-	8,500
	101,026	266,443	-	367,469
Less accumulated depreciation	(9,196)	(60,253)	-	(69,449)
	$ 91,830	$ 206,190	$ -	$ 298,020

(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.

(5) Related Party Transactions, Continued

A summary of related party transactions for the years ended September 30, 2009 and 2008 is as follows:

	2009			
	Revenues	Expenses	Receivables	Payables
Tobolar Copra Processing Plant, Inc.	$ 365,668	$ -	$ 8,607	$ -
Marshall Islands Social Security Administration	-	103,773	-	50,301
Marshalls Energy Company, Inc.	400	319,713	-	1,323
Majuro Water and Sewer Company, Inc.	-	3,466	-	-
Republic of the Marshall Islands	182,667	2,579	28,847	10,666
Other	1,126	10,577	-	8,048
	$ 549,861	$ 440,108	$ 37,454	$ 70,338

	2008			
	Revenues	Expenses	Receivables	Payables
Tobolar Copra Processing Plant, Inc.	$ 281,567	$ -	$ -	$ -
Marshall Islands Social Security Administration	-	92,460	-	55,672
Marshalls Energy Company, Inc.	148,578	623,075	-	6,338
Majuro Water and Sewer Company, Inc.	-	19,562	-	8,370
Republic of the Marshall Islands	301,441	11,839	56,762	8,745
Other	1,750	10,208	280	2,018
	$ 733,336	$ 757,144	$ 57,042	$ 81,143

During the years ended September 30, 2009 and 2008, the operations of MISC were funded by appropriations, totaling $1,091,847 and $1,008,150, respectively, from the Nitijela of RepMar.

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.

(6) Contingency

MISC receives a substantial amount of its revenue from annual RepMar appropriations. A significant reduction in the level of budgetary support form RepMar, if this were to occur, may have an effect on MISC's programs and activities. For the year ended September 30, 2010, RepMar appropriated funding to MISC in the amount of $975,000 for the purpose of funding operations.

MARSHALL ISLANDS SHIPPING CORPORATION

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

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL AND ON COMPLIANCE

YEAR ENDED SEPTEMBER 30, 2009

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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 the financial statements of the Marshall Islands Shipping Corporation (MISC), as of and for the year ended September 30, 2009, and have issued our report thereon dated January 24, 2011, which report was qualified due to the inadequacy of accounting records. Except as discussed in the preceding sentence, we conducted our audit 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered MISC's internal control over financial reporting as a basis for designing our auditing procedures 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 over financial reporting. Accordingly, we do not express an opinion on the effectiveness of MISC's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A *control deficiency* 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies described in the accompanying Schedule of Findings and Responses (pages 3 through 10) as items 2009-1 through 2009-6 to be significant deficiencies in internal control over financial reporting.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Member of
Deloitte Touche Tohmatsu

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we consider the significant deficiencies described above to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether MISC's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, 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 2009-7 and 2009-8.

We also noted certain matters that we reported to management of MISC in a separate letter dated January 24, 2011.

MISC's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Responses. We did not audit MISC's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of management, the Board of Directors, and others within the entity, and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte + Touche LLP

January 24, 2011

Finding No. 2009-1

Revenues

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

Condition: Pre-numbered charter request forms are not utilized. Charters are invoiced based on written information provided by management, often without sufficient detail to enable verification of the charges. Additionally, freight is invoiced based on oral declarations from customers without further verification due to lack of adequate space and equipment. Cargo is also loaded without verification against bills of lading.

Daily collection/sales reports are not independently reviewed and verified.

MISC has not adopted a policy pertaining to the provision for doubtful accounts.

Sales invoices, payment receipts, and validated deposit receipts for various other revenue test selections were not provided during the audit. In addition, collection amounts did not match report amounts, and set sales price were not provided to support inventory sales.

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

Effect: The effect of the above condition is a possible misstatement of revenues and results in an opinion qualification.

Recommendation: We recommend that management establish policies and procedures pertaining to revenues. Furthermore, we recommend that MISC ensure all supporting documentation (e.g. invoices, receipts, set sales price, etc.) is arranged and is kept in file for future reference. We further recommend that MISC ensure collections be accurately 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 and 2008.

Auditee Response and Corrective Action Plan:

Who: Head Accounting Officer

What: He/She will need to make sure A/R department have all sale invoices and cash receipts provided or issued for approval before and after making payment.

When: Next Fiscal Year in 2010.

MARSHALL ISLANDS SHIPPING CORPORATION

Schedule of Findings and Responses, Continued
Year Ended September 30, 2009

Finding No. 2009-2

Purchases/Disbursements

Criteria: Expenses should be supported by adequate documentation.

Condition:

1) Documentation such as invoices, travel authorizations, etc. were not available to support the following expenses:

Check#	Amount	Check#	Amount	Check#	Amount
13334	$13,000	15021	$3,709	15592	$15,084
13057	$ 419	16096	$9,734	13585	$ 675
13320	$ 7,270	14215	$7,128	15148	$ 1,800

2) A purchase order (PO) was not prepared for the following expenses:

Check#	Amount	Check#	Amount	Check#	Amount
13338	$13,600	13978	$2,772	13971	$ 116
13465	$43,725	14064	$ 112	12909	$ 1,435
13962	$30,260	14599	$ 6	13450	$ 1,832
14726	$ 1,244	15008	$ 31	13976	$ 3,182
14230	$13,380	15252	$ 24	15136	$ 47
15732	$ 3,980	15445	$1,970	15590	$ 192
13053	$ 120	15864	$3,800	13033	$ 600

Cause: The cause of the above condition is the lack of established policies and procedures requiring that non-payroll disbursements be supported by adequate documentation.

Effect: The effect of the above condition is the possibility of unauthorized and invalid expenses and results in an audit qualification.

Recommendation: We recommend that management establish policies and procedures to require that expenses are supported by adequate documentation.

Prior Year Status: Lack of established policies and procedures pertaining to non-payroll disbursements was reported as a finding in the audits of MISC for fiscal years 2007 and 2008.

Auditee Response and Corrective Action Plan:

Who: Head Accounting Officer

What: He/She need to make sure that A/P department have all purchase invoices, receipts, and other supporting documents provided at al times before issuing a check to vendors. Documentation also needs to be approved and correctly input into the accounting system.

When: Next Fiscal Year in 2010.

Finding No. 2009-3

Inventory

Criteria: Inventory should be monitored and reconciled.

Condition: The preliminary trial balance provided for audit included inventory of $220,762 for which a final valuation report (inventory assets schedule) was not available. Upon the application of additional audit procedures, the final inventory was $8,972. Accordingly, an audit adjustment was proposed to reduce inventory to the correct amount with a corresponding adjustment to cost of goods sold. However, no underlying documentation supporting the reduction in inventory balances as cost of goods sold was made available.

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

Effects: The effect of the above condition is a possible misstatement of inventory balances and invalid expenses and results in opinion qualification.

Recommendation: We recommend that management establish policies and procedures pertaining to reconciliation of inventory assets.

Auditee Response and Corrective Action Plan:

Who: Management

What: He/She need to establish new policies and procedures pertaining to inventory assets.

When: Next Fiscal Year in 2010.

Finding No. 2009-4

Fixed Assets

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

Condition: MISC has not established policies and procedures pertaining to fixed assets, specifically asset lives and capitalization thresholds. Furthermore, fixed assets are not tagged, and additions and depreciation expense are recorded directly to net asset balances. Audit adjustments were proposed to record depreciation expense and to correct net assets.

We also noted two line items with the same description, but different acquisition dates, under Motor Vehicles in the subsidiary register that pertain to one vehicle.

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

Effects: The effect of the above condition is a possible misstatement of fixed assets.

Recommendation: We recommend that management establish policies and procedures pertaining to fixed assets.

Prior Year Status: Lack of established policies and procedures pertaining to fixed assets was reported as a finding the audits of MISC for fiscal years 2007 and 2008.

Auditee Response and Corrective Action Plan:

Who: Head Accounting Officer

What: He/She need to establish new policies and procedures pertaining to the fixed assets register. And also have all the fixed assets tagged and correctly recorded into the system. The assets cost, freight and tax should be included and recorded together when imputing the cost of assets into the system.

When: Next Fiscal Year in 2010

Finding No. 2009-5

Copra Purchases Payable

Criteria: Copra payable should be supported by a reconciled subsidiary ledger.

Condition: At September 30, 2009, MISC recorded copra purchases payable of $200,637 which was not supported by a reconciled subsidiary ledger. Further, it is our understanding that copra purchases from growers are made based on check payments that are initially made out to a MISC employee who cashes the check and then distributes the cash to the growers.

Cause: The cause of the above condition is the lack of established policies and procedures pertaining to copra purchases payable, specifically monitoring and reconciliation of the liability account.

Effects: The effect of the above condition is possible misstatement of copra purchases payable and results in an audit qualification.

Recommendation: We recommend that management establish policies and procedures requiring retention of a copra purchases payable subsidiary ledger that is periodically monitored and reconciled.

Auditee Response and Corrective Action Plan:

Who: Head Accounting Officer/Management

What: He/She need to make sure all Copra Purchase are records, reconciled, completed and approved. Also Management needs to establish policies and procedures pertaining to copra purchase.

When: Next Fiscal Year in 2010.

Finding No. 2009-6

External Financial Reporting

Criteria: General journal entries should be supported by independently reviewed and approved journal vouchers with adequate supporting documentation.

Condition: General journal entries are not supported by independently reviewed and approved journal vouchers with adequate documentation.

Cause: The cause of the above condition is the lack of established policies and procedures pertaining to general journal vouchers.

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

Recommendation: We recommend that management establish policies and procedures requiring journal vouchers to be independently reviewed and approved and to be supported with adequate documentation.

Prior Year Status: Lack of established policies and procedures pertaining to journal entries was reported as a finding in the audits of MISC for fiscal years 2007 and 2008.

Auditee Response and Corrective Action Plan:

Who: Management/Head Accounting Officer

What: He/She need to make sure management established policies and procedures that segregate duties and the retention of documents supporting journal entries. Furthermore, all documentation pertaining to journal entries needs to be approved and signed by management.

When: Next Fiscal Year in 2010

Finding No. 2009-7

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 of the Republic to vest absolutely in MISC. Further, all assets and liabilities, rights, duties, and obligations, and all contracts and agreements of the Republic relating to shipping services, subsisting on the date of MISC's establishment, shall stand transferred and vest in MISC.

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

Cause: The cause of the above condition is the lack of official documentation transferring all assets and liabilities; rights, duties and obligations; and all contracts and agreements of the Republic relating to shipping services, subsisting 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 and 2008.

Auditee Response and Corrective Action Plan:

Who: Management

What: He/She need to get all documentation of all assets and liabilities; rights, duties and obligations; and all contracts and agreements of the Republic relating to shipping services from the Ministry of Transportation and Communication (T & C), which are now operated by MISC. Management needs to have all requirements of Public Law 2005-41 documenting the four vessels (Aemman, Jeljelat Ae, Landrik, and Ribuuk Ae), vehiles and other files transferred from the Ministry of T&C for MISC records.

When: Next Fiscal Year in 2010

Finding No. 2009-8

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 a supply, service, or construction item without competition when it is determined in writing that there is only one source for the required supply, service, or construction them.

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

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

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

Recommendation: We recommend that management establish policies and procedures to ensure 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 and 2008.

Auditee Response and Corrective Action Plan:

Who: Management

What: He/She need to establish policies and procedures to ensure compliance with RepMar's Procurement Code.

When: Next Fiscal Year in 2010

MARSHALL ISLANDS SHIPPING CORPORATION

Unresolved Prior Year Findings
Year Ended September 30, 2009

The status of unresolved prior year findings is disclosed within the schedule of Findings and Responses sections (pages 3 through 10) of this report.