

MAJURO WATER AND SEWER COMPANY, INC.

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

**FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED SEPTEMBER 30, 2010 AND 2009

INDEPENDENT AUDITORS' REPORT

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

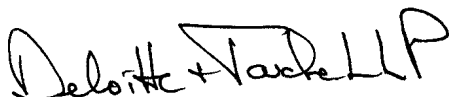
We have audited the accompanying statements of net assets of Majuro Water and Sewer Company, Inc. (MWSC), a component unit of the Republic of the Marshall Islands, as of September 30, 2010 and 2009, and the related statements of revenues, expenses and changes in net assets and of cash flows for the years then ended. These financial statements are the responsibility of MWSC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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 MWSC'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.

In our opinion, such financial statements present fairly, in all material respects, the financial position of MWSC as of September 30, 2010 and 2009, 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.

The Management's Discussion and Analysis on pages 2 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 MWSC'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 the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 15, 2011, on our consideration of MWSC's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is 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.



February 15, 2011

MAJURO WATER AND SEWER COMPANY, INC.

Management's Discussion and Analysis Year Ended September 30, 2010

This section of the Majuro Water and Sewer Company, Inc. (MWSC) annual financial report presents management's discussion and analysis of MWSC's financial performance during the fiscal year ended 30th September, 2010. This discussion has been prepared by management along with the financial statements and related footnote disclosure and should be read in conjunction with them. Management assumes full responsibility for the completeness and reliability of information presented in this report.

FINANCIAL HIGHLIGHTS

MWSC's net assets increased \$182,585 in 2010 compared to a decrease of \$61,946 in 2009. This was due to the capital contribution of \$221,600 received in 2010. The purpose of the capital contribution was for the purchase of a water delivery truck and a sewer truck. There were no capital contributions in 2009.

An operating subsidy of \$318,099 and \$346,928 was received from the Republic of the Marshall Islands (RepMar) for fiscal years ended September 2010 and 2009, respectively. This subsidy was used to pay the electricity owed to Marshalls Energy Company, Inc. (MEC) and was slightly decreased by \$28,829 in 2010.

Total operating revenue increased by \$27,879 (3%) compared to a decrease in revenue of \$129,329 in 2009. Within operating revenues, utility billings increased by \$36,830 (4%) from \$894,805 in 2009 to \$931,635 in 2010. Hookups and delivery billings increased by \$12,807 (8%) from \$154,675 in 2009 to \$167,482 in 2010. The increase in operating revenues for both utility billing activity is mainly due to the acquisition of a water delivery truck and a sewer truck in 2010. The increased revenue is also a reflection of MWSC efforts to resolve illegal water hookups and to issue customer billings as appropriate.

Operating expenses decreased by \$5,689 (0.4%) from \$1,342,178 in 2009 to \$1,336,489 in 2010. The main contributing factor for the decrease in operating expenses is with salaries, wages and benefit expenses. Salaries, wages and benefits decreased from \$710,389 in 2009 to \$674,897 in 2010 as a result of a change in management. Overall, the continued decreasing trend in operating expenses is a positive indicator of MWSC's consistency and proactive efforts towards cost savings.

Statement of Cash Flows net change in cash was (\$12,975) and \$1,848 in 2009 and 2010, respectively. The operating activities of MWSC generated a net cash inflow of \$29,982 in 2010 compared to a net cash inflow of \$69,130 for 2009. As a result of the decrease in net cash flow, MWSC's net cash used for noncapital financing and for capital financing activities decreased in 2010 as well.

FINANCIAL ANALYSIS OF MWSC

The Statement of Net Assets and the Statement of Revenues, Expenses and Changes in Net Assets provide an indication of MWSC's financial condition. MWSC's net assets reflect the difference between assets and liabilities. An increase in net assets over time typically indicates an improvement in financial condition.

MAJURO WATER AND SEWER COMPANY, INC.

Management's Discussion and Analysis Year Ended September 30, 2010

A summary of MWSC's Statement of Net Assets is presented below:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Current assets	\$ 387,581	\$ 358,246	\$ 356,543
Capital assets net	<u>227,690</u>	<u>59,445</u>	<u>44,880</u>
Total Assets	<u>615,271</u>	<u>417,691</u>	<u>401,423</u>
Current liabilities	<u>280,301</u>	<u>265,306</u>	<u>187,092</u>
Total Liabilities	<u>280,301</u>	<u>265,306</u>	<u>187,092</u>
Net Assets:			
Invested in capital assets	227,690	59,445	44,880
Unrestricted	<u>107,280</u>	<u>92,940</u>	<u>169,451</u>
Total Net Assets	\$ <u>334,970</u>	\$ <u>152,385</u>	\$ <u>214,331</u>

As indicated above, total assets increased by \$197,580 from \$417,691 in 2009 to \$615,271 in 2010. Total liabilities reflect an increase of \$14,995 from \$265,306 in 2009 to \$280,301 in 2010. Total net assets increased by \$182,585 from a surplus of \$152,385 in 2009 to \$334,970 in 2010. There were no non-current liabilities at 30th September 2010 or 2009.

A summary of MWSC's Statement of Revenues, Expenses and Changes in Net Assets is presented below:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Revenues:			
Operating revenues	\$ 986,593	\$ 958,714	\$ 1,088,043
Non operating revenues	<u>318,099</u>	<u>346,928</u>	<u>1,258,763</u>
Total revenues	<u>1,304,692</u>	<u>1,305,642</u>	<u>2,346,806</u>
Expenses:			
Operating expenses	1,336,489	1,342,178	1,422,261
Non-operating expenses	<u>7,218</u>	<u>25,410</u>	<u>8,506</u>
Total expenses	<u>1,343,707</u>	<u>1,367,588</u>	<u>1,430,767</u>
Capital contribution	<u>221,600</u>	-	-
Change in net assets	\$ <u>182,585</u>	\$ <u>(61,946)</u>	\$ <u>916,039</u>

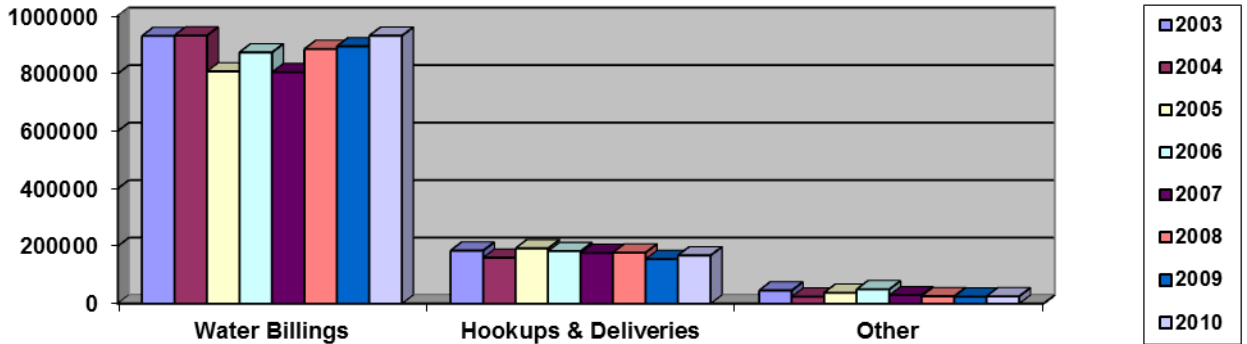
The Statement of Revenue, Expenses and Changes in Net Assets identify the various revenue and expense items that impacted the change in net assets. As indicated above, MWSC's operating revenue slightly increased by \$27,879 or approximately 3% from \$958,714 in 2009 to \$986,593 in 2010. The increase in operating revenues for 2010 consists of utility billings increasing by \$36,830 (4%), hookup and delivery services increasing by \$12,807 (8%), and uncollectable accounts \$23,204 (17%).

Non-operating revenues represent subsidies received from RepMar. The subsidy received in 2008 in the amount of \$1,258,763 was applied in its entirety to the overdue electricity bills owed to MEC. RepMar's continued financial support to assist MWSC with the payment of the monthly electricity bills owed to MEC is represented by \$346,928 and \$318,099 received in 2009 and 2010, respectively. There was a decrease of \$28,829 in the subsidy received from RepMar from 2009 to 2010 due to decreased electricity billings owed to MEC.

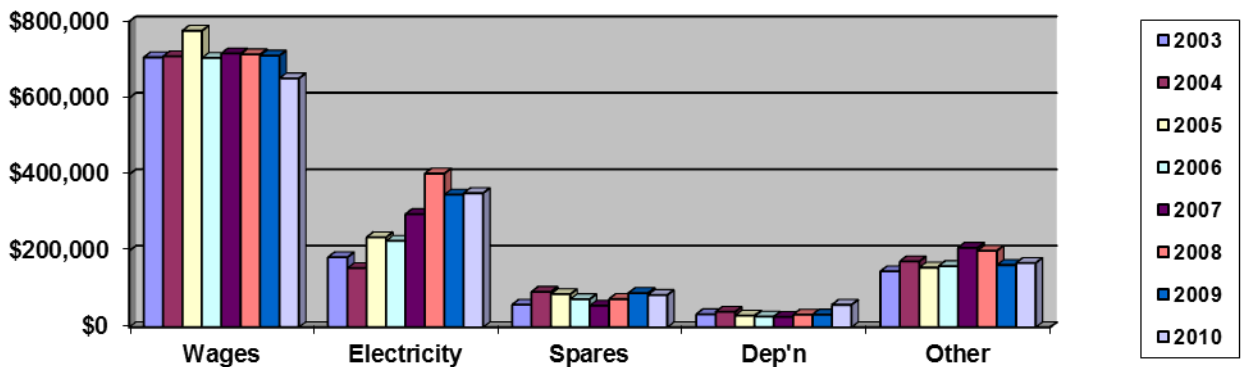
MAJURO WATER AND SEWER COMPANY, INC.

Management's Discussion and Analysis Year Ended September 30, 2010

The graph below shows the major components of operating revenue for 2010 compared with the years 2003 through to 2009:



Operating expenses decreased by \$5,689 or approximately 0.4% to \$1,336,489 in 2010 from \$1,342,178 in 2009. The decrease in operating expenses is mainly due to a decrease in salaries, wages and benefits from \$710,389 in 2009 to \$674,897 in 2010 and an increase in depreciation expenses from \$33,134 in 2009 to \$58,564 in 2010. Electricity expenses have slightly increased by \$4,009 from \$346,742 in 2009 to \$350,751 in 2010 and most likely a reflection of the increase tariff rates imposed during 2010. The graph below shows the major components of operating expenses for 2010 compared with the years 2003 through to 2010:



Management's Discussion and Analysis for the year ended September 30, 2009 is set forth in MWSC's report on the audit of financial statements, which is dated July 7, 2010. Such Management Discussion and Analysis explains the major factors impacting the 2009 financial statements and can be obtained from MWSC's General Manager via the contact information on page 7.

CAPITAL ASSETS

Net capital assets increased by \$168,245 in 2010 as a result of the acquisition of a water delivery truck and a sewage cleaning truck for a total cost of \$224,860 and office equipments costing \$1,949 less total depreciation for the year of \$58,564.

MAJURO WATER AND SEWER COMPANY, INC.

Management's Discussion and Analysis Year Ended September 30, 2010

A summary of MWSC's capital assets is presented below:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Motor Vehicles	\$ 141,000	\$ 141,000	\$ 116,582
Machinery and Equipment	318,341	93,481	94,318
Office Equipment	33,872	31,923	34,580
Buildings and Leasehold Improvements	<u>54,317</u>	<u>54,317</u>	<u>54,317</u>
	547,530	320,721	299,797
Less Accumulated Depreciation	<u>(319,840)</u>	<u>(261,276)</u>	<u>(254,917)</u>
	\$ <u>227,690</u>	\$ <u>59,445</u>	\$ <u>44,880</u>

MWSC received capital contributions of \$221,600 from RepMar through a grant received from the Pacific Islands Applied GeoScience Commission (SOPAC), which was utilized to purchase the water delivery truck and a sewage cleaning truck.

Refer to note 4 to the accompanying financial statements for additional information relating to capital assets.

FUTURE OUTLOOK ON SUSTAINABILITY

MWSC water and sewer infrastructure is at a high risk and in a serious state of deteriorating conditions. As infrastructures continue to wear out with time, lack of funding for proper maintenance and other environmental impacts, MWSC capacity decreases and capacity needs are on the rise due to increased customer base. For future sustainability, the following will need to be addressed and incorporated into MWSC's long term strategies and goals:

- 1.) Promote better management of water and wastewater utilities, which encompasses best practices to include asset management. MWSC needs to be able to carry out an ongoing process of oversight, evaluation, maintenance and replacement of their assets, as needed, to maximize the useful life of infrastructure.
- 2.) Achieve full cost recovery, which will help MWSC to capture its actual cost of operations, raise revenues and also to help conserve water. Like many utility companies, MWSC is faced with the challenges of balancing its social responsibility to ensure that water is accessible and affordable to promote quality of life versus generating sufficient income to sustain its core operations. As such, MWSC may not be able to recover its full cost in its entirety and may continue to place reliance and dependency on RepMar to subsidize the deficiency.
- 3.) Efficient water use is a critical factor especially with water shortages that the RMI may experience due to lack of capacity or seasonal droughts. Incentives and educational programs will encourage more efficient use of water and to protect the water resources among the RMI community.

MAJURO WATER AND SEWER COMPANY, INC.

Management's Discussion and Analysis
Year Ended September 30, 2010

MWSC FOCUS IN THE COMING FISCAL YEAR

MWSC has continued to incur losses from operations during the years ended September 30, 2010 and 2009 in the amounts of \$349,896 and \$383,464, respectively. MWSC will continue to monitor operating expenses and maintain tight fiscal constraints and control over cash and will continue to endeavor to improve collections. The ongoing viability of MWSC as a going concern will continue to be dependent upon future financial support of RepMar in the form of:

- Timely payment by RepMar for the cost of actual utility services provided,
- Collection of long outstanding utility receivables,
- Continuing improvements in operations.

Following are specific MWSC's goals for the coming fiscal year to include but not limited to:

- 1.) Research and tap into funding sources available for MWSC. Management has identified possible funding sources to include the Office of Environmental Planning and Policy Coordination (OEPPC), Asian Development Bank (ADB) and grant writer opportunities. Funding will be needed to rehabilitate MWSC water reservoir and water pumps.
- 2.) Develop a Comprehensive Recovery Plan for MWSC. Projects identified for opportunities to rehabilitate MWSC water reservoir and water pumps include repairing the leakage problems at the bottom of water reservoir #3, #4 and #5; extending the concrete at the top of the water reservoirs in order to increase capacity; and to purchase motors and pumps as back up should the need arise.
- 3.) The purchase of several equipments and materials such as the purchase of a generator, which is necessary to sustain daily water and septic operations during power outages; the purchase of water reservoir cover to replace existing covers; and purchase of water motors and pumps. There are three (3) different types of pumps required for sewer, salt water and fresh water. Sewer motor and pumps cost approximately \$120,000; salt water pumps cost approximately \$90,000; and water pumps cost range between \$20,000 through \$25,000. To further illustrate the total cost exposure, there are six (6) sewer pump stations with three (3) sewer pumps running. As a result, MWSC will need a total of \$2.1M to have back up pumps available. With the toxicity of sewage, it is essential and a matter of safety to explore MWSC's need for backup pumps.
- 4.) Initiate opportunities to install a reverse osmosis system for increased fresh water capacity. Given the high cost of a reverse osmosis system, this is most likely a long term goal for MWSC.
- 5.) Develop contingency plan for operating of the pump stations. There is currently no contingency plan developed and ready to execute should any of the pump stations become inoperable. With environmental and quality of life implications, it is critical that the management of MWSC develop a contingency plan to address emergency situations pertaining to the pump stations.
- 6.) Reduce illegal water connections and enforce penalties, as appropriate. Explore potential opportunities to train and collaborate with MEC meter readers to report illegal water connections.

MAJURO WATER AND SEWER COMPANY, INC.

Management's Discussion and Analysis
Year Ended September 30, 2010

- 7.) Ensure timely and accurate filing and payment of taxes to include social security (MISSA) and withholding taxes to avoid late and hefty penalty fees. In 2011, MISSA has completed its audit of MWSC's taxes filed for the years 2006 through 2009. As such, additional taxes, interest and penalties totaling approximately \$27K has been identified to be payable by MWSC.
- 8.) Reduce MWSC aging receivables. MWSC's aging receivables has continued to be a challenge and constraint on MWSC's cash flow. Without an effective leverage to enforce collections, there is opportunity to utilize MEC Cash Power to collect aging receivables for MWSC.
- 9.) Develop and roll out public and radio programs to educate the general public regarding MWSC operations and water conservation.
- 10.) Restructure MWSC organization and downsize, where necessary. If employees resign or are terminated, management will review and assess company needs to determine if work flow can be absorbed by existing staff prior to hiring a replacement.
- 11.) Promote energy conservation. This goal is attributed to the MWSC employees who have recognized that energy is one of the leading costs for MWSC that can be controlled. There are proactive steps that have already been implemented in MWSC's efforts to for energy efficiency and conservation.

ADDITIONAL FINANCIAL INFORMATION

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

MAJURO WATER AND SEWER COMPANY, INC.

Statements of Net Assets
September 30, 2010 and 2009

<u>ASSETS</u>	<u>2010</u>	<u>2009</u>
Current assets:		
Cash	\$ 44,145	\$ 42,297
Receivables:		
Utility	1,732,770	1,549,423
Affiliates	130,744	132,026
Other	2,746	2,470
	<u>1,866,260</u>	<u>1,683,919</u>
Less allowance for doubtful accounts	<u>(1,664,406)</u>	<u>(1,526,588)</u>
	<u>201,854</u>	<u>157,331</u>
Inventory	137,089	148,001
Prepaid expenses	<u>4,493</u>	<u>10,617</u>
Total current assets	387,581	358,246
Capital assets, net	<u>227,690</u>	<u>59,445</u>
	<u>\$ 615,271</u>	<u>\$ 417,691</u>
<u>LIABILITIES AND NET ASSETS</u>		
Current liabilities:		
Accounts payable	\$ 52,610	\$ 40,950
Social security taxes payable	50,061	67,940
Withholding taxes payable	36,264	51,971
Payable to affiliates	47,442	-
Deferred revenue	34,105	43,915
Other accrued liabilities	<u>59,819</u>	<u>60,530</u>
Total current liabilities	<u>280,301</u>	<u>265,306</u>
Commitment and contingency		
Net assets:		
Invested in capital assets	227,690	59,445
Unrestricted	<u>107,280</u>	<u>92,940</u>
Total net assets	<u>334,970</u>	<u>152,385</u>
	<u>\$ 615,271</u>	<u>\$ 417,691</u>

See accompanying notes to financial statements.

MAJURO WATER AND SEWER COMPANY, INC.

Statements of Revenues, Expenses and Changes in Net Assets
Years Ended September 30, 2010 and 2009

	2010	2009
Operating revenues:		
Utility billings	\$ 931,635	\$ 894,805
Hook-up and deliveries	167,482	154,675
Other	25,294	23,848
	1,124,411	1,073,328
Less uncollectable accounts	(137,818)	(114,614)
Total operating revenues	986,593	958,714
Operating expenses:		
Salaries, wages and benefits	674,897	710,389
Electricity	350,751	346,742
Spare parts	84,243	89,390
Depreciation and amortization	58,564	33,134
Petroleum, oil and lubricants	39,965	28,595
Insurance	34,007	20,950
Communications	21,898	21,630
Office supplies	18,897	19,722
Contractual services	6,000	15,838
Repairs and maintenance	5,832	9,703
Travel	34	2,617
Miscellaneous	41,401	43,468
Total operating expenses	1,336,489	1,342,178
Operating loss	(349,896)	(383,464)
Nonoperating revenues (expenses):		
RepMar subsidy	318,099	346,928
Penalties and interest	(7,218)	(25,410)
Total nonoperating revenues (expenses), net	310,881	321,518
Capital contributions	221,600	-
Change in net assets	182,585	(61,946)
Net assets at beginning of year	152,385	214,331
Net assets at end of year	\$ 334,970	\$ 152,385

See accompanying notes to financial statements.

MAJURO WATER AND SEWER COMPANY, INC.

Statements of Cash Flows
Years Ended September 30, 2010 and 2009

	2010	2009
Cash flows from operating activities:		
Cash received from customers	\$ 932,260	\$ 1,045,321
Cash payments to suppliers for goods and services	(213,987)	(297,390)
Cash payments to employees for services	(688,291)	(678,801)
Net cash provided by operating activities	29,982	69,130
Cash flows from noncapital financing activities:		
Principal payments on RepMar promissory note	(12,502)	(26,800)
Penalties and interest paid	(10,423)	(7,606)
Net cash used for noncapital financing activities	(22,925)	(34,406)
Cash flows from capital and related financing activities:		
Acquisition of capital assets	(5,209)	(47,699)
Net change in cash	1,848	(12,975)
Cash at beginning of year	42,297	55,272
Cash at end of year	\$ 44,145	\$ 42,297
Reconciliation of operating loss to net cash provided by operating activities:		
Operating loss	\$ (349,896)	\$ (383,464)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation and amortization	58,564	33,134
Bad debts	137,818	114,614
(Increase) decrease in assets:		
Receivables:		
Utility	(183,347)	(157,854)
Affiliates	1,282	61,406
Other	(276)	768
Inventory	10,912	(22,995)
Prepaid expenses	6,124	(10,617)
Increase (decrease) in liabilities:		
Accounts payable	11,660	8,884
Social security taxes payable	(17,879)	32,186
Payable to affiliates	365,541	329,078
Deferred revenue	(9,810)	43,915
Other accrued liabilities	(711)	20,075
Net cash provided by operating activities	\$ 29,982	\$ 69,130
Summary of noncash financing activities:		
RepMar subsidy and capital contribution	\$ 539,699	\$ 346,928
Decrease in payables to affiliates	(318,099)	(346,928)
Increase in capital assets due to contributed capital assets	(221,600)	-
	\$ -	\$ -

See accompanying notes to financial statements.

MAJURO WATER AND SEWER COMPANY, INC.

Notes to Financial Statements
September 30, 2010 and 2009

(1) Organization

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

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

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

MWSC'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 MWSC 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. MWSC 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*, which was subsequently amended by GASB Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus*, and modified by GASB Statement No. 38, *Certain Financial Statement Note Disclosures*, establishes 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.

MAJURO WATER AND SEWER COMPANY, INC.

Notes to Financial Statements
September 30, 2010 and 2009

(2) Summary of Significant Accounting Policies, Continued

To conform to the requirements of GASB Statement 34, retained earnings are presented in the following net asset categories:

- Investment 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.

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 statements of net assets. Proprietary fund operating statements present increases and decreases in net 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. MWSC considers utility revenues and costs that are directly related to utility operations to be operating revenues and expenses. Revenues and expenses related to financing and other activities are reflected as nonoperating.

Cash

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

For purposes of the statements of net assets and cash flows, cash is defined as cash on hand and cash held in demand accounts. As of September 30, 2010 and 2009, cash was \$44,145 and \$42,297, respectively, and the corresponding bank balances were \$38,058 and \$35,328, respectively. Of the bank balance amounts, \$32,233 and \$35,328, respectively, were maintained in one financial institution subject to Federal Deposit Insurance Corporation (FDIC) insurance and were fully FDIC insured.

MAJURO WATER AND SEWER COMPANY, INC.

Notes to Financial Statements
September 30, 2010 and 2009

(2) Summary of Significant Accounting Policies, Continued

Receivables

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

Inventory

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

Plant and Equipment

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

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

Taxes

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

Revenue Recognition

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

MAJURO WATER AND SEWER COMPANY, INC.

Notes to Financial Statements
September 30, 2010 and 2009

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards

During fiscal year 2010, the MWSC implemented the following pronouncements:

- GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, which addresses whether and when intangible assets should be considered capital assets for financial reporting purposes.
- GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, which 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.
- GASB 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.
- GASB Statement No. 58, *Accounting and Financial Reporting for Chapter 9 Bankruptcies*, which provides guidance for governments that have petitioned for protection from creditors by filing for bankruptcy under Chapter 9 of the United States Bankruptcy Code, and establishes requirements for recognizing and measuring the effects of the bankruptcy process on assets and liabilities, and for classifying changes in those items and related costs.

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

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 has not evaluated the effect that the implementation of this statement will have on the financial statements of MWSC.

In December 2009, GASB issued Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, which amends Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, and addresses issues related to measurement of OPEB obligations by certain employers participating in agent multiple-employer OPEB plans. The provisions of Statement 57 related to the use and reporting of the alternative measurement method are effective immediately. The provisions related to the frequency and timing of measurements are effective for actuarial valuations first used to report funded status information in OPEB plan financial statements for periods beginning after June 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of MWSC.

MAJURO WATER AND SEWER COMPANY, INC.

Notes to Financial Statements
September 30, 2010 and 2009

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In June 2010, GASB issued Statement No. 59, Financial Instruments Omnibus, which updates and improves existing standards regarding financial reporting of certain financial instruments and external investment pools. The provisions of this statement are effective for periods beginning after June 15, 2010. Management has not evaluated the effect that the implementation of this statement will have on the financial statements of MSWC.

(3) Risk Management

MWSC is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. MWSC has elected to purchase commercial insurance from independent third parties for the risks of loss to which it is exposed. However, as of September 30, 2010, MWSC is self-insured for any losses that could befall its buildings, equipment and inventory. Claims expenses and liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. No losses as a result of these risks have occurred in any of the past three years.

(4) Capital Assets

Capital asset activity for the years ended September 30, 2010 and 2009, was as follows:

	2010			
	October 1, <u>2009</u>	<u>Additions</u>	<u>Retirements</u>	September 30, <u>2010</u>
Vehicles	\$ 141,000	\$ -	\$ -	\$ 141,000
Machinery and equipment	93,481	224,860	-	318,341
Office equipment	31,923	1,949	-	33,872
Buildings and leasehold improvements	<u>54,317</u>	<u>-</u>	<u>-</u>	<u>54,317</u>
	320,721	226,809	-	547,530
Less accumulated depreciation and amortization	<u>(261,276)</u>	<u>(58,564)</u>	<u>-</u>	<u>(319,840)</u>
	<u>\$ 59,445</u>	<u>\$ 168,245</u>	<u>\$ -</u>	<u>\$ 227,690</u>
	2009			
	October 1, <u>2008</u>	<u>Additions</u>	<u>Retirements</u>	September 30, <u>2009</u>
Vehicles	\$ 116,582	\$ 45,000	\$ (20,582)	\$ 141,000
Machinery and equipment	94,318	2,299	(3,136)	93,481
Office equipment	34,580	400	(3,057)	31,923
Buildings and leasehold improvements	<u>54,317</u>	<u>-</u>	<u>-</u>	<u>54,317</u>
	299,797	47,699	(26,775)	320,721
Less accumulated depreciation and amortization	<u>(254,917)</u>	<u>(33,134)</u>	<u>26,775</u>	<u>(261,276)</u>
	<u>\$ 44,880</u>	<u>\$ 14,565</u>	<u>\$ -</u>	<u>\$ 59,445</u>

MAJURO WATER AND SEWER COMPANY, INC.

Notes to Financial Statements
September 30, 2010 and 2009

(5) Withholding Taxes Payable

At September 30, 2010 and 2009, MWSC was liable for delinquent withholding taxes payable to RepMar in the amount of \$35,523 and \$30,748, respectively, and related penalties and interest in the amount of \$741 and \$21,223, respectively. On January 30, 2006, a promissory note was refinanced whereby MWSC agreed to repay the sum of \$164,048 plus penalties and interest of \$29,336 over a period of twenty-seven months. The terms of the agreement include interest at 12% per annum commencing January 30, 2006. Changes in MWSC's promissory note payable to RepMar for the years ended September 30, 2010 and 2009, was as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Repayments</u>	<u>Ending Balance</u>
2010	\$ <u>14,848</u>	\$ <u>-</u>	\$ <u>(14,848)</u>	\$ <u>-</u>
2009	\$ <u>41,648</u>	\$ <u>-</u>	\$ <u>(26,800)</u>	\$ <u>14,848</u>

MWSC did not comply with the repayment terms of this promissory note. Accordingly, this payable is reflected as a current liability in the accompanying financial statements.

(6) Related Party Transactions

MWSC is a component unit of RepMar and is therefore affiliated with all RepMar-owned and affiliated entities.

During the years ended September 30, 2010 and 2009, MWSC received an operating subsidy from RepMar in the amount of \$318,099 and \$346,928, respectively, which were paid directly to the Marshalls Energy Company, Inc. as payment on outstanding electricity billings owed by MWSC.

During the year ended September 30, 2010, MWSC received a capital contribution from RepMar totaling to \$221,600 through a grant received from the Pacific Islands Applied GeoScience Commission (SOPAC).

MWSC's utility service is provided to RepMar and all RepMar-owned and affiliated entities. Services are extended to these entities at more favorable terms and conditions than those afforded to third parties.

MWSC utilizes services from certain affiliated entities at substantially more favorable terms and conditions than those provided to third parties.

A summary of related party transactions for the years ended September 30, 2010 and 2009, and related receivable and payable balances as of September 30, 2010 and 2009, is as follows:

MAJURO WATER AND SEWER COMPANY, INC.

Notes to Financial Statements
September 30, 2010 and 2009

(6) Related Party Transactions

	2010			
	Revenues	Expenses	Receivables	Payables
RepMar	\$ 153,451	\$ 20,476	\$ 64,761	\$ 36,264
Marshalls Energy Company, Inc.	4,606	367,354	30,134	47,418
Marshall Islands National Telecommunications Authority	3,915	12,255	1,265	-
Marshall Islands Social Security Administration	794	60,091	130	50,061
Majuro Resort, Inc.	38,419	520	13,118	-
Other	<u>20,822</u>	<u>864</u>	<u>21,336</u>	<u>24</u>
	<u>\$ 222,007</u>	<u>\$ 461,560</u>	<u>\$ 130,744</u>	<u>\$ 133,767</u>
	2009			
	Revenues	Expenses	Receivables	Payables
RepMar	\$ 241,676	\$ 23,788	\$ 69,063	\$ 51,971
Marshalls Energy Company, Inc.	7,430	357,362	23,158	-
Marshall Islands National Telecommunications Authority	10,585	13,030	614	-
Marshall Islands Social Security Administration	1,091	63,763	131	67,940
Majuro Resort, Inc.	49,004	-	10,358	-
Other	<u>32,029</u>	<u>2,669</u>	<u>28,702</u>	<u>-</u>
	<u>\$ 341,815</u>	<u>\$ 460,612</u>	<u>\$ 132,026</u>	<u>\$ 119,911</u>

Receivables from and payables to affiliates are uncollateralized, are interest free and have no set repayment terms except as disclosed in note 5.

(7) Commitment

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

Total future minimum lease payments for subsequent years ending September 30, are as follows:

Year ending <u>September 30,</u>	
2011	\$ 566,667
2012	100,000
2013	100,000
2014	100,000
2015	100,000
2016	<u>33,333</u>
	<u>\$ 1,000,000</u>

MAJURO WATER AND SEWER COMPANY, INC.

Notes to Financial Statements
September 30, 2010 and 2009

(7) Commitment, Continued

During the years ended September 30, 2010 and 2009, MWSC did not record the liability per the franchise agreement due to lack of capacity to make the payments in the foreseeable future. MWSC essentially depends on financing from RepMar and MEC to be able to continue as a going concern. Thus, management will negotiate the franchise terms with RepMar. If negotiations fail, MWSC may become liable for the above amounts but management does not believe that it will possess the ability to liquidate that liability.

(8) Going Concern

MWSC has incurred losses from operations of \$349,896 and \$383,464 during the years ended September 30, 2010 and 2009, respectively. Management believes that the continuation of MWSC's operations is dependent upon the future financial support of RepMar, compensation by RepMar for the cost of actual utility service provided, the collection of long outstanding utility receivables, and/or significant improvements in operations, among other matters. Additionally, in order for MWSC to continue as a going concern, it may need to delay payments to the Marshalls Energy Company, Inc. for electric usage or to delay payments to RepMar for delinquent employee withholding taxes.