

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, 2012 AND 2011

INDEPENDENT AUDITORS' REPORT

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

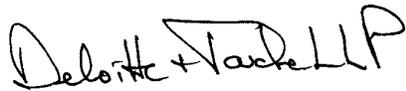
We have audited the accompanying statements of net assets of Majuro Water and Sewer Company, Inc. (MWSC), a component unit of the Republic of the Marshall Islands, as of September 30, 2012 and 2011, and the related statements of revenues, expenses and changes in net assets and of cash flows for the years 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, 2012 and 2011, 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 20, 2013, 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 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.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 3 through 7 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

A handwritten signature in black ink that reads "Deloitte + Tatchell LLP". The signature is written in a cursive, stylized font.

June 20, 2013

MAJURO WATER AND SEWER COMPANY, INC.

Management's Discussion and Analysis Years Ended September 30, 2012 and 2011

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 2012. 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 decreased by \$38,851 in 2012 compared to an increase of \$744 in 2011. This was due to no RepMar subsidy received in 2012 compared with \$124,431 received in 2011. This subsidy was used to pay the electricity bills owed to Marshalls Energy Company, Inc. (MEC).

Total operating revenues decreased by \$68,019 compared to an increase in revenue of \$238,594 in 2011. Within the operating revenues, utility billings decreased by \$6,737 from \$1,069,492 in 2011 to \$1,062,755 in 2012. Hook ups and delivery billings increased by \$168,107 from \$156,587 in 2011 to \$324,694 in 2012. The decrease in revenue is due to illegal water hookups. Furthermore, there has been an increase in MWSC's uncollectable accounts.

Operating expenses increased by \$201,875 from \$1,360,572 in 2011 to \$1,562,447 in 2012. The main contributing factor for the increase in operating expenses is an increase in electricity of \$96,729, spare parts of \$23,207, petroleum of \$12,841, contractual services of \$11,780, repairs and maintenance of \$13,372, travel of \$10,485 and miscellaneous expense of \$20,160 offset by a decrease in communications of \$846 and insurance of \$10,192.

The Statement of Cash Flows net change in cash was \$53,492 and \$92,866 in 2011 and 2012, respectively. The operating activities of MWSC generated a net cash inflow of \$166,058 in 2012 compared to a net cash inflow of \$112,256 for 2011. As a result of the increase in net cash flows, MWSC's net cash used for capital and related financing activities increased in 2012 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.

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

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Current assets	\$ 564,245	\$ 538,223	\$ 387,581
Capital and other assets	<u>520,526</u>	<u>234,767</u>	<u>227,690</u>
Total Assets	<u>1,084,771</u>	<u>772,990</u>	<u>615,271</u>
Current liabilities	<u>787,908</u>	<u>437,276</u>	<u>280,301</u>

MAJURO WATER AND SEWER COMPANY, INC.

Management's Discussion and Analysis Years Ended September 30, 2012 and 2011

Net Assets:

Invested in capital assets	370,526	234,767	227,690
Restricted	223,648	-	-
Unrestricted	<u>(297,311)</u>	<u>100,947</u>	<u>107,280</u>
 Total Net Assets	 \$ <u>296,863</u>	 \$ <u>335,714</u>	 \$ <u>334,970</u>

As indicated above, total assets increased by \$311,781 from \$772,990 in 2011 to \$1,084,771 in 2012. Total liabilities reflects an increase of \$350,632 from \$437,276 in 2011 to \$787,908 in 2012. Total net assets decreased by \$38,851 from \$335,714 in 2011 to \$296,863 in 2012. There were no non-current liabilities at 30th September 2012 or 2011.

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

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Revenues:			
Operating revenues	\$ 1,157,168	\$ 1,225,187	\$ 986,593
Non-operating revenues	<u>89,099</u>	<u>124,431</u>	<u>318,099</u>
Total revenues	<u>1,246,267</u>	<u>1,349,618</u>	<u>1,304,692</u>
 Expenses:			
Operating expenses	1,562,447	1,360,572	1,336,489
Non-operating expenses	<u>6,139</u>	<u>2,699</u>	<u>7,218</u>
Total expense	<u>1,568,586</u>	<u>1,363,271</u>	<u>1,343,707</u>
Capital contributions	<u>283,468</u>	<u>14,397</u>	<u>221,600</u>
Change in net assets	\$ <u>(38,851)</u>	\$ <u>744</u>	\$ <u>182,585</u>

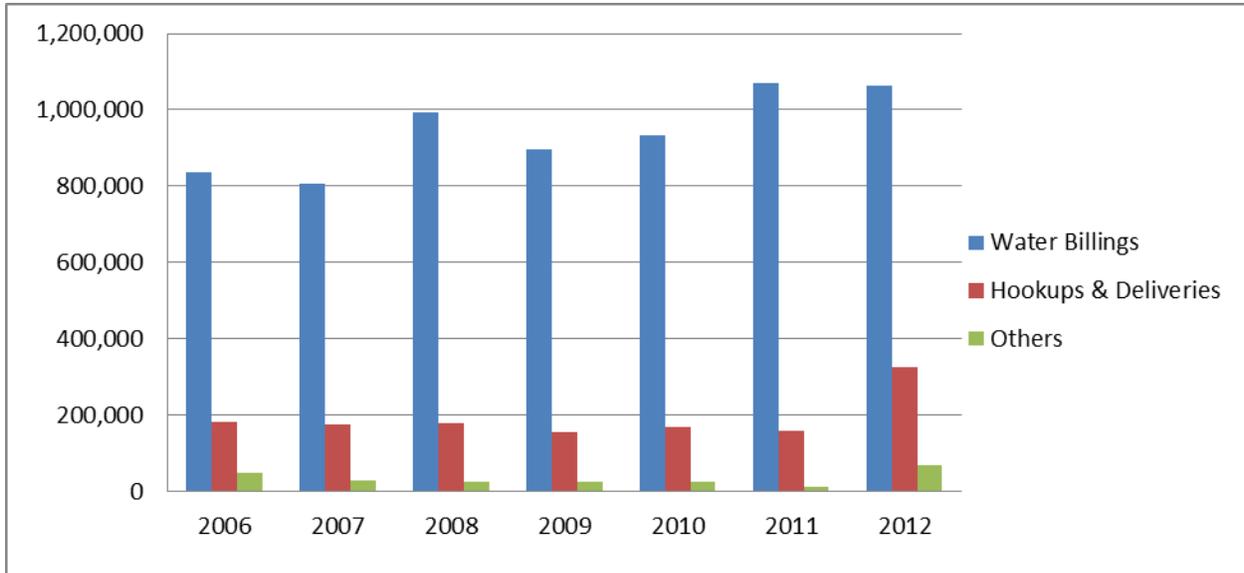
The Statement of Revenue, Expenses and Changes in Net Assets identify the various revenue and expense items that impacted the change in net assets. As indicated above, MWSC's operating revenue decreased by \$68,019 or approximately 5.55% from \$1,225,187 in 2011 to \$1,157,168 in 2012. The decrease in operating revenue for 2012 consists of utility billings decreasing by \$6,737 (0.63%) and an increase in uncollectible accounts of \$255,737.

Non-operating revenues represent subsidies and grants received. RepMar's discontinued financial support to assist MWSC with the payment of the monthly electricity bills owed to MEC is represented by \$124,431 received in 2011 while no subsidy was received in 2012. There was subsidy of \$150,000 received from RepMar in 2012 for Capital Improvement Projects. Another grant was received in 2012 of \$133,468 from the Government of Australia for the acquisition of accounting and billing systems. There was also a grant of \$89,099 received in 2012 from SPREP for the acquisition of flow meters and leak detection equipment.

MAJURO WATER AND SEWER COMPANY, INC.

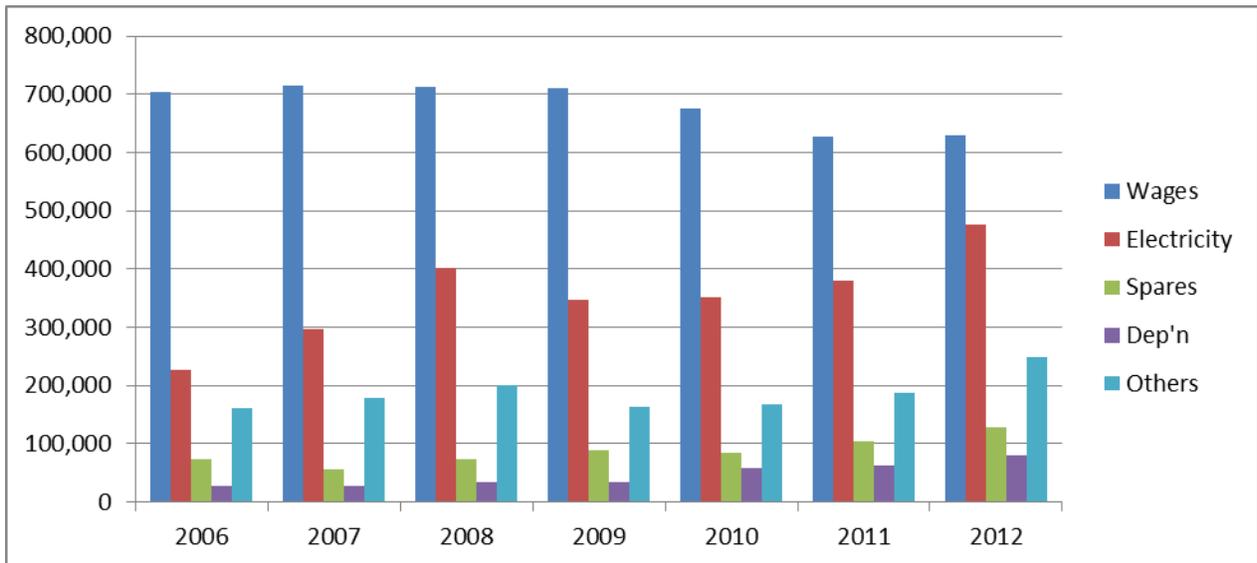
Management's Discussion and Analysis Years Ended September 30, 2012 and 2011

The graph below shows the major components of operating revenue for 2012 compared with the year 2006 through 2011.



Operating expenses increased by \$201,875 or approximately 14.8% to \$1,562,447 in 2012 from \$1,360,572 in 2011.

The graph below shows the major components of operating expenses for 2012 compared with the years 2006 through to 2011.



Management's Discussion and Analysis for the year ended September 30, 2011 is set forth in MWSC's report on the audit of financial statements, which is dated July 3, 2012. Such Management Discussion and Analysis explains the major factors impacting the 2011 financial statements and can be obtained from MWSC's General Manager via the contact information on page 7.

MAJURO WATER AND SEWER COMPANY, INC.

Management's Discussion and Analysis
Years Ended September 30, 2012 and 2011

CAPITAL ASSETS

Net capital assets increased by \$135,759 in 2012 as a result of the acquisition of a vehicle for a total cost of \$17,479 and miscellaneous office, other equipment and building and leasehold improvements costing \$198,774 less total depreciation for the year of \$80,494.

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

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Motor Vehicles	\$ 153,724	\$ 193,495	\$ 141,000
Machinery and equipment	356,567	324,179	318,341
Office Equipment	115,728	36,954	33,872
Building and leasehold Improvement	<u>95,987</u>	<u>62,623</u>	<u>54,317</u>
	722,006	617,251	547,530
Less Accumulated Depreciation	<u>(351,480)</u>	<u>(382,484)</u>	<u>(319,840)</u>
	\$ <u>370,526</u>	\$ <u>234,767</u>	\$ <u>227,690</u>

MWSC received capital contributions of \$283,460 from two sources. The \$150,000 was received from RepMar to acquire spare parts. The \$133,460 was received from the Government of Australia for the acquisition of accounting and billing systems.

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 infrastructure continues to wear out with time, lack of funding for proper maintenance and other environmental impacts, MWSC capacity decreased 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 shortage 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.
4. To promote install drinking water vending machines throughout the community.

MAJURO WATER AND SEWER COMPANY, INC.

Management's Discussion and Analysis
Years Ended September 30, 2012 and 2011

MWSC'S FOCUS IN THE COMING FISCAL YEAR

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

1. Obtain funding from the Government of Japan for the purchase of three water trucks and a Jetting Machine. The acquisition of the aforementioned capital assets will increase revenues resulting from increased water deliveries and sewer services, respectively.
2. Initiate Community Service Obligation to RepMar (Cabinet) to assist MWSC with its electricity bills.
3. Initiate opportunities to install a reverse osmosis system for increased fresh water capacity.
4. Reduce illegal water connections and enforce penalties, as appropriate.

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, 2012 and 2011

<u>ASSETS</u>	<u>2012</u>	<u>2011</u>
Current assets:		
Cash	\$ 190,503	\$ 97,637
Receivables:		
Utility	872,768	1,723,724
Affiliates	180,652	198,355
Other	22,319	11,110
	<u>1,075,739</u>	<u>1,933,189</u>
Less allowance for doubtful accounts	<u>(926,120)</u>	<u>(1,677,978)</u>
	<u>149,619</u>	<u>255,211</u>
Inventory	211,506	146,694
Prepaid expenses	12,617	38,681
Total current assets	564,245	538,223
Deposit on equipment	150,000	-
Capital assets, net	<u>370,526</u>	<u>234,767</u>
	<u>\$ 1,084,771</u>	<u>\$ 772,990</u>
 <u>LIABILITIES AND NET ASSETS</u> 		
Current liabilities:		
Accounts payable	\$ 70,408	\$ 52,644
Payable to affiliates	664,584	352,388
Deferred revenue	15,740	-
Other accrued liabilities	37,176	32,244
Total current liabilities	<u>787,908</u>	<u>437,276</u>
Commitment and contingency		
Net assets:		
Invested in capital assets	370,526	234,767
Restricted	223,648	-
Unrestricted	<u>(297,311)</u>	<u>100,947</u>
Total net assets	<u>296,863</u>	<u>335,714</u>
	<u>\$ 1,084,771</u>	<u>\$ 772,990</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, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Operating revenues:		
Utility billings	\$ 1,062,755	\$ 1,069,492
Hook-up and deliveries	324,694	156,587
Other	39,028	12,680
	<u>1,426,477</u>	<u>1,238,759</u>
Less uncollectable accounts	<u>(269,309)</u>	<u>(13,572)</u>
Total operating revenues	<u>1,157,168</u>	<u>1,225,187</u>
Operating expenses:		
Salaries, wages and benefits	630,425	627,710
Electricity	475,548	378,819
Spare parts	127,357	104,150
Depreciation and amortization	80,494	62,644
Petroleum, oil and lubricants	59,527	46,686
Contractual services	31,985	20,205
Office supplies	22,592	18,818
Repairs and maintenance	22,433	9,061
Communications	21,335	22,181
Insurance	18,704	28,896
Travel	14,680	4,195
Miscellaneous	57,367	37,207
Total operating expenses	<u>1,562,447</u>	<u>1,360,572</u>
Operating loss	<u>(405,279)</u>	<u>(135,385)</u>
Nonoperating revenues (expenses):		
RepMar subsidy	-	124,431
Grant	89,099	-
Penalties and interest	(6,139)	(2,699)
Total nonoperating revenues (expenses), net	<u>82,960</u>	<u>121,732</u>
Capital contributions	<u>283,468</u>	<u>14,397</u>
Change in net assets	(38,851)	744
Net assets at beginning of year	<u>335,714</u>	<u>334,970</u>
Net assets at end of year	<u>\$ 296,863</u>	<u>\$ 335,714</u>

See accompanying notes to financial statements.

MAJURO WATER AND SEWER COMPANY, INC.

Statements of Cash Flows Years Ended September 30, 2012 and 2011

	2012	2011
Cash flows from operating activities:		
Cash received from customers	\$ 1,290,500	\$ 1,137,725
Cash payments to suppliers for goods and services	(475,537)	(333,803)
Cash payments to employees for services	(648,905)	(691,666)
Net cash provided by operating activities	166,058	112,256
Cash flows from noncapital financing activities:		
Penalties and interest paid	(6,139)	(3,440)
Cash flows from capital and related financing activities:		
Capital contributions received	299,200	-
Acquisition of capital assets	(366,253)	(55,324)
Net cash used for capital and related financing activities	(67,053)	(55,324)
Net change in cash	92,866	53,492
Cash at beginning of year	97,637	44,145
Cash at end of year	\$ 190,503	\$ 97,637
Reconciliation of operating loss to net cash provided by operating activities:		
Operating loss	\$ (405,279)	\$ (135,385)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation and amortization	80,494	62,644
Bad debts	269,309	13,572
(Increase) decrease in assets:		
Receivables:		
Utility	(170,211)	9,046
Affiliates	17,703	(67,611)
Other	(11,209)	(8,364)
Inventory	24,295	(9,605)
Prepaid expenses	26,064	(34,188)
Increase (decrease) in liabilities:		
Accounts payable	17,764	34
Payable to affiliates	312,196	343,793
Deferred revenue	-	(34,105)
Other accrued liabilities	4,932	(27,575)
Net cash provided by operating activities	\$ 166,058	\$ 112,256
Summary of noncash financing activities:		
Grant received	\$ 89,099	\$ -
Increase in inventories	(89,099)	-
	\$ -	\$ -
RepMar subsidy and capital contributions received	\$ -	\$ 138,828
Decrease in payables to affiliates	-	(124,431)
Increase in capital assets due to contributed capital assets	-	(14,397)
	\$ -	\$ -

See accompanying notes to financial statements.

MAJURO WATER AND SEWER COMPANY, INC.

Notes to Financial Statements
September 30, 2012 and 2011

(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, 2012 and 2011

(2) Summary of Significant Accounting Policies, Continued

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

- Investment in capital assets; capital assets, net of accumulated depreciation, plus construction or improvement of those assets.
- Restricted net assets - resources in which MWSC is legally or contractually obligated to spend resources in accordance with restrictions either externally imposed by creditors, grantors, contributors, and the like, or imposed by law.
- 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, 2012 and 2011, cash was \$190,503 and \$97,637, respectively, and the corresponding bank balances were \$55,474 and \$105,796, respectively, of which \$41,274 and \$93,412, respectively, were maintained in a financial institution subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2012 and 2011, bank deposits in the amount of \$41,274 and \$93,412, respectively, were FDIC insured. MWSC does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC coverage are uncollateralized. Accordingly, these deposits were exposed to custodial credit risk.

MAJURO WATER AND SEWER COMPANY, INC.

Notes to Financial Statements
September 30, 2012 and 2011

(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.

Reclassification

Certain account balances in 2011 have been reclassified to conform with the 2012 financial statement presentation.

MAJURO WATER AND SEWER COMPANY, INC.

Notes to Financial Statements
September 30, 2012 and 2011

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards

During fiscal year 2012, MWSC implemented the following pronouncements:

- GASB 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 the frequency and timing of measurements for actuarial valuations first used to report funded status information in OPEB plan financial statements. The implementation of this pronouncement did not have a material effect on the accompanying financial statements.
- GASB Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions* (an amendment of GASB Statement No. 53), which will improve financial reporting by state and local governments by clarifying the circumstances in which hedge accounting continues to be applied when a swap counterparty, or a swap counterparty's credit support provider, is replaced. The implementation of this pronouncement did not have a material effect on the accompanying financial statements.

In December 2010, GASB issued Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, which addresses how to account for and report service concession arrangements (SCAs), a type of public-private or public-public partnership that state and local governments are increasingly entering into. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of MWSC.

In December 2010, GASB issued Statement No. 61, *The Financial Reporting Entity: Omnibus*, which is designed to improve financial reporting for governmental entities by amending the requirements of Statements No. 14, *The Financial Reporting Entity*, and No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, to better meet user needs and address reporting entity issues that have come to light since those Statements were issued in 1991 and 1999, respectively. The provisions of this statement are effective for periods beginning after June 15, 2012. Management does not believe that the implementation of this statement will have a material effect on the financial statements of MWSC.

In December 2010, GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which is intended to enhance the usefulness of its Codification by incorporating guidance that previously could only be found in certain FASB and American Institute of Certified Public Accountants (AICPA) pronouncements. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of MWSC.

In July 2011, GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which establishes guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position. The provisions of this statement are effective for periods beginning after December 15, 2011. Management has not yet determined the effect of implementation of this statement on the financial statements of MWSC.

MAJURO WATER AND SEWER COMPANY, INC.

Notes to Financial Statements
September 30, 2012 and 2011

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In April 2012, GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*, which clarifies the appropriate reporting of deferred outflows of resources and deferred inflows of resources to ensure consistency in financial reporting. The provisions of this statement are effective for periods beginning after December 15, 2012. Management has not yet determined the effect of implementation of this statement on the financial statements of MWSC.

In April 2012, GASB issued Statement No. 66, *Technical Corrections - 2012*, which enhances the usefulness of financial reports by resolving conflicting accounting and financial reporting guidance that could diminish the consistency of financial reporting. The provisions of this statement are effective for periods beginning after December 15, 2012. Management has not yet determined the effect of implementation of this statement on the financial statements of MWSC.

In June 2012, GASB issued Statement No. 67, *Financial Reporting for Pension Plans*, which revises existing guidance for the financial reports of most pension plans, and Statement No. 68, *Accounting and Financial Reporting for Pensions*, which revises and establishes new financial reporting requirements for most governments that provide their employees with pension benefits. The provisions in Statement 67 are effective for financial statements for periods beginning after June 15, 2013. The provisions in Statement 68 are effective for fiscal years beginning after June 15, 2014. Management has not yet determined the effect of implementation of these statements on the financial statements of MWSC.

(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, 2012, 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, 2012 and 2011, was as follows:

	2012			September 30, 2012
	October 1, 2011	Additions	Retirements	
Vehicles	\$ 193,495	\$ 17,479	\$ (57,250)	\$ 153,724
Machinery and equipment	324,179	70,923	(38,535)	356,567
Office equipment	36,954	94,487	(15,713)	115,728
Buildings and leasehold improvements	<u>62,623</u>	<u>33,364</u>	<u>-</u>	<u>95,987</u>
	617,251	216,253	(111,498)	722,006
Less accumulated depreciation and amortization	<u>(382,484)</u>	<u>(80,494)</u>	<u>111,498</u>	<u>(351,480)</u>
	<u>\$ 234,767</u>	<u>\$ 135,758</u>	<u>\$ -</u>	<u>\$ 370,526</u>

MAJURO WATER AND SEWER COMPANY, INC.

Notes to Financial Statements
September 30, 2012 and 2011

(4) Capital Assets, Continued

	2011			September 30, 2011
	October 1, 2010	<u>Additions</u>	<u>Retirements</u>	
Vehicles	\$ 141,000	\$ 52,495	\$ -	\$ 193,495
Machinery and equipment	318,341	5,838	-	324,179
Office equipment	33,872	3,082	-	36,954
Buildings and leasehold improvements	<u>54,317</u>	<u>8,306</u>	<u>-</u>	<u>62,623</u>
	547,530	69,721	-	617,251
Less accumulated depreciation and amortization	<u>(319,840)</u>	<u>(62,644)</u>	<u>-</u>	<u>(382,484)</u>
	<u>\$ 227,690</u>	<u>\$ 7,077</u>	<u>\$ -</u>	<u>\$ 234,767</u>

(5) Restricted Net Assets

Restricted net assets at September 30, 2012 and 2011, consist of the following:

	<u>2012</u>	<u>2011</u>
RepMar	\$ 150,000	\$ -
Government of Australia	<u>73,648</u>	<u>-</u>
	<u>\$ 223,648</u>	<u>\$ -</u>

(6) Related Party Transactions

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

During the year ended September 30, 2012, MWSC received a contribution from RepMar in the amount of \$150,000, which was paid to a vendor as a deposit for the acquisition of equipment.

During the year ended September 30, 2012, MWSC received a contribution from RepMar in the amount of \$149,200 representing a grant from the Government of Australia for the acquisition of a utility billing system and accounting software. At September 30, 2012, grant receipts in the amount of \$15,732 remained unexpended.

During the year ended September 30, 2012, MWSC received a contribution from RepMar in the amount of \$89,099 representing a grant from the Secretariat of the Pacific Regional Environment Programme, which was paid directly to a vendor for the acquisition of inventory.

During the year ended September 30, 2011, MWSC received an operating subsidy from RepMar in the amount of \$124,431, which was paid directly to the Marshalls Energy Company, Inc. as payment on outstanding electricity billings owed by MWSC.

During the year ended September 30, 2011, MWSC received a contribution from RepMar in the amount of \$14,397, representing a grant from the Pacific Islands Applied GeoScience Commission.

MAJURO WATER AND SEWER COMPANY, INC.

Notes to Financial Statements
September 30, 2012 and 2011

(6) Related Party Transactions, Continued

A summary of related party transactions for the years ended September 30, 2012 and 2011, and related receivable and payable balances as of September 30, 2012 and 2011, is as follows:

	2012			
	<u>Revenues</u>	<u>Expenses</u>	<u>Receivables</u>	<u>Payables</u>
RepMar	\$ 203,839	\$ 22,311	\$ 108,682	\$ 7,475
Marshall's Energy Company, Inc.	5,704	479,851	33,356	642,799
Marshall Islands National Telecommunications Authority	2,483	12,248	3,290	1,000
Marshall Islands Social Security Administration	1,119	55,104	424	12,848
Majuro Resort, Inc.	50,244	1,050	12,236	-
Other	<u>21,815</u>	<u>11,418</u>	<u>22,664</u>	<u>462</u>
	<u>\$ 285,204</u>	<u>\$ 581,982</u>	<u>\$ 180,652</u>	<u>\$ 664,584</u>
	2011			
	<u>Revenues</u>	<u>Expenses</u>	<u>Receivables</u>	<u>Payables</u>
RepMar	\$ 367,888	\$ 12,078	\$ 140,283	\$ 14,361
Marshall's Energy Company, Inc.	5,891	408,960	26,303	302,448
Marshall Islands National Telecommunications Authority	6,317	15,278	3,530	365
Marshall Islands Social Security Administration	1,192	55,260	95	29,374
Majuro Resort, Inc.	46,816	-	6,204	-
Other	<u>23,285</u>	<u>19,348</u>	<u>21,940</u>	<u>5,840</u>
	<u>\$ 451,389</u>	<u>\$ 510,924</u>	<u>\$ 198,355</u>	<u>\$ 352,388</u>

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

(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>	
2013	\$ 766,667
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, 2012 and 2011

(7) Commitment, Continued

During the years ended September 30, 2012 and 2011, 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 \$405,279 and \$135,385 during the years ended September 30, 2012 and 2011, 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.