MARSHALL ISLANDS SHIPPING CORPORATION

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

FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT

YEARS ENDED SEPTEMBER 30, 2013 AND 2012

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

Years Ended September 30, 2013 and 2012
Table of Contents

		Page No.
I.	INDEPENDENT AUDITORS' REPORT	1
II.	MANAGEMENT'S DISCUSSION AND ANALYSIS	3
III.	BASIC FINANCIAL STATEMENTS:	
	Statements of Net Position	13
	Statements of Revenues, Expenses and Changes in Net Position	14
	Statements of Cash Flows	15
	Notes to Financial Statements	16
IV.	INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS	
	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*	23
	Schedule of Findings and Responses	25
	Unresolved Prior Year Findings	29

Deloitte & Touche LLP
361 South Marine Corps Drive
Tamuning, GU 96913-3911
USA

Tel: (671)646-3884
Fax: (671)649-4932
www.deloitte.com

INDEPENDENT AUDITORS' REPORT

Board of Directors
Marshall Islands Shipping Corporation:

Report on the Financial Statements

We have audited the accompanying financial statements of the Marshall Islands Shipping Corporation (MISC), a component unit of the Republic of the Marshall Islands, which comprise the statements of net position as of September 30, 2013 and 2012, and the related statements of revenues, expenses and changes in net position and of cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of MISC as of September 30, 2013 and 2012, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 to 12 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.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated July 7, 2014, on our consideration of MISC's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is 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 financing reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering MISC's internal control over financial reporting and compliance.

Deloitte & Touche LLP

July 7, 2014

Marshalls Islands Shipping Corporation (MISC) herewith presents a discussion and analysis of the company's financial performance for the financial year ended 30th September 2013. It is to be read in conjunction with the financial statements following this section.

FINANCIAL HIGHLIGHTS

MISC's net position increased by $225,742 in 2013 compared to an increase in net position of $230,805 in 2012. The slight decrease in net position from 2012 to 2013 is an indicator of the stabilization of MISC operations.

MISC continues to face challenges to minimize major financial and operational losses driven by its inability to achieve full cost recovery with its current tariff structure, which has been in place since the early 1980's. In addition, MISC is burdened with a reduced and aging shipping vessel fleet. In January 2011, MISC's shipping vessel fleet was reduced with the sinking of its only landing craft, Jeljelat AE. The Jeljelat AE was the main source of MISC's chartering revenue and the loss of the landing craft has resulted in a significant decrease of revenue in 2011 and 2012. With the continued deteriorating conditions of its existing shipping fleet, there has been a reduction in the number of field trips in 2011 and 2012 to account for major repairs and dry dock services in Fiji. The Landrik MV was not operating between the months of July to October 2011; the Ribbuk AE was not operating between the months of November 2011 and March 2012; and the Aemman AE was not operating between the months of October and December 2012. With the completion of major repairs for the MISC shipping fleet, the MISC was operating in its full capacity with all three vessels in operation during majority of 2013. The number of field trips increased in 2013 resulting in revenue increases in its passenger and cargo revenues. MISC chartering revenues also began to rebound and improve significantly in 2013 as a result of the Drought Disaster Declaration issued by RepMar, effective June and July 2013.

MISC's total net operating revenue increased significantly by $190,760 (23%) from $841,608 in 2012 compared to $1,032,368 in 2013. MISC's charter revenue is the primary driver for the significant increase in MISC's net operating revenue. MISC's charter revenue increased significantly from no revenues for chartering services in 2012 to $150,551 in 2013. MISC's cargo revenues increased by $63,421 (14%) to $521,768 in 2013 compared to $458,347 in 2012. MISC's passenger revenue increased by $14,858 (17%) to $101,401 in 2013 compared to $86,543 in 2012. MISC's other revenue sources also increased significantly by $25,100 to $26,979 compared to $1,879 in 2012. A trend in other revenue sources is equipment rentals. MISC's ship sales, on the other hand, decreased by $53,173 to $219,159 in 2013 compared to $272,332 in 2012. The decrease in ship sales is a result of the authorization for private vendors to operate ship sales on selected MISC shipping vessels.

Total operating expenses has been consistent and stabilized from 2012 to 2013. Total operating expenses were $2,032,030 in 2013 compared to $2,007,138 in 2012. Overall, MISC increased its total operating expenses slightly by $24,892 (1%). Personnel and petroleum, oil, and lube (POL) expenses continue to remain as MISC's leading operational expenses. With the establishment of the Shipping Vessel Repairs and Maintenance Act, there is a growing trend on expenses for materials and supplies as another leading operational expense. Salaries, wages and benefit expenses continue to be on a declining trend. Salaries, wages and benefit expenses were reduced by $166,143 (17%) from $1,004,406 in 2011 to $838,263 in 2012 and reduced further by $68,075 (8%) to $770,188 in 2013. With an increase in field trips and charter trips, POL expenses have increased by $82,519 (26%) from $314,021 in 2012 to $396,540 in 2013. Material and supply expenses increased by $53,151 (21%) from $248,580 in 2012 to $301,731 in 2013.

MISC's operating loss decreased by $165,868 (14%) from an operating loss of $1,165,530 in 2012 compared to an operating loss of $999,662 in 2013. Although MISC has continued in its efforts to reduce its operating expenses, MISC will continue to operate at a loss of approximately $1M to $1.5M annually based on the current tariff rate structure that has been in place since the early 1980's. In addition to the current tariff rate structure, which does not allow for full cost recovery, the shortage in its shipping fleet are also a contributing factor to MISC's continuing operating loss.

MISC is expecting to increase its existing fleet with the donation of two new shipping vessels by the government of Japan. The building of the two new shipping vessels, one of which is a landing craft, was completed and delivered to MISC in November 2013. With the establishment of the Shipping Vessel Repairs and Maintenance Act passed in 2011, funding will be provided by the Republic of the Marshall Islands (RepMar) government to ensure major and routine repairs and maintenance of the MISC shipping fleet are performed.

MISC continues to depend on subsidies from RepMar, which accounts for approximately 54% of MISC's source of operating and non-operating revenues during 2013. The subsidy received from RepMar in 2013 includes the funding to support the Shipping Vessel Repairs and Maintenance Act. In 2012, the subsidies from RepMar accounted for approximately 62% of MISC's source of operating and non-operating revenues. The decrease in subsidy from 2012 to 2013 is in line with the scheduled decrease in subsidies for Shipping Vessel Repairs and Maintenance. Without the approval of RepMar to allow the management of MISC to increase its tariff rates, it is expected that MISC will always operate at a loss and its future sustainability will continue to be a burden on RepMar.

FINANCIAL ANALYSIS OF MISC

The Statement of Net Position and the Statement of Revenues, Expenses and Changes in Net Position provide an indication of MISC's financial condition. MISC's net position reflects the difference between total assets and total liabilities. An increase in net position over time normally indicates an improvement in financial condition. As illustrated in the figures below MISC's net position increased for the year ended September 30, 2013.

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

	2013	2012	2011
Current and other assets	$ 448,217	$ 173,749	$ 226,805
Capital assets	69,295	127,034	164,339
Total Assets	517,512	300,783	391,144
Current Liabilities	381,813	390,827	711,993
Total Liabilities	381,813	390,827	711,993
Net position:			
Net investment in capital assets	69,295	127,034	164,339
Unrestricted	66,404	(217,078)	(485,188)
Total net position	$ 135,699	$ (90,044)	$ (320,849)

Total assets decreased from $391,144 in 2011 to $300,783 in 2012 but have increased to $517,512 in 2013. The decrease in total assets by $90,361 (23%) from 2011 to 2012 is primarily due to the decrease in inventory $47,059 (93%) from $50,566 in 2011 to $3,507 in 2012; and a decrease in capital assets by $37,305 (23%) from $164,339 in 2011 to $127,034 in 2012. In 2013, total assets increased significantly by $216,729 (72%) primarily due to a significant increase in total net receivables by $190,448 (289%) from $65,978 in 2012 to $256,426 in 2013; an increase in cash by $111,746 (147%) from $76,205 in 2012 to $187,951 in 2013; and a decrease in capital assets by $57,739 (45%) from $127,034 in 2012 to $69,295 in 2013.

The significant decrease in inventory is attributed primarily to timing. In 2011, a large amount of inventory was purchased for MISC's entire shipping fleet in preparation to embark on field trips that occurred towards the end of September prior to the year-end for the purpose of sale of goods activity. In 2012, all of MISC's shipping fleet returned to port in Majuro prior to year-end, resulting in the significant decrease in inventory. Field trips resumed in October 2012. Similarly in 2013, inventory balances remained at a low level due to timing of the MISC shipping fleets return to port prior to year-end and resuming of voyages in the following fiscal year.

Net capital assets decreased from $164,339 in 2011 to $127,034 in 2012 and decreased significantly further to $69,295 in 2013. In 2012, net capital assets decreased by $37,305 (23%) as a result of the annual depreciation charge of $81,556 offset by the purchases of equipment in the amount of $34,043; by the purchases of vehicles in the amount of $6,308; and by the purchases of furniture in the amount of $3,900. The equipment purchases are mainly part of the asset acquisitions necessary for the major repairs and services that the MISC shipping fleet underwent in Fiji. In 2013, net capital assets decreased significantly by $57,739 (45%) as a result of the annual depreciation charge of $61,174 offset by the purchase of motorboats in the amount of $3,435. With no new major capital assets acquired, majority of MISC's capital assets are quickly approaching full depreciation. The dry dock repairs extending the life span of the vessels are currently being treated as a direct expense provided the shipping vessel asset have yet to be transferred to MISC as required under the Public Law 2005-41. Public Law 2005-41, established MISC and authorized all movable and immovable property of the shipping services under the Ministry of Transportation and Communication be vest absolutely in MISC.

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

Total liabilities decreased significantly from $711,993 in 2011 to $390,827 in 2012 and decreased slightly further to $381,813 in 2013. The $321,166 (45%) decrease in total liabilities from 2011 to 2012 is primarily due to decrease in its payables to affiliates, attributing mainly to MISC's efforts to decrease its tax liabilities and re-payment of the $100,000 advance to Tobolar. The Tobolar advance to MISC was for the purpose of assisting MISC with the purchase of copra from growers in the outer islands. The total advance amount was repaid in December 2011 upon termination of the agreement between MISC and Tobolar effective November 2011.

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

	2013	2012	2011
Revenue:			
Operating revenue	$ 1,032,368	$ 841,608	$ 844,307
Expenses:			
Operating expenses	2,032,030	2,007,138	2,305,581
Operating loss	(999,662)	(1,165,530)	(1,461,274)
Nonpoperating revenues (expenses), net	1,225,405	1,396,335	1,117,143
Change in net position	$ 225,743	$ 230,805	$ (344,131)

The Statements of Revenue, Expenses and Changes in Net Position identify the various revenue and expense items that contributed to the change in net position. MISC's total revenue decreased slightly in 2012 by $2,699 (0.3%) to a total of $841,608 compared to $844,307 in 2011. In 2013, MISC's total operating revenue increased significantly by $190,760 (23%) to a total of $1,032,368. The major factors contributing to the increase in operating revenue for 2013 is primarily due an increase in chartering trips in response to the relief efforts of the State of Drought Disaster issued in June-July 2013. In addition, the number of field trips has increased as a result of having all MISC shipping fleet back in operation for most of 2013 with the completion of major repairs and maintenance services that were received in Fiji in previous years.

During 2011, MISC experienced a catastrophic loss with the sinking of the Jeljelat AE in January 2011. The Jeljelat AE was MISC's only landing craft and main source for chartering revenue. In addition to the loss of Jeljelat AE, the number of field trips taken during 2011 and 2012 also decreased. In 2011 and 2012, there were a total of 28 and 25 field trips taken, respectively, compared to a total of 43 field trips taken in 2010. In 2013, the number of field trips has increased further with all three shipping vessels back in operation and the increase in chartering voyages. The number of field trips indicated excludes the number of field trips provided by the use of small shipping vessels from the private sector.

These series of events contributing to MISC's shipping fleet shortages had a significant financial loss impact on MISC's operating revenues during 2012. There were no charter revenues in 2012 compared to $48,474 in 2011 and $277,396 in 2010. In the absence of charter revenues, the total operating revenue has decreased significantly from 2010 to 2011 and stabilized in 2011 to 2012. The total operating revenue trends in 2011 and 2012 is expected to continue into subsequent fiscal years until MISC increases its shipping fleet. With the State of Drought Disaster Declaration issued by RepMar in June and July 2013, MISC chartering revenue rebounded and increased to $150,551 in 2013. MISC is expecting its chartering revenue to increase further as relief efforts continue into 2014.

Ship sales revenue decreased significantly by $53,173 (20%) from $272,332 in 2012 to $219,159 in 2013; and copra fee decreased by $5,555 (16%) from $35,092 in 2012 to $29,537 in 2013. On the other hand, charter revenue increased by $150,551 in 2013 compared to no charter revenues in 2012; cargo revenue increased by $63,421 (14%) from $458,347 in 2012 to $521,768 in 2013; passenger revenue increased by $14,858 (17%) from $86,543 in 2012 to $101,401 in 2013; and other revenues increased by $25,100 (1336%) from $1,879 in 2012 to $26,979 in 2013. The increase in revenue is primarily due to increased number of field trips and charter trips.

With the establishment of the Repairs and Maintenance Act (R&M), MISC a source of funding by way of a government subsidy that is made available on an annual basis. The R&M Act provides a strong position for MISC to continue to advocate for and to receive subsidy for the sole purpose of repairs and maintenance needs of its aging fleet. Without the R&M subsidy, the continued deteriorating conditions of MISC's shipping vessels will have a negative impact on MISC's ability to provide frequent, safe and reliable shipping services.

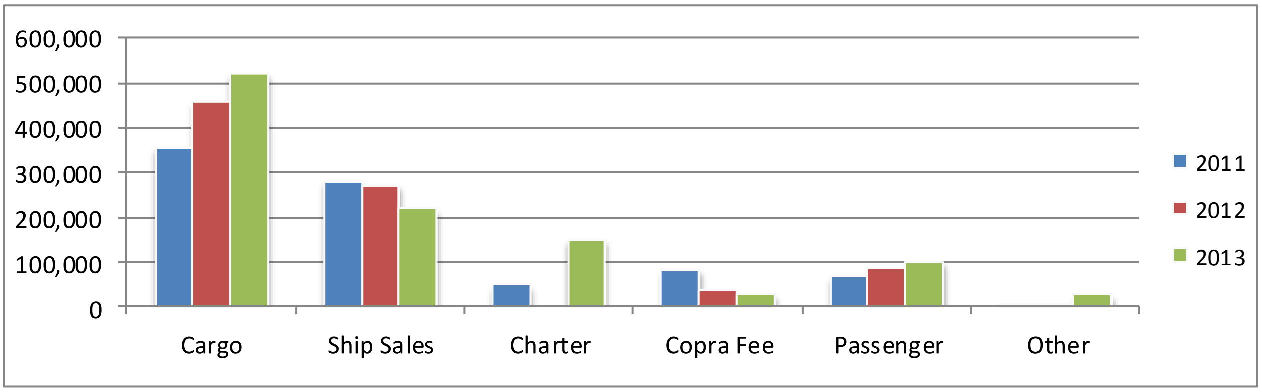
Ship sales service aboard the shipping vessels to the outer island consumers has been one of MISC's main sources of income to subsidize its operations and was initiated in 2009. As MISC continues to operate with low tariff rates established during the early 1980's and continues to receive a declining subsidization source of funding from RepMar, the ship sales operation provides an alternative source of revenue and cash flow for MISC. As an indicator of its success to provide an alternative source of income to cross subsidize MISC operations, the revenue from the ship sales historically consisted of approximately 31-33% of MISC's operating revenue mix in 2010 - 2012. In 2013, however, the ship sales as a percentage of MISC's operating revenue mix dropped to 21%, attributed primarily due to the authorization issued by RepMar for MISC to allow private vendors to establish ship sale operations on selected shipping vessels. It is crucial that MISC reviews its ship sales process to identify and remediate any internal control gaps in order to maximize the revenue generation opportunity. Although this strategy may have eliminated the ship sales monopoly, MISC should continue to monitor the negative impacts this may have contributed to the revenue and cash flow position of MISC. As a burden on the RepMar national budget, ship sales provide a viable business solution for MISC as an alternative source of revenue for cross subsidization opportunities for MISC.

The operating loss before non-operating revenues (i.e. RepMar subsidy) for 2013 was approximately $1.0M compared to $1.2M and $1.5M in 2012 and 2011, respectively. In 2012, the decrease in operating loss by $295,744 (20%) is primarily attributed to MISC efforts to reduce its operational costs primarily in its personnel and POL expenditures. In 2013, the decrease in operating loss by $165,868 (14%) is primarily attributed to the increase in operating revenues from the increase in field trips and charter trips. The overall operating expenses for MISC have remained fairly consistent from 2012 to 2013 at $2,007,138 and $2,032,030, respectively.

Operating subsidies of $1,225,405 were received in 2013 compared to $1,396,335 in 2012 and $1,142,466 in 2011. Of the $1,225,405 subsidy amount received from RepMar, $427,691 was solely for the purpose of the Shipping Vessel Repairs and Maintenance Act and $807,596 was the MISC's operating subsidy. The subsidy to support the Shipping Vessel Repairs and Maintenance Act fluctuates annually based on the repairs and maintenance schedule and costing developed with the technical assistance of the Japan International Cooperation Agency (JICA) and has taken into account major repairs that will need to be completed and the inclusion of two additional vessels to the MISC fleet.

The operating subsidy received from RepMar in 2011 was reduced by $123,704 (13%) and remained unchanged in 2012 and 2013. With its current tariff rate structure, MISC is not able to achieve full cost recovery to cover its operational costs and maintain adequate major and ongoing repairs and maintenance without financial support from RepMar. The future financial sustainability and conditions of the MISC shipping fleet will continue to depend on sufficient financial support from RepMar.

The graphic below shows the major components of MISC's operating revenue from 2011 through to 2013:



Unlike previous years where MISC's total operating expenses have been on a declining trend, MISC's total operating expenses from 2012 to 2013 have remained consistent and increased slightly. Total operating expenses decreased significantly by $298,443 (13%) from $2.3M in 2011 compared to $2.00M in 2012. In 2013, the total operating expenses increased slightly by $24,892 (1%) to $2.03M. Overall, MISC has successfully and consistently been decreasing and stabilizing its total operating expenses. However, with the additional of two new vessels, total operating expenses are expected to be on the rise in 2014 but should offset by the revenues generated.

For 2013, the top five components of operating expenses are: (1) Salaries, Wages and Benefits, (2) Petroleum, Oil & Lube (POL), (3) Materials and Supplies (4) Cost of Goods Sold and (5) Foodstuff.

Salaries, wages and benefits remain as the leading operational expense and decreased by $166,143 (17%) from $1.00M in 2011 to $0.84M in 2012 and decreased further by $68,075 (8%) to $0.77M in 2013. The decrease in the salary and wage bill is a result of management's continued efforts to reduce and control its recurrent expenditures for personnel due to a shortage of workload due to the loss of one its shipping vessels.

POL expenses decreased by $112,919 (26%) from $426,940 in 2011 to $314,021 in 2012, but were increased by $82,519 (26%) to $396,540 in 2013. Along with decrease in fuel cost, there were a total of 25 field trips taken in 2012 compared to 28 field trips taken in 2011. There was an increase in field trips and chartering trips in 2013, resulting in increased POL expenses.

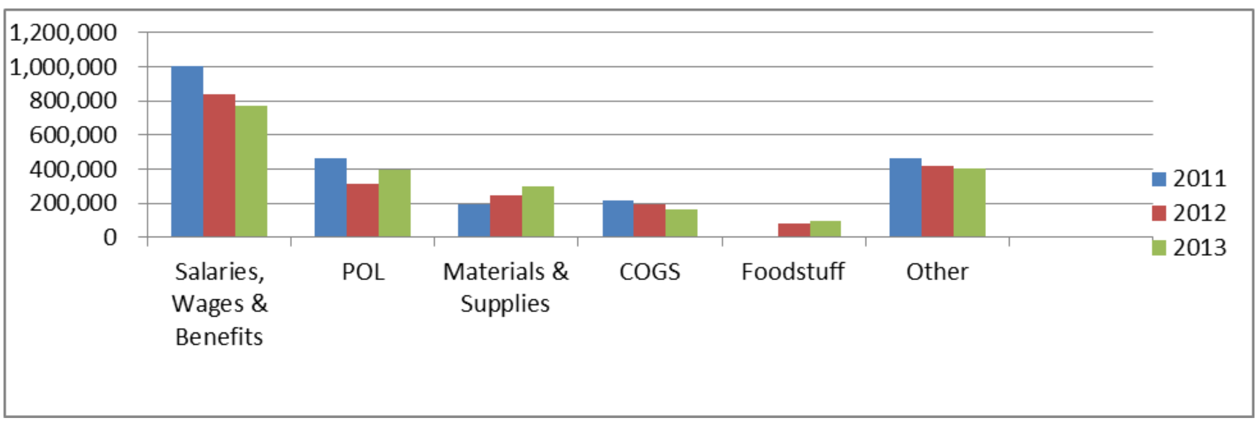
Materials and supplies expenses increased by $57,675 (30%) from $190,905 in 2011 to $248,580 in 2012 and increased further by $53,151 (21%) to $301,731 in 2013. With the establishment of the Shipping Vessel Repairs and Maintenance Act in 2011, annual subsidy is granted by RepMar for proper and timely repairs and maintenance to be undertaken by MISC to ensure the good and operable conditions of the shipping fleet for the safety and reliability of sea transportation services for the RMI outer island community. An increase in materials and supplies expense is expected to be on the increasing trend and offer a positive indicator that necessary routine repairs and maintenance are being undertaken to improve the conditions of the shipping fleet to remain operable.

Cost of goods sold (COGS) is an operating expense component introduced in 2009 for the ship sales aboard the shipping vessels to the outer island consumers. COGS decreased by $25,917 (12%) from $216,742 in 2011 to $190,825 in 2012 and decreased further by $28,762 (15%) to $162,063 in 2013. The decrease in cost of goods sold is attributed primarily to controls and processes implemented to mitigate the gaps in the ship sales processes and introduction of private vendors to establish ship sales aboard selected shipping vessels.

Other expenses decreased by $51,139 (11%) from $466,588 in 2011 to $415,449 in 2012 and decreased further by $13,941 (3%) in 2013 to $401,508. The repairs and maintenance cost component is the main driver for the increase in other expenses during 2011.

With funding provided by RepMar to support the Shipping Vessel Repairs and Maintenance Act, Aemman the last of MISC's shipping fleet to be sent to Fiji in November – December 2012 to undergo major repairs and dry dock services. As the newest vessel, major repairs and costs were not extensive in comparison to the other two shipping vessels. As a result, there was a decrease in repairs and maintenance expenses by $45,207 (38%) from $117,519 in 2011 to $72,312 in 2012. In 2013, repairs and maintenance expenses remained consistent at $71,985.. By 2013, the first round of major repairs and maintenance services were completed on the MISC's shipping fleet, with the exception of new movable properties, which were expensed rather than capitalized due to the fact that the capital assets of the shipping vessels have yet to be transferred to MISC from the Ministry of Transportation and Communications.

The following graphic shows the major components of operating expenses from 2011 through to 2013:



CAPITAL ASSET AND DEBT

Net capital assets decreased by $57,739 (45%) in 2013 as a result of the acquisition of motor boats for a total cost of $3,435 less total depreciation for the year of $61,174.

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

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.

CASH FLOW

Net cash used for operating activities for 2013 was $1.11M compared to net cash used for operating activities of $1.31M in 2012 and $1.22M in 2011. The cash provided by operational activities was absorbed entirely by MISC's operational costs. Additionally, injection of cash flows from RepMar subsidies were received in the amount of $1.22M, $1.40M and $1.14M during 2013, 2012 and 2011, respectively. During 2011 and 2012, the RepMar subsidies were utilized by MISC to cover its operational expenses in the amount of $0.84M and for repairs and maintenance expenses in the amount $0.30M and $0.56M, respectively. The increase in the 2012 repairs and maintenance subsidy represents the subsidy short fall in 2011. In 2013, the RepMar subsidies were utilized by MISC to cover its operational expenses in the amount of $0.80M and for repairs and maintenance expenses in the amount of $0.42M.

FUTURE OUTLOOK ON SUSTAINABILITY

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

As an indicator of MISC's future outlook on sustainability, MISC's has a net position of $135,699 in 2013, compared to a net position deficiency of $90,044 in 2012 and a net position of $320,849 in 2011. The vast improvement in MISC's financial position from a net position deficiency in 2012 to a net position in 2013 is a result of tough management decisions and persistence to streamline its operational expenses and to continue to reduce its personnel costs along with rebounds achieved in generating additional revenue streams. The measures taken by management on the expenditure side included non-performing personnel lay-offs and decreases in the salary and wage bill across all MISC active personnel. For the revenue generation, chartering revenue along with cargo and passenger revenues rebounded with the increase in field trips due to less down time for the shipping vessels and the demand for chartering services in response to the relief efforts of the State of Drought Disaster issued in June – July 2013.

With MISC's improved net position over the years is an indication MISC management to reduce its recurrent expenditure and a positive indicator that it is finally recovering from the loss of the landing craft in January 2011. However, at its current tariff rate structure, MISC will continue to have operational losses and rely on RepMar subsidies to minimize the operational losses. In order to revive the MISC operations for future sustainability, MISC must be able to obtain RepMar approval to increase its tariff rates or continue to rely on a steady flow of subsidy amounts as a community service obligation to absorb the operational losses of MISC to provide affordable sea-transport services to the people.

Historically, the operating revenue generated by MISC has never been sufficient to cover the related expenses necessary to operate the shipping vessels and provide sea-transportation services. With operating losses over $1M to $1.5M annually, MISC continues to be dependent on financial support from RepMar. Most importantly, MISC is not able to generate sufficient revenue through its operations due to its low tariff rate structure, which has been in place since the early 1980's and have not increased despite the increase in fuel costs and inflation rates. As a state owned entity, MISC does not have the authority to increase its tariff rates without the approval of RepMar. MISC has made numerous requests to RepMar but have yet to be successful.

It is the intention of MISC to continue its lobbying efforts for the authority and flexibility to increase its tariff rates to account for the rising fuel costs and inflation rates. MISC received Technical Assistance from ADB to develop a three-year strategic plan and needs further assistance to implement its strategic plan. In the absence of a tariff rate increase, the state owned enterprise reform bill that was introduced into Nitijela in September 2012 should recognize MISC as a community service obligation. As such, tariff rates will remain low and on-going financial support from RepMar will have to continue and may need to increase, as appropriate.

The future outlook on sustainability for MISC continues to be threatened by the deteriorating conditions of the shipping vessels and remain at risk of not being a recipient of a repairs and maintenance subsidy from RepMar. In 2011, RepMar passed the Shipping Vessel Repairs and Maintenance Act to ensure that funding is made available to ensure that major repairs and services are performed regularly. The Act also provides funding provision for safety equipment. As of September 2013, two of MISC's existing fleet had been sent to Fiji's dry dock facilities to undergo major repairs and services. Repairs and maintenance services were completed on the last shipping vessel in December 2013. With the support of the government of Japan, MISC is also expected to receive two new shipping vessels towards the end of 2013 to include a landing craft vessel type.

To summarize, MISC's future outlook on sustainability is dependent but not limited to the following factors:

- Approval from RepMar to increase MISC's tariff rate structure;
- Ongoing recipient of RepMar subsidy to support both MISC operations and the Shipping Vessel Repairs and Maintenance Act;
- Ensure MISC's current and future shipping fleet continue to undergo major repairs and maintenance at a dry dock facility timely;
- Develop and adhere to an ongoing annual repairs and maintenance schedule;
- Increase the number of vessels in its shipping fleet;
- Explore other financing opportunities (i.e. ADB, World Bank, RUS, etc.);
- Continue with budgetary controls to minimize operational expenses where possible;
- Improve financial and operational management reporting
- Capacity building opportunities for MISC personnel
- Seek assistance from Ministry of Transportation & Communication to transfer shipping assets to MISC
- Document and improve inventory asset procedures and accounting processes

MISC FOCUS IN THE COMING FISCAL YEAR

MISC's focus in the coming fiscal year includes but is not limited to the following:

- MISC, through its Board of Directors, will continue to lobby for the approval from Cabinet to increase the MISC tariff rates. As previously mentioned, MISC cannot continue to operate with its current tariff rate structure. At a minimum, MISC goal is to propose a tariff rate increase to cover the fluctuating cost of fuel. In the event that MISC efforts to secure Cabinet approval are futile, the passing of the State Owned Enterprise Reform Bill that was introduced in Nitijela in September 2012 will be the guiding principle for MISC to operate as a community service obligation and retain its current low tariff structure.

- With the support of its Board of Directors, MISC will continue to implement activities laid out in its strategic plan. In April 2012, MISC was one of the state owned entities selected to participate in the ADB Technical Assistance (TA) Supporting the Public Sector Program. The ADB TA provided an opportunity for the MISC management to work closely with an ADB consultant with sea-transport and financial expertise. The outcome of the ADB TA is a completed three to five year strategic plan for MISC, which will address both the operational and financial goals of MISC for future sustainability. The strategic plans include but are not limited to the following:

  - Develop a tariff rate template to incorporate rising cost and fluctuation of fuel and inflation rates;
  - Review of operational processes (such as stevedoring, field trip scheduling, shipping vessel loading and unloading process to reduce downtime and turn ships around more frequently to increase its services to the outer island);
  - Review copra purchasing relationship with Tobolar to reach a mutually beneficial relationship for both state owned entities;
  - Develop and improve management and financial reporting;
  - Address capacity building weaknesses and provide or seek opportunities for capacity building;
  - Ongoing RepMar financial support as a community service obligation
  - Development and adherence to a repairs and maintenance schedule.

- Ensure remaining MISC shipping fleet complete the major repair and maintenance services at a dry dock facility and all shipping vessels in its existing fleet continue to receive ongoing repairs and maintenance services timely.

- Prepare its operation (in terms of capacity building and increase in personnel) for the arrival of the two new shipping vessels donated by the Government of Japan.

ADDITIONAL FINANCIAL INFORMATION

This discussion and analysis is designed to provide MISC's customers and other stakeholders with an overview of the company's operations and financial condition as at 30th September 2013. Should the reader have questions regarding the information included in this report, or wish to request additional financial information, please contact the Marshall Islands Shipping Corporation General Manager at P.O. Box 1198, Majuro, Marshall Islands, MH 96960.

MARSHALL ISLANDS SHIPPING CORPORATION

Statements of Net Position
September 30, 2013 and 2012

ASSETS	2013	2012
Current assets:		
Cash	$ 187,951	$ 76,205
Receivables:		
Affiliates	98,512	57,766
Trade	182,551	29,405
Employees	26,837	13,254
	307,900	100,425
Less allowance for doubtful accounts	(51,474)	(34,447)
Total receivables, net	256,426	65,978
Inventory	3,840	3,507
Prepaid expense	-	28,059
Total current assets	448,217	173,749
Equipment, net	69,295	127,034
	$ 517,512	$ 300,783
LIABILITIES AND NET POSITION		
Current liabilities:		
Accounts payable	$ 64,448	$ 48,009
Payable to affiliates	230,737	261,333
Accrued payroll liabilities	86,628	81,485
Total liabilities	381,813	390,827
Commitments and contingencies		
Net position:		
Net investment in capital assets	69,295	127,034
Unrestricted	66,404	(217,078)
Total net position	135,699	(90,044)
	$ 517,512	$ 300,783

See accompanying notes to financial statements.

MARSHALL ISLANDS SHIPPING CORPORATION

Statements of Revenues, Expenses and Changes in Net Position
Years Ended September 30, 2013 and 2012

	2013	2012
Operating revenues:		
Cargo	$ 521,768	$ 458,347
Ship sales	219,159	272,332
Charter	150,551	-
Passenger	101,401	86,543
Copra fee	29,537	35,092
Other	26,979	1,879
Total operating revenues	1,049,395	854,193
Provision for bad debts	(17,027)	(12,585)
Net operating revenues	1,032,368	841,608
Operating expenses:		
Salaries, wages and benefits	770,188	838,263
Petroleum, oil and lube	396,540	314,021
Material and supplies	301,731	248,580
Cost of goods sold	162,063	190,825
Foodstuffs	96,545	84,621
Repairs and maintenance	71,985	72,312
Depreciation	61,174	81,556
Rent	37,857	48,504
Professional fees	30,079	22,912
Travel and entertainment	27,681	11,939
Utilities	24,345	22,461
Freight	15,032	21,612
Communications	13,106	6,381
Contributions	2,850	5,170
Miscellaneous	20,854	37,981
Total operating expenses	2,032,030	2,007,138
Operating loss	(999,662)	(1,165,530)
Nonoperating revenues:		
Operating subsidies	1,225,405	1,396,335
Change in net position	225,743	230,805
Net position at beginning of year	(90,044)	(320,849)
Net position at end of year	$ 135,699	$ (90,044)

See accompanying notes to financial statements.

MARSHALL ISLANDS SHIPPING CORPORATION

Statements of Cash Flows
Years Ended September 30, 2013 and 2012

	2013	2012
Cash flows from operating activities:		
Cash received from customers	$ 841,920	$ 813,363
Cash payments to suppliers for goods and services	(1,187,099)	(1,275,782)
Cash payments to employees for services	(765,045)	(851,966)
Net cash used for operating activities	(1,110,224)	(1,314,385)
Cash flows from noncapital financing activities:		
RepMar subsidy received	1,225,405	1,396,335
Cash flows from capital and related financing activities:		
Acquisition of capital assets	(3,435)	(44,251)
Net change in cash	111,746	37,699
Cash at beginning of year	76,205	38,506
Cash at end of year	$ 187,951	$ 76,205
Reconciliation of operating loss to net cash used for operating activities:		
Operating loss	$ (999,662)	$ (1,165,530)
Adjustments to reconcile operating loss to net cash used for operating activities:		
Depreciation	61,174	81,556
Provision for bad debts	17,027	12,585
(Increase) decrease in assets:		
Receivables:		
Affiliates	(40,746)	74,319
Trade	(153,146)	(11,822)
Employees	(13,583)	(3,328)
Inventory	(333)	47,059
Prepayments	28,059	(28,059)
Increase (decrease) in liabilities:		
Advance from Tobolar	-	(100,000)
Accounts payable	16,439	(50,593)
Payable to affiliates	(30,596)	(89,828)
Copra purchases payable	-	(64,247)
Accrued payroll liabilities	5,143	(16,497)
Net cash used for operating activities	$ (1,110,224)	$ (1,314,385)

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.

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 position categories:

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

- Unrestricted; net position that is not subject to externally imposed stipulations. Unrestricted net position may be designated for specific purposes by action of management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

Basis of Accounting

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

(2) Summary of Significant Accounting Policies, Continued

Cash

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

For purposes of the statements of net position and cash flows, cash is defined as cash on hand and cash held in demand accounts. As of September 30, 2013 and 2012, the carrying amount of cash was $87,951 and $76,205, respectively, and the corresponding bank balances were $191,769 and $97,802, respectively, which were maintained in a financial institution subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2013 and 2012, bank deposits were fully FDIC insured.

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 are 5 years.

Deferred Outflows of Resources

In addition to assets, the statement of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources represents a consumption of net position that applies to a future period and so will not be recognized as an outflow of resources (deduction of net position) until then. MISC has no items that qualify for reporting in this category.

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.

(2) Summary of Significant Accounting Policies, Continued

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, 2013 and 2012, the accumulated vacation leave liability totals $51,764 and $53,879, respectively, and is included within the statements of net position as other liabilities and accruals.

Deferred Inflows of Resources

In addition to liabilities, the statement of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources represents an acquisition of net position that applies to a future period and so will not be recognized as an inflow of resources (additions to net position) until then. MISC has no items that qualify for reporting in this category.

Revenue Recognition

Cargo, charter and passenger revenue are recognized when the transportation is provided. Other components of other operating revenue are recognized as revenue when the related goods and services are provided.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) 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.

New Accounting Standards

During the year ended September 30, 2013, MISC implemented the following pronouncements:

- GASB Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, which addressed 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 implementation of this statement did not have a material effect on the accompanying financial statements.

- GASB Statement No. 61, *The Financial Reporting Entity: Omnibus,* which improved 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 implementation of this statement did not have a material effect on the accompanying financial statements.

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

- GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which enhanced the usefulness of its Codification by incorporating guidance that previously could only be found in certain Financial Accounting Standards Board (FASB) and American Institute of Certified Public Accountants (AICPA) pronouncements issued on or before November 30, 1989, which does not conflict or contradict GASB pronouncements. GASB Statement No. 62 superseded GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*. The implementation of this statement did not have a material effect on the accompanying financial statements.

- GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which established guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position, and GASB 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. These Statements amend the net asset reporting requirements in Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, and other pronouncements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets. With the implementation of GASB Statement No. 63 and Statement No. 65, the Statement of Net Assets was renamed the Statement of Net Position. In addition, the Statement of Net Position includes two new classifications separate from assets and liabilities. Amounts reported as deferred outflows of resources are reported in a separate section following assets. Likewise, amounts reported as deferred inflows of resources are reported in a separate section following liabilities.

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 MISC.

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 MISC.

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In January 2013, GASB issued Statement No. 69, *Government Combinations and Disposals of Government Operations*, which improves accounting and financial reporting for state and local governments' combinations and disposals of government operations. Government combinations include mergers, acquisitions, and transfers of operations. A disposal of government operations can occur through a transfer to another government or a sale. The provisions in Statement 69 are effective for fiscal years beginning after December 15, 2013. Management has not yet determined the effect of implementation of these statements on the financial statements of MISC.

In April 2013, GASB issued Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*, which requires a state or local government guarantor that offers a nonexchange financial guarantee to another organization or government to recognize a liability on its financial statements when it is more likely than not that the guarantor will be required to make a payment to the obligation holders under the agreement. The provisions in Statement 70 are effective for fiscal years beginning after June 15, 2013. Management has not yet determined the effect of implementation of these statements 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, 2013 and 2012 is as follows:

	2013			
	October 1, 2012	Additions	Retirements	September 30, 2013
Equipment	$ 286,863	$ -	$ -	$ 286,863
Vehicles	149,630	-	-	149,630
Furniture	6,000	-	-	6,000
Motor boats	43,188	3,435	-	46,623
	485,681	3,435	-	489,116
Less accumulated depreciation	(358,647)	(61,174)	-	(419,821)
	$ 127,034	$ (57,739)	$ -	$ 69,295

(4) Equipment, Continued

	2012			
	October 1, 2011	Additions	Retirements	September 30, 2012
Equipment	$ 252,820	$ 34,043	$ -	$ 286,863
Vehicles	143,322	6,308	-	149,630
Furniture	2,100	3,900	-	6,000
Motor boats	43,188	-	-	43,188
	441,430	44,251	-	485,681
Less accumulated depreciation	(277,091)	(81,556)	-	(358,647)
	$ 164,339	$ (37,305)	$ -	$ 127,034

(5) Related Party Transactions

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

A summary of related party transactions for the years ended September 30, 2013 and 2012 is as follows:

	2013			
	Revenues	Expenses	Receivables	Payables
Tobolar	$ 345,459	$ -	$ 86,606	$ -
Marshall Islands Social Security Administration	-	135,695	-	53,323
Marshalls Energy Company, Inc.	62	160,334	-	5,978
RMI Ports Authority	-	35,770	-	115,976
Republic of the Marshall Islands	89,621	139,904	11,783	42,855
Other	643	20,725	123	12,605
	$ 435,785	$ 492,428	$ 98,512	$ 230,737

	2012			
	Revenues	Expenses	Receivables	Payables
Tobolar	$ 344,130	$ -	$ 46,915	$ -
Marshall Islands Social Security Administration	-	72,526	-	54,666
Marshalls Energy Company, Inc.	-	271,557	-	3,247
RMI Ports Authority	-	45,146	-	81,121
Republic of the Marshall Islands	64,878	1,776	-	113,113
Other	635	37,224	10,851	9,186
	$ 409,643	$ 428,229	$ 57,766	$ 261,333

During the years ended September 30, 2013 and 2012, the operations of MISC were funded by appropriations, totaling $1,225,405 and $1,396,335, respectively, from the Nitijela of RepMar.

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

As described in note 6, MISC leases space from a related party.

(6) Commitments and Contingencies

Commitments

MISC leases a warehouse for $3,393 per month and revised to $2,905 per month, effective April 1, 2011, from the RMI Ports Authority, which expires on July 31, 2014. In addition, MISC leases garage and storage space for $688 per month from a related party, which expires on September 30, 2013. For the years ended September 30, 2013 and 2012, MISC recorded rent expense associated with these leases of $37,857 and $48,504, respectively. Total minimum future rental payments for non-cancelable lease agreements for 2014 are $29,046.

Contingencies

MISC receives a substantial amount of its revenue from annual RepMar appropriations. A significant reduction in the level of budgetary support from RepMar, if this were to occur, may have an effect on MISC's programs and activities. For the year ended September 30, 2014, RepMar appropriated $1,309,533 to MISC for the purpose of funding operations.

MISC is party to certain legal proceedings arising from the ordinary course of its business. Management is of the opinion that the ultimate outcome of these proceedings is currently not determinable. Therefore, no provision has been recorded in the accompanying financial statements.

Deloitte & Touche LLP
361 South Marine Corps Drive
Tamuning, GU 96913-3911
USA

Tel: (671)646-3884
Fax: (671)649-4932
www.deloitte.com

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

Chairman
Board of Directors
Marshall Islands Shipping Corporation:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Marshall Islands Shipping Corporation (MISC), which comprise the statement of net position as September 30, 2013, and the related statements of revenues, expenses and changes in net position and of cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated July 7, 2014.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered MISC's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of MISC's internal control. Accordingly, we do not express an opinion on the effectiveness of MISC's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, maternal weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying Schedule of Findings and Responses we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying Schedule of Findings and Responses as items 2013-1 and 2013-2 to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the MISC's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Findings and Responses as items 2013-3 and 2013-4.

MISC's Response to Findings

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

Purpose of this Report

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

Deloitte + Touche LLP

July 7, 2014

Finding No. 2013-1

Fixed Assets

Criteria: Adequate internal control policies and procedures should be established to require that the subsidiary fixed assets register includes appropriate detail, a physical inventory of fixed assets is taken and 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 over fixed assets, specifically asset lives and capitalization thresholds. Furthermore, fixed assets are not tagged.

Fixed assets should be included in the subsidiary register with accurate descriptions and acquisition dates. Two line items exist with the same description but with different acquisition dates that pertain to one vehicle. We also noted two vessel equipment that were damaged and were non-operational but were not retired or assessed for impairment.

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

Effect: The effect of the above condition is a potential misstatement of fixed assets

Recommendation: We recommend that MISC adopt policies and procedures pertaining to fixed assets.

Prior Year Status: Lack of policies and procedures pertaining to fixed assets was reported as a finding in the audits of MISC for fiscal years 2007 through 2012.

Auditee Response and Corrective Action Plan:

Who: Head Accounting Officer

What: MISC management will review the current draft policy to ensure it remains in line with the accounting needs of MISC, it addresses any possible internal control gaps, it provides specific guidelines for capitalization thresholds and depreciation method, it addresses proper acquisition and disposal of assets, it ensures proper procedures are well documented to including tagging of the fixed assets and updating the fixed assets subsidiary ledger. Upon completion of the updates, the MISC management will submit to the Board for approval during FY 2014.

In addition, the Accounting Department will review the fixed assets subsidiary ledger and address the issues of accurate descriptions and acquisition dates, to include the possible duplicated data as noted above for one vehicle. Furthermore, initial efforts to have fixed asset tags have been initiated and will be part of the Fixed Asset policy and process as noted above.

When: Fiscal Year 2014

Finding No. 2013-2

Revenues and Cost of Goods Sold

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

Condition: The following exceptions concerning revenue tests were noted:

1. Significant delays occur in preparation and completion of cargo manifests. As of May 13, 2014, cargo manifests for the fiscal year-ended September 30, 2013 could not be provided. Missing sequences in passenger tickets per passenger manifest were not investigated.

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

3. A gross profit analysis for merchandise sales per voyage was not performed and MISC was not able to fully reconcile the difference of actual gross profit margin against the mark-up percent for retail price.

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.

Recommendation: We recommend that management establish policies and procedures requiring that all supporting documentation (e.g. invoices, receipts, set sales price, etc.) be arranged and be kept in file for future reference. Furthermore, we recommend that MISC maintain and organize cargo and passenger manifests and make regular back-ups of the booking staff computer. Furthermore, we recommend that revenue analysis (cargo, passenger, sale of goods) be performed per voyage to verify the reasonableness of recorded revenues against voyage data provided by the booking staff.

Prior Year Status: Lack of established policies and procedures pertaining to revenues was reported as a finding in the audits of MISC for fiscal years 2007 through 2012.

Auditee Response and Corrective Action Plan:

Who: Head Accounting Officer

What: Management will establish MISC revenue policies and procedures to be in effect for FY 2014. Given the timing of when the FY 2013 was completed, there had not been any sufficient time to develop and implement the policy process. Effective FY 2014, MISC will establish policies and procedures to address the issues identified above.

When: Fiscal Year 2014

Finding No. 2013-3

Local Noncompliance

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

Condition: No documentation was provided to indicate that all assets, liabilities, rights, duties and obligations, and all contracts and agreements relating to shipping services existing on the date of MISC's establishment have been transferred to MISC. Specifically, four vessels (Aemman, 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 relating to shipping services existing on the date of MISC's establishment.

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

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

Prior Year Status: Noncompliance with Public Law 2005-41 was reported as a finding in the audits of MISC for fiscal years 2007 through 2012.

Auditee Response and Corrective Action Plan:

Who: Head Accounting Officer

What: The noncompliance issue with the Public law 2005-41 has been escalated to the MISC Board. Management's understanding of the progress to have the assets transferred to MISC, as appropriate is slow and at a standstill.

Management will revisit the issue with the MISC Board and document the steps taken to address the issue, the RMI contact points, and most importantly the RMI contact point response to noncompliance issue. If all else fails, MISC Board may engage the services of the Auditor General to push the issue and require that both RMI T&C and MISC comply with the requirements of the Public Law 2005-41.

When: Fiscal Year 2014

Finding No. 2013-4

Local Noncompliance

Criteria: RepMar's Procurement Code states the following:

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

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

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

Condition: 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 the lack of established policies and procedures requiring documentation of procurement procedures to ensure compliance with RepMar's Procurement Code.

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

Prior Year Status: Noncompliance with RepMar's Procurement Code was reported as a finding in the audits of MISC for fiscal years 2007 through 2012.

Auditee Response and Corrective Action Plan:

Who: Head Accounting Officer

What: MISC will adopt the RepMar Procurement policy requiring a minimum of three quotes. In addition, MISC will tailor its Procurement policy to the specialized needs of MISC. In some case, MISC access to vendors in the shipping industry is limited for ordering shipping vessel parts. In the case where a minimum of three quotes cannot be met, the Accounting Department will ensure to clearly document the deviation and in compliance with the RepMar Procurement policy.

When: Fiscal Year 2014

MARSHALL ISLANDS SHIPPING CORPORATION

Unresolved Prior Year Findings
Year Ended September 30, 2013

The status of unresolved prior year findings is disclosed within the Schedule of Findings and Responses sections (pages 25 through 28) of this report.