MARSHALL ISLANDS SHIPPING CORPORATION

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

FINANCIAL STATEMENTS AND INDEPENDENT AUDITORS' REPORT

YEARS ENDED SEPTEMBER 30, 2016 AND 2015

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

Years Ended September 30, 2016 and 2015

Table of Contents

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

Tel: +1 (671) 646-3884
Fax: +1 (671) 649-4265

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, 2016 and 2015, 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.

Deloitte.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Marshall Islands Shipping Corporation as of September 30, 2016 and 2015, 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 10 be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the 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 financial statements, and other knowledge we obtained during our audit of the 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 June 5, 2017, 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 financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering MISC's internal control over financial reporting and compliance.

Deloitte & Touche LLP

June 5, 2017

Marshalls Islands Shipping Corporation (MISC) herewith presents a discussion and analysis of the company's financial performance for the financial year ended 30th September 2016. It is to be read in conjunction with the financial statements following this section.

FINANCIAL HIGHLIGHTS

MISC's net position at the end of the fiscal year 2016 was $401,081 compared to net position of $279,970 in 2015. The increase in net position from 2015 to 2016 is a positive indicator of the stabilization of MISC operations, and ongoing efforts by management to maintain its expenditure spending within its operational revenues, as well as nonoperational revenues in the form of government subsidies.

MISC's total net operating revenues increased by $122,842 (10%) from $1,204,281 in 2015 compared to $1,327,123 in 2016 due to an increase in Charter revenue offset by a decrease in revenue for Cargo, Ships Sales, Passenger and Other revenue, which was driven by two factors. First, MISC's current fleet was reduced to four (4) vessels in FY16 and FY15. MISC's shipping fleet suffered a loss with MV Landrik, which was forced to be fully decommissioned and is no longer operational due to deteriorating conditions posing a safety concern for its passengers. The second factor is based on the absence of prior year's extraordinary circumstances in the form of a natural disaster, which provided a revenue generating opportunity for MISC. MISC's charter revenue increased significantly by $278,284 (68%) from $411,786 in 2015 to $690,070 in 2016. The passenger revenues experienced a slight decrease by $33,440 (35%) to $62,791 in 2016. MISC's cargo revenues decreased by $17,327 (3%) to $493,278 in 2016 compared to $510,605 in 2015. MISC's ship sales revenue decreased by $22,836 (11%) to $181,249 in 2016 compared to $204,085 in 2015. Other revenue sources decreased significantly by $67,924 (97%) to $1,860 in 2016 compared to $69,784 in 2015. There is an increasing trend with copra fee revenues. Copra fee revenues increased by $12,953 (69%) to $31,615 in 2016 compared to $18,662 in 2015. This increase in copra fee revenue is an indicator of MISC's support to assist Tobolar with copra purchases and is authorized at the discretion of the ship vessels captain.

Total operating expenses increased marginally from 2015 to 2016. Total operating expenses were $2,948,603 in 2016 compared to $2,898,783 in 2015. Overall, MISC increased its total operating expenses by $49,820 (2%). Personnel and petroleum, oil, and lube (POL) expenses continue to remain as MISC's leading operational expenses. Salaries, wages and benefits expenses decreased by $9,940 (1%) from $1,085,079 in 2015 to $1,075,139 in 2016. In line with declining global fuel prices and the reduction in MISC's shipping fleet, POL expenses decreased by $76,195 (12%) from $649,347 in 2015 to $573,152 in 2016.

MISC's operating loss decreased by $73,022 (4%) from an operating loss of $1,694,502 in 2015 compared to an operating loss of $1,621,480 in 2016. Although MISC has maintained its efforts to reduce its operating expenses, MISC will continue to operate at a loss of ranging from $1.2M to $1.8M annually based on the current tariff rate structure that has been in place since the early 1980's.

MISC continues to depend heavily on subsidies from RepMar, which accounts for approximately 57% of MISC's source of total operating and non-operating revenues during 2016. The subsidy from RepMar to support the Shipping Vessel Repairs and Maintenance Act resumed in 2016. Although it was appropriated in the national budget, MISC did not receive the 2014 subsidy for the Shipping Vessel Repairs Act and 2016 subsidy for Ship Purchase of $1.7M. As a result, the subsidies from RepMar accounted for approximately 59% of MISC's source of total operating and non-operating revenues in 2015. Without the approval of RepMar to allow 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 as a community service obligation.

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 reflect 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 30th September 2016.

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

	2016	2015	2014
ASSETS:			
Current and other assets	$ 782,619	$ 506,717	$ 450,275
Capital assets	227,043	238,474	242,444
Total assets	1,009,662	745,191	692,719
LIABILITIES:			
Current and other liabilities	608,581	465,221	467,788
Total Liabilities	608,581	465,221	467,788
NET POSITION:			
Net investment in capital assets	227,043	238,474	242,444
Restricted	82,047	190,641	-
Unrestricted	91,991	(149,145)	(17,513)
Total net position	$ 401,081	$ 279,970	$ 224,931

Total assets increased from $692,719 in 2014 to $745,191 in 2015, and increased further to $1,009,662 in 2016. The increase in total assets by $52,472 (8%) from 2014 to 2015 is driven primarily by a significant increase in capital assets with the acquisition of vehicles including utility flatbeds. In 2016, total assets increased further by $264,471 (35%) primarily due to the dry dock prepayment. Capital asset acquisition of $112,299 was offset by accumulated depreciation of $94,478.

Net capital assets decreased from $242,444 in 2014 to $238,474 in 2015, and decreased to $227,043 in 2016. In 2015, net capital assets decreased slightly by $3,970 (2%) with the purchase of equipment and vehicles for the total amount of $74,752 offset by the annual depreciation amount of $78,722. In 2016, net capital assets decreased slightly by $11,431 (5%) with capital asset acquisition of $112,299 offset by retirements of $97,499 and annual depreciation of $94,478. Capital asset acquisition was primarily equipment totaling $38,340. 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 the MISC and authorized all movable and immovable property of the shipping services under the Ministry of Transportation and Communication be vest absolutely in MISC.

Total liabilities decreased by $2,567 (1%) from $467,788 in 2014 to $465,221 in 2015, and increased by $143,360 (31%) in 2016. In 2015, MISC's total liabilities for RepMar related parties were $276,564, down by $19,653 (7%) in comparison to 2014. Although, MISC's total liabilities due to RMIPA increased by $27,227 (17%), it was offset by decreases to MISSA by $26,478 (36%), to Ministry of Finance by $8,083 (17%), and to the remaining other RepMar related parties by $12,319 (74%). In 2016, MISC's total liabilities for RepMar related parties were $395,136, up by $118,572 (43%) in comparison to 2015. MISC's total liabilities due to RMIPA increased by $54,474 (29%), payable to MISSA increased significantly by $47,223 (101%), payable to Ministry of Finance increased by $5,063 (13%), and payable to the remaining other RepMar related parties increased by $11,812 (277%).

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

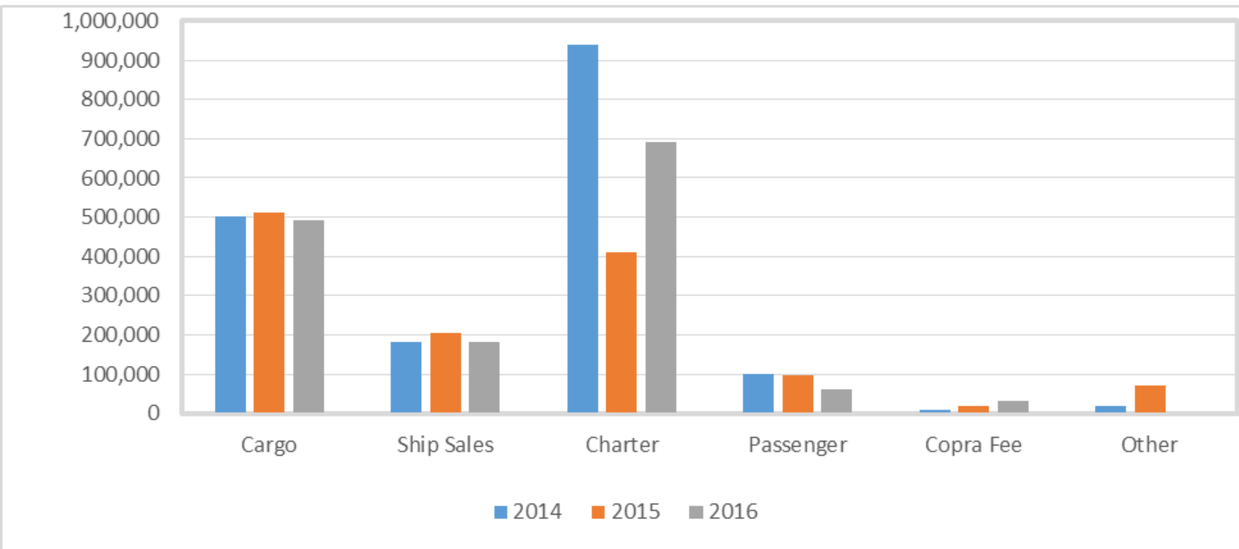
	2016	2015	2014
REVENUES:			
Operating revenues	$ 1,327,123	$ 1,204,281	$ 1,659,203
Nonoperating revenues	1,742,591	1,749,541	1,299,057
	3,069,714	2,953,822	2,958,260
EXPENSES:			
Operating expenses	2,948,603	2,898,783	2,869,028
Change in net position	$ 121,111	$ 55,039	$ 89,232

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 net operating revenue decreased by $454,922 (27%) to a total of $1,204,281 in 2015 compared to $1,659,203 in 2014. In 2016, net operating revenue increased by $122,842 (10%). The major factors contributing to the significant increase in net operating revenue for 2014 is driven by two factors. With the State of Drought Disaster Declaration issued by RepMar in June and July 2013, ongoing relief efforts resulted in the increase in MISC chartering revenue. In addition, RepMar received two new shipping vessels from the government of Japan in December 2013. The increase in vessels, bringing MISC's existing shipping fleet to a total five (5) is another driver for the increase in net operating revenues. All shipping vessels in MISC's fleet were in service during 2014. In 2015, MISC's shipping fleet was reduced to four (4) with the decommissioning of MV Landrik. The decrease in charter demands and the reduction of MISC's shipping fleet had resulted in a significant decrease in MISC's net operating revenue for 2015. In FY2016, Charter increased to deliver goods and materials to rebuild houses that were damaged from heavy rough waves. Additionally, Aemman had been taken out of service briefly to undergo dry dock services in June 2015 and MV Ribuuk Ae in 2016.

Charter revenue increased significantly by $278,284 (68%) from $411,786 in 2015 to $690,070 in 2016; cargo sales decreased by $17,327 (3%) from $510,605 in 2015 to $493,278 in 2016; ship sales decreased by $22,836 (11%) from $204,085 in 2015 to $181,249 in 2016; passenger sales decreased by $33,440 (35%) from $96,231 in 2015 to $62,791 in 2016; copra fee increased by $12,953 (69%) from $18,662 in 2015 to $31,615 in 2016; and all other revenue decreased by $67,924 (97%) from $69,784 in 2015 to $1,860 in 2016.

There appears to be a growing trend with copra fee revenues as an indicator of MISC's assistance to pay the copra farmers due to possible cash flow constraints experienced by Tobolar at times. Revenue recognized from ship sales have reversed from a positive upward to a declining trend trend in 2015 and 2016. Ship sales service aboard the shipping vessels to the outer island consumers has been one of MISC's alternative sources of income and cash flow to subsidize its operations and was initiated in 2009. It is crucial that MISC continues to review its ship sales process to identify and remediate any internal control gaps in order to maximize the revenue generation opportunity. As a constraint on RepMar's national budget, ship sales provide a viable business solution for MISC as an alternative source of revenue for cross subsidization opportunities for MISC while continuing to operate with low tariff rates.

The graphic below shows the major components of MISC's operating revenue from 2014 through to 2016:



Total operating expenses increased slightly by $29,755 (1%) from $2.87M in 2014 compared to $2.90M in 2015. In 2016, the total operating expenses remained constant with a slight increase by $49,820 (2%) to $2.95M. For 2016, the top five components of operating expenses are: (1) salaries, wages and benefits, (2) petroleum, oil and lube (POL), (3) materials and supplies (4) foodstuffs and (5) cost of goods sold.

Salaries, wages and benefits remain as the leading operational expense and increased significantly by $34,496 from $1.05M in 2014 to $1.08M in 2015 and decreased by $9,940 (1%) to $1.08M in 2016. Since 2011, MISC's salaries, wages and benefits for MISC had been on a declining trend as a result of management's 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, Jeljelat AE, back in January 2011. As expected, the salary and wage bill increased in 2014 with the additional two new shipping vessels received in December 2013 and MV Landrik decommissioned in 2015.

POL expenses decreased by $86,222 (12%) from $735,569 in 2014 to $649,347 in 2015, and decreased further by $76,195 (12%) to $573,152 in 2016. In 2015 and 2016, the decrease was a result of the declining trend in global fuel processes together with the reduction of MISC's shipping fleet.

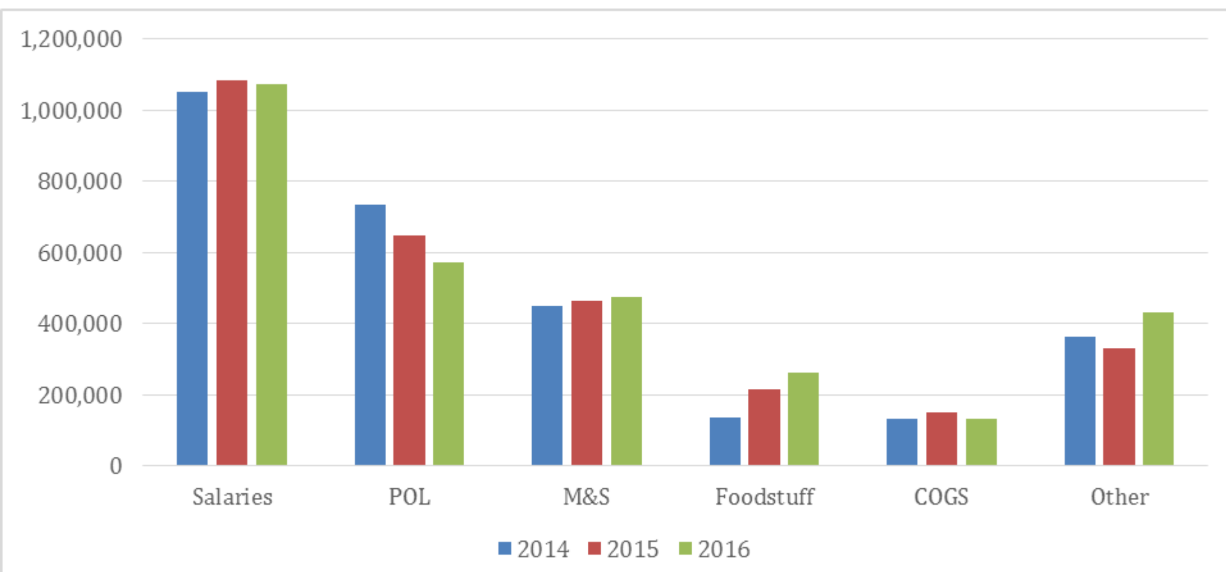
Materials and supplies expenses increased by $16,116 (4%) from $449,326 in 2014 to $465,442 in 2015 and increased further by $8,579 (2%) to $474,021 in 2016. With the establishment of the Shipping Vessel Repairs and Maintenance Act in 2011, annual subsidy is granted by RepMar for proper and timely repairs 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. Although MISC did not receive its repair and maintenance subsidy for 2014, an increase in materials and supplies expense offer a positive indicator that this remains a priority focus for MISC, despite cash flow constraints.

Foodstuff expenses increased by $79,429 (58%) from $137,281 in 2014 to $216,710 in 2015 and increased further by $44,295 (20%) to $261,005 in 2016. The increase in 2015 and 2016 does not appear to be consistent, considering the number of field trips declined compared to 2015. Close monitoring will need to be done to control foodstuff expenses.

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. Ship sales service aboard the shipping vessels to the outer island consumers provides MISC an alternative source of income to subsidize its operations. COGS increased by $17,518 (13%) from $133,459 in 2014 to $150,977 in 2015 and decreased by $17,817 (12%) to $133,160 in 2016. For 2015, the increase in COGS is in line with the SOG revenues. For FY2016, MISC COGS decreased with the loss of MV Landrik and with MV Ribuuk Ae went on dry-docking during the year.

Other expenses decreased by $31,582 (9%) from $362,810 in 2014 to $331,228 in 2015, and increased by $100,898 (30%) to $432,126 in 2016. The rent component, followed by travel and entertainment and dry-dock expense were the main drivers for the increase in other expenses in 2015 and 2016. Repair and maintenance expenses are included in the other expenses.

The following graphic shows the major components of operating expenses from 2014 through to 2016:



The operating loss before non-operating revenues (i.e. RepMar subsidy) for 2016 was approximately $1.62M compared to $1.69M in 2015 and $1.21M in 2014, respectively. In 2015, operating loss increased further with re-establishment of the repairs and maintenance subsidy, allowing MISC to incur additional expenditures to prolong the lifetime of its most critical asset, the shipping vessels. In 2016, operating loss decreased by $73,022 (4%) with dry-docking of MV Aemman and follow by MV Ribuuk Ae and loss of MV Landrik.

Total subsidies, for operations and for repairs and maintenance, were $1.74M in 2016 compared to $1.75M in 2015 and $1.30M in 2014. The subsidy amount of $1.30M received from RepMar in 2014 represents MISC's operating subsidy only. RepMar's Appropriation Act for the 2014 budget had approved MISC to receive a total subsidy of $1.75M. MISC did not receive the appropriated funds earmarked for the repair and maintenance subsidy. In 2015 and 2016, receipt of the repair and maintenance subsidy resumed. 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 2016 was decreased by $12,304 (1%), reflecting the repairs and maintenance subsidy that was not provided to MISC in the prior year 2015. 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.

Management's Discussion and Analysis for the year ended September 30, 2015 is set forth in MISC's report on the audit of financial statements, which is dated August 19, 2016. That Management's Discussion and Analysis explains the major factors impacting 2015 financial statements and can be obtained from MISC's General Manager via the contact information below.

CAPITAL ASSETS AND DEBT

Net capital assets decreased by $11,431 (5%) in 2016 as a result of the acquisition of equipment and vehicles for a total cost of $112,299 less retirements of $97,499 and total depreciation for the year of $94,478.

Refer to note 5 to the accompanying financial statements for additional information relating to capital assets.

CASH FLOWS

Net cash used for operating activities for 2016 was $1.71M compared to net cash used for operating activities of $1.72M in 2015 and $0.99M in 2014. The cash provided by operational activities was absorbed entirely by MISC's operational costs. Additionally, injection of cash flow from the RepMar subsidies were received in the amount of $1.74M, $1.75M and $1.30M during 2016, 2015 and 2014, respectively. In 2015, RepMar subsidies were utilized by MISC to cover its operational expenses in the amount of $1.27M; and for repairs and maintenance expenses in the amount of $0.48M. The repair and maintenance subsidy amount is determined by a schedule developed in January 2011 under the JICA Preparatory Study for the "Project for Improvement of Domestic Shipping Services in the Marshall Islands". In 2016, the RepMar subsidies were utilized by MISC to cover its operational expenses in the amount of $1.26M; and for repairs and maintenance expenses in the amount of $0.48M.

FUTURE OUTLOOK ON SUSTAINABILITY

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

As an indicator of MISC's future outlook on sustainability, MISC's has continued to improve and increase its net position since 2012. MISC's net position was $401,081 in 2016, compared to a net position of $279,970 in 2015, $224,931 in 2014, a net position of $135,699 in 2013, and a net deficiency of $90,044 in 2012. The vast improvement in MISC's financial position from a net deficiency in 2012 to an increasing net position in 2013 – 2016 is a result of increases in revenue streams stemming from increases in charter trips in response to the ongoing relief efforts of the State of Drought Disaster originally issued in June – July 2013, and in 2016 Climate Change such as El Nino, along with the increases in field trips with the addition of the two shipping vessels donated by the government of Japan. Combined with management efforts and persistence to streamline its operational expenses and to continue to reduce its personnel costs in prior years, the rebounds achieved in generating additional revenue streams have been a success factor to MISC's current net position.

MISC's improved trend on net position over the period 2014 to 2016 provides an indicator of MISC management's efforts to reduce its recurrent expenditures. 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 $1.2M to 1.7M 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's strategic plan expired in 2015; and will therefore need Technical Assistance to update its three-year strategic plan. In the absence of a tariff rate increase, the state owned enterprise reform act that was passed into Nitijela in September 2015 is a key legislation to support reform efforts for MISC together with all other state own enterprises. With tariff rates likely to remain low, on-going financial support from RepMar will have to continue and may need to increase, as appropriate to satisfy the community service obligation provided by MISC.

The future outlook on sustainability for MISC continues to be threatened by the deteriorating conditions of the shipping vessel. In 2011, RepMar passed the Shipping Vessel Repairs and Maintenance Act (R&M) to ensure that subsidy funding is made available on an annual basis to ensure that major repairs and services are performed regularly and for the procurement of safety equipment. The R&M Act provides a strong position for MISC to continue to advocate for and to receive subsidy for the sole purpose of repairs and maintenance needs of its aging fleet. Without the R&M subsidy, the continued deteriorating conditions of more than half of MISC's shipping fleet will have a negative impact on MISC's ability to provide safe and reliable shipping services.

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

- Approval from RepMar to increase MISC's tariff rate structure towards full cost recovery;
- Ongoing recipient of RepMar subsidy to support both MISC operations and the Shipping Vessel Repairs and Maintenance Act;
- Develop and adhere to an ongoing annual repairs and maintenance schedule;
- Increase the number of vessels in its shipping fleet;
- Explore other grant financing opportunities (i.e. ADB, World Bank, RUS, etc.);
- Continue with budgetary controls to minimize operational expenses where possible;
- Improve financial and operational management reporting and streamline processes:
- Capacity building opportunities for MISC personnel (administration and technical)

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.
- Update MISC strategic plan 2016-2018.
- With the support of its Board of Directors, MISC will continue to implement and monitor activities laid out in its strategic plan addressing both the operational and financial goals of MISC. The strategic plans include but are not limited to the following:
  - Allow vendors (such as MISCO) merchant on board;
  - Lobby and seek government and development partner opportunities to finance or co-finance procurement of additional shipping vessels to increase MISC's existing shipping fleet;
  - Develop a tariff rate template to incorporate rising cost and fluctuation of fuel and inflation rates;
  - Streamline operational processes (such as stevedoring, field trip scheduling, shipping vessel loading and unloading process to reduce downtime and turn ships around more frequently to increase its services to the outer island);
  - Develop and improve management and financial reporting;
  - Address capacity building weaknesses and provide or seek opportunities for capacity building; and
  - Ensure adherence to the shipping repairs and maintenance schedule.

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 2016. 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, 2016 and 2015

ASSETS	2016	2015
Current assets:		
Cash	$ 161,289	$ 214,423
Receivables:		
Affiliates	353,714	223,028
Trade	203,792	167,104
Employees	58,234	43,303
	615,740	433,435
Less allowance for doubtful accounts	(385,422)	(251,682)
Total receivables, net	230,318	181,753
Inventory	7,847	17,808
Current portion of prepaid drydocking	152,541	30,911
Total current assets	551,995	444,895
Noncurrent assets:		
Prepaid drydocking, net of current portion	230,624	61,822
Equipment, net	227,043	238,474
	$ 1,009,662	$ 745,191
LIABILITIES AND NET POSITION		
Current liabilities:		
Accounts payable	$ 95,475	$ 69,012
Payable to affiliates	395,136	276,564
Accruals and other liabilities	117,970	119,645
Total liabilities	608,581	465,221
Commitments and contingencies		
Net position:		
Net investment in capital assets	227,043	238,474
Restricted	82,047	190,641
Unrestricted	91,991	(149,145)
Total net position	401,081	279,970
	$ 1,009,662	$ 745,191

See accompanying notes to financial statements.

MARSHALL ISLANDS SHIPPING CORPORATION

Statements of Revenues, Expenses and Changes in Net Position
Years Ended September 30, 2016 and 2015

	2016	2015
Operating revenues:		
Charter	$ 690,070	$ 411,786
Cargo	493,278	510,605
Ship sales	181,249	204,085
Passenger	62,791	96,231
Copra fee	31,615	18,662
Other	1,860	69,784
Total operating revenues	1,460,863	1,311,153
Provision for bad debts	(133,740)	(106,872)
Net operating revenues	1,327,123	1,204,281
Operating expenses:		
Salaries, wages and benefits	1,075,139	1,085,079
Petroleum, oil and lube	573,152	649,347
Material and supplies	474,021	465,442
Foodstuffs	261,005	216,710
Cost of goods sold	133,160	150,977
Depreciation	94,478	78,722
Drydock expense	68,748	5,710
Travel and entertainment	66,326	51,313
Rent	63,170	50,066
Freight	25,873	31,683
Utilities	18,454	19,019
Contributions	16,425	15,555
Communications	12,049	7,368
Professional fees	9,868	35,163
Miscellaneous	56,735	36,629
Total operating expenses	2,948,603	2,898,783
Operating loss	(1,621,480)	(1,694,502)
Nonoperating revenues:		
Operating subsidies	1,737,237	1,749,541
Gain on disposal of fixed assets	5,354	-
Nonoperating revenues	1,742,591	1,749,541
Change in net position	121,111	55,039
Net position at beginning of year	279,970	224,931
Net position at end of year	$ 401,081	$ 279,970

See accompanying notes to financial statements.

MARSHALL ISLANDS SHIPPING CORPORATION

Statements of Cash Flows

Years Ended September 30, 2016 and 2015

	2016	2015
Cash flows from operating activities:		
Cash received from customers	$ 1,278,558	$ 1,215,914
Cash payments to suppliers for goods and services	(1,888,815)	(1,864,526)
Cash payments to employees for services	(1,102,421)	(1,066,857)
Net cash used for operating activities	(1,712,678)	(1,715,469)
Cash flows from noncapital financing activities:		
RepMar subsidy received	1,737,237	1,749,541
Cash flows from capital and related financing activities:		
Acquisition of capital assets	(112,299)	(74,752)
proceeds from sale of capital assets	34,606	-
Net cash used for capital and related financing activities	(77,693)	(74,752)
Net change in cash	(53,134)	(40,680)
Cash at beginning of year	214,423	255,103
Cash at end of year	$ 161,289	$ 214,423
Reconciliation of operating loss to net cash used for operating activities:		
Operating loss	$ (1,621,480)	$ (1,694,502)
Adjustments to reconcile operating loss to net cash used for operating activities:		
Depreciation	94,478	78,722
Provision for bad debts	133,740	106,872
(Increase) decrease in assets:		
Receivables:		
Affiliates	(130,686)	(33,454)
Trade	(36,688)	(38,165)
Employees	(14,931)	(23,620)
Inventory	9,961	(16,022)
Prepayments	(290,432)	(92,733)
Increase (decrease) in liabilities:		
Accounts payable	26,463	(1,136)
Payable to affiliates	118,572	(19,653)
Accruals and other liabilities	(1,675)	18,222
Net cash used for operating activities	$ (1,712,678)	$ (1,715,469)

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 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.

- Restricted - net position that is constrained for specific purposes which are externally imposed by providers, such as creditors or amounts constrained due to constitutional provisions or enabling legislation.

- 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 deferred outflows of resources, and liabilities and deferred inflows of resources 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 position. The accrual basis of accounting is utilized by proprietary funds. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. 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, 2016 and 2015, the carrying amount of cash was $161,289 and $214,423, respectively, and the corresponding bank balances were $220,791 and $277,980, respectively, which were maintained in a financial institution subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2016 and 2015, bank deposits in the amount of $220,791 and $250,000, respectively, were FDIC insured. MISC does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk.

Receivables

All receivables are uncollateralized and are due from affiliates or customers, located within the Republic of the Marshall Islands. The allowance for doubtful accounts is stated at an amount which management believes will be adequate to absorb possible losses on accounts receivable that may become uncollectible based on evaluation of the collectability of these accounts. The allowance is established through a provision for bad debts charged to expense.

Inventory

Inventory consists of items purchased for resale (on the ships) during outer islands voyages. Inventory is valued at the lower of cost (moving average) or market value (net realized value).

Deferred Dry-dock Expenditures

Dry-dock expenditures have been recognized as an asset when the recognition criteria were met. The recognition is made when the dry-docking has been performed and is amortized over the period until the next scheduled dry-docking usually 2 to 3 years. Any remaining carrying amount of the cost of the previous inspection is de-recognized. Ordinary repairs and maintenance expenses are charged to the income statement during the financial period in which they are incurred.

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 represents a consumption of net position that applies to a future period and so will not be recognized as an asset outflow of resources (deduction of net position) until then. MISC has no items that qualify for reporting in this category.

(2) Summary of Significant Accounting Policies, Continued

Taxes

Corporate profits are not subject to income tax in the Republic of the Marshall Islands. The Government of the Republic of the Marshall Islands imposes a gross receipts tax of 3% on revenues. MISC is specifically exempt from this tax.

Compensated Absences

Vested or accumulated vacation leave is recorded as an expense and liability as the benefits accrue to employees. No liability is recorded for non-vesting accumulating rights to receive sick pay benefits. As of September 30, 2016 and 2015, the accumulated vacation leave liability totals $67,888 and $70,465, respectively, and is included within the statements of net position as accruals and other liabilities.

Deferred Inflows of Resources

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

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 accordance 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 deferred outflows of resources, liabilities and deferred inflows of resources, 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.

Reclassifications

Certain balances in the 2015 financial statements have been reclassified to conform to the 2016 presentation.

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards

During the year ended September 30, 2016, MISC implemented the following pronouncements:

- GASB Statement No. 72, *Fair Value Measurement and Application*, which addresses accounting and financial reporting issues related to fair value measurements and requires entities to expand their fair value disclosures by determining major categories of debt and equity securities within the fair value hierarchy on the basis of the nature and risk of the investment.

- GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, which eliminates two of the four categories of authoritative GAAP that exist under the existing hierarchy prescribed by Statement No. 55. The two categories that will remain under the new standard are (1) GASB Statements and (2) GASB technical bulletins and implementation guides in addition to AICPA guidance that the GASB clears.

- GASB Statement No. 79, *Certain External Investment Pools and Pool Participants*, addresses for certain external investment pools and their participants the accounting and financial reporting implications that result from changes in the regulatory provisions referenced by previous accounting and financial reporting standards. Those provisions were based on the Investment Company Act of 1940, Rule 2a7. Rule 2a7 contains the Securities and Exchange Commission's regulations that apply to money market funds and were significantly amended in 2014.

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

In June 2015, GASB issued Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not Within the Scope of GASB Statement No. 68, and Amendments to Certain Provisions of GASB Statements No. 67 and No. 68*, which aligns the reporting requirements for pensions and pension plans not covered in GASB Statements No. 67 and No. 68 with the reporting requirements in Statement No. 68. The provisions in Statement No. 73 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In June 2015, GASB issued Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which replaces Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans, as amended*, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and addresses financial reporting requirements for governments whose employees are provided with postemployment benefits other than pensions (other postemployment benefits or OPEB). The provisions in Statement No. 74 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In June 2015, GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, which replaces the requirements of Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions, as amended*, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and provides guidance on reporting by governments that provide OPEB to their employees and for governments that finance OPEB for employees of other governments. The provisions in Statement No. 75 are effective for fiscal years beginning after June 15, 2017. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In August 2015, GASB issued Statement No. 77, *Tax Abatement Disclosures*, which requires governments that enter into tax abatement agreements to disclose certain information about the agreements. The provisions in Statement No. 77 are effective for fiscal years beginning after December 15, 2015. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In December 2015, GASB issued Statement No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*, which addresses a practice issue regarding the scope and applicability of Statement No. 68, *Accounting and Financial Reporting for Pensions*. The provisions in Statement No. 78 are effective for fiscal years beginning after December 15, 2015. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In January 2016, GASB issued Statement No. 80, *Blending Requirements for Certain Component Units - an amendment of GASB Statement No. 14*, which improves financial reporting by clarifying the financial statement presentation requirements for certain component units. The provisions in Statement No. 80 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In March 2016, GASB issued Statement No. 81, *Irrevocable Split-Interest Agreements*, which improves accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement. The provisions in Statement No. 81 are effective for fiscal years beginning after December 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In March 2016, GASB issued Statement No. 82, *Pension Issues - an amendment of GASB Statements No. 67, No. 68, and No. 73*, which addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements. The provisions in Statement No. 82 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

(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) Prepaid Drydocking

During the years ended September 30, 2016 and 2015, MISC incurred dry-dock expenditures of $359,180 and $98,443, respectively, for the MV Aemman and MV Ribuuk Ae ships in Fiji, which is to be amortized for 3 years. In 2016 and 2015, amortized dry-dock expense amounted to $68,748 and $5,710, respectively. As of September 30, 2016 and 2015, prepaid dry-docking amounted to $383,165 and $92,733, respectively.

(5) Equipment

Capital asset activity for the years ended September 30, 2016 and 2015 is as follows:

	2016			
	October 1, 2015	Additions	Retirements	September 30, 2016
Equipment	$ 350,125	$ 38,340	$ (29,607)	$ 358,858
Vehicles	322,097	31,200	(24,089)	329,208
Vessel	50,110	30,259	(43,803)	36,566
Motor boats	86,623	12,500	-	99,123
	808,955	112,299	(97,499)	823,755
Less accumulated depreciation	(570,481)	(94,478)	68,247	(596,712)
	$ 238,474	$ 17,821	$ (29,252)	$ 227,043

	2015			
	October 1, 2014	Additions	Retirements	September 30, 2015
Equipment	$ 283,873	$ 66,252	$ -	$ 350,125
Vehicles	313,597	8,500	-	322,097
Vessel	50,110	-	-	50,110
Motor boats	86,623	-	-	86,623
	734,203	74,752	-	808,955
Less accumulated depreciation	(491,759)	(78,722)	-	(570,481)
	$ 242,444	$ (3,970)	$ -	$ 238,474

(6) Related Party Transactions

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

A summary of related party transactions as of September 30, 2016 and 2015 and for the years then ended are as follows:

	2016			
	Revenues	Expenses	Receivables	Payables
Tobolar	$ 313,778	$ -	$ 254,856	$ -
Marshall Islands Social Security Administration	-	98,143	-	93,960
Marshalls Energy Company, Inc.	113,827	75,604	2,527	1,812
RMI Ports Authority	-	59,263	-	240,342
Republic of the Marshall Islands	178,674	10,471	81,449	44,753
Other	40,385	63,379	14,882	14,269
	$ 646,664	$ 306,860	$ 353,714	$ 395,136

	2015			
	Revenues	Expenses	Receivables	Payables
Tobolar	$ 290,087	$ -	$ 134,885	$ -
Marshall Islands Social Security Administration	-	94,635	-	46,737
Marshalls Energy Company, Inc.	246,330	21,525	38,500	1,867
RMI Ports Authority	-	48,444	-	185,868
Republic of the Marshall Islands	132,165	14,542	49,513	39,690
Other	401	40,878	130	2,402
	$ 668,983	$ 220,024	$ 223,028	$ 276,564

During the years ended September 30, 2016 and 2015, the operations of MISC were funded by appropriations, totaling $1,260,085 and $1,310,085, respectively, from the Nitijela of RepMar. In addition, during the years ended September 30, 2016 and 2015, MISC received an appropriation from the Nitijela of RepMar of $477,152 and $439,456, respectively, restricted for dry-docking and related expenses. As of September 30, 2016 and 2015, MISC had yet to expend $82,047 and $190,641, respectively, of this appropriation. Accordingly, these amounts are restricted within net position.

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

As described in note 7, MISC leases space from a related party.

(7) Commitments and Contingencies

Commitments

MISC leased a warehouse for $2,557 per month, effective August 1, 2015, from the RMI Ports Authority, and expires on July 31, 2020. For the years ended September 30, 2016 and 2015, MISC recorded rent expense associated with this lease of $33,462 and $34,855, respectively.

Total minimum future rental payments for non-cancelable lease agreements for subsequent years ending September 30, are as follows:

Year ending September 30,	
2017	$ 30,678
2018	30,678
2019	30,678
2020	25,565
	$ 117,599

Contingencies

During the years ended September 30, 2016 and 2015, MISC incurred losses from operations of $1,621,480 and $1,694,502, respectively. For the years ended September 30, 2016 and 2015, MISC received operational subsidies of $1,260,085 and $1,310,085, respectively, from the Nitijela of RepMar in conjunction with $477,152 and $439,456, respectively, for dry-docking expenses. Although RepMar has provided funding in the past, MISC does not have a formal agreement with RepMar to provide future funding. 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, 2017, RepMar appropriated $1,450,000 and $460,000, respectively, to fund MISC operations and dry-docking expenses.

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

Tel: +1 (671) 646-3884
Fax: +1 (671) 649-4265

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, 2016, 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 June 5, 2017.

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, material weaknesses or significant deficiencies may exist that have not been 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 item 2016-001 to be material weaknesses.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying Schedule of Findings and Responses as item 2016-002 to be significant deficiencies.

Deloitte.

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 2016-003 through 2016-006.

MISC's Response to Findings

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

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

June 5, 2017

Finding No. 2016-001

Revenues

Criteria: Adequate internal control policies and procedures should be established requiring that revenues be accurately supported, identified, and recorded.

Condition: The following exceptions concerning revenue tests were noted:

1. Significant delays occur in preparation and completion of cargo and passenger manifests. As of the report date, cargo and passenger manifests for the fiscal year ended September 30, 2016 could not be provided.

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

3. One charter trip was provided with a charter fee discount without written formal documentation supporting the authority to provide the discount.

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

Effect: The effect of the above condition is possible misstatement of revenues.

Recommendation: We recommend that MISC maintain and organize cargo and passenger manifests. Furthermore, we recommend that revenue analysis (cargo and passenger) be performed per voyage to verify the reasonableness of recorded revenues against voyage data provided by the booking staff. Also, we recommend that all decisions, orders, rules and regulations relating to the financial operation of MISC shall be made by resolution of the Board of Directors at a meeting and shall be recorded in the minutes of such meeting of the Board.

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 2015.

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 2017.

With technical assistance provided by the Asian Development Bank Development Coordination Office, the local consultant will support MISC in the fourth quarter of FY2016 to assist with establishment of MISC's revenue policies and procedures policy and to assist the Accounting Department with capacity building and implementation of the policy. In addition, support will be provided to address the findings.

It is highly likely this will be a repeat finding in FY2017.

When: Fiscal Year 2017

Finding No. 2016-002

Capital Assets

Criteria: Adequate internal control policies and procedures should be established requiring proper authorization, approval and recordation of sale of capital assets. Also, policies over proper turn-over of assets, policies over actual estimated useful lives and proper tagging should be adopted and implemented.

Condition: The following exceptions concerning capital assets were noted:

1. Board of Director approval for the following sale of assets to the previous General Manager was not made available:

Asset Description	Date of Sale	Net Book Value as of Date of Sale	Sale Amount
2007 Dodge Ram Pickup Truck	05/24/2016	$ 31,700	$ 31,700
1999 Dodge Pickup Laramie, 2500 Ram	09/05/2016	$ 11,242	$ 5,000
2005 Dodge Ram, 2500 Diesel	11/30/2016	$ 11,882	$ 13,516
2011 Hyundai Porter	11/30/2016	$ 9,333	$ 6,250

2. Disposals of two capital assets were incorrectly recorded.

3. Two assets were incorrectly tagged and four assets were not tagged.

4. MISC has no established policies and procedures governing determination of estimated useful lives of capital assets.

5. Turn-over of the following assets was not performed by the previous General Manager:

Asset Description	Amount / Net Book Value
35FT Boat	$ 22,000
2000 Dodge Ram 2500 SLT, Diesel	$ 10,304
Mobile phone per Inv#484509	$ 1,130

Cause: The cause of the above condition is the lack of established policies and procedures governing capital assets.

Effect: The effect of the above condition is a possible misstatement of capital assets.

Recommendation: We recommend that material decisions, orders, rules and regulations relating to the financial operations of MISC be made by resolution of the Board of Directors and be recorded in the minutes of such meetings. Also, we recommend that MISC establish internal control policies and procedures governing capital assets.

Finding No. 2016-002, Continued

Capital Assets

Auditee Response and Corrective Action Plan:

Who: General Manager

What: The MISC board had made a decision on the timely return of the vehicles in question by the previous GM. Such a decision, reflected in a couple of the 2017 Board Meeting Minutes, had been communicated to the previous GM. Also in the absence of written policies for MISC regarding disposal of assets, the Board, through its meeting Minutes, has decided to follow the Government Disposal Policy. The Board also decided that any decisions taken and reflected in its Meeting Minutes shall become Board Policies. Tags and Seals have been ordered and will correctly tags according to the Fixed Assets register. With assistance through the Ministry of Foreign Affairs, from either the Australian Retiree Consultant Assistance Program or New Zealand, such consultancy is aimed to assist in capacity building, institutional strengthening, policies and regulations promulgations, etc.

When: Fiscal Year 2017

Finding No. 2016-003

Local Noncompliance

Criteria: Public Service Regulations of the Republic of the Marshall Islands states the following:

(a) Section 55.2 – the maximum amount of leave that can be accumulated at the end of the leave year, December 31, is 208 hours.

(b) Section 55.3 – at the end of each year, annual leave to the credit of an employee in excess of 208 hours shall be dealt with as follows:

1) the first 80 hours in excess shall be paid to the employee in the cash equivalence; and
2) hours in excess of 288 hours will be forfeited.

(c) Section 55.7 – in case a Public Service employee leaves or resigns his service in any manner, he shall be paid salary for his accumulated leave up to a maximum of 208 hours.

Condition: The following vacation leave hours were paid to the departing General Manager and do not appear consistent with the criteria. As of September 30, 2016, 168 hours leave hours were recorded in the books as due to the departing General Manager. Despite that official record and despite the limitations imposed in the criteria, the following leave hours were subsequently paid.

Fiscal Year	Number of Hours	Amount	Check Number	Check Date
2007	208	$ 3,800	37850	11/30/2016
2008	208	$ 3,800	37850	11/30/2016
2009	208	$ 3,800	37850	11/30/2016
2010	208	$ 3,800	37850	11/30/2016
2011	208	$ 3,800	37850	11/30/2016
2012	208	$ 3,619	37850	11/30/2016
2013	208	$ 3,619	37850	11/30/2016
2015	208	$ 3,619	35136	01/12/2016
2016	192	$ 3,341	37850	11/30/2016
2017	8	$ 139	37850	11/30/2016

Cause: The cause of the above condition appears to be noncompliance with requirements of the Public Service Regulations and is further at odds with the amount recognized to be due and payable per the Company records.

Effect: The effect of the above condition is noncompliance with Public Service Regulations and what appears to represent a receivable from the prior General Manager.

Recommendation: We recommend that management establish policies and procedures to be in compliance with the criteria.

Finding No. 2016-003, Continued

Local Noncompliance, Continued

Auditee Response and Corrective Action Plan:

Who: General Manager

What: The Board has already taken a decision that in the absence of its own policies, it will follow PSC Policies or Regulations. MISC will comply with the recommendation. Such a requirement will be included in the above mentioned consultancy project.

When: Fiscal Year 2017

Finding No. 2016-004

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, Ribuuk Ae, Majuro and Kwajalein) operated by MISC and vehicles previously with the Ministry of Transportation and Communications were 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 2015.

Auditee Response and Corrective Action Plan:

Who: General Manager

What: Management and Board were of the understanding that Public Law 2005-41, a law in itself, would suffice in the formal transfer of these assets, liabilities, right, duties, obligations, contract and agreements, as well as vessels. The Recommendation will be complied with. In fact, an MOU in this effect, has been made and ready for signatures by the Minister of Finance, Ministry of Transportation, Secretary of Finance, Secretary of T&C, and MISC.

When: Fiscal Year 2017

Finding No. 2016-005

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 noncompliance 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 2015.

Auditee Response and Corrective Action Plan:

Who: General Manager

What: In the absence of any written policies or regulations, MISC, as had been decided by its Board, shall follow the Government's policies, in this case, the Procurement Code. MISC will comply with the Recommendation, particularly in sourcing quotations on ships' parts not available on islands. Management has already determined that not only that this is a requirement, but it is a cost efficient strategy and should contribute to significant cost savings in the long run. Even with small purchases, Management has already required at least three sources of quotations, even for normal ships provisions.

When: Fiscal Year 2017

Finding No. 2016-006

Local Noncompliance

Criteria: Section 426 of Marshall Islands Shipping Corporation Act, 2004 states the following:

(a) The Corporation may from time to time fix charges for services provided by the Corporation.

(b) In fixing the charges, the Corporation must follow the procedures set out in this section.

(c) Before fixing the charges, the Corporation must submit the proposed charges to Cabinet for approval.

(d) The Corporation must publish notice of charges in the local newspaper or the local radio station.

Condition: MISC is charging based on the rate for charter without the approval of the Cabinet.

Cause: The cause of the above condition is approval by the Cabinet has not been obtained.

Effect: Noncompliance with Marshall Islands Shipping Corporation Act, 2004 appears to have occurred.

Recommendation: We recommend that management obtain approval from the Cabinet to be in compliance with Marshall Islands Shipping Corporation Act, 2004.

Prior Year Status: Noncompliance with Marshall Islands Shipping Corporation Act, 2004 was reported as a finding in the audits of MISC for fiscal years 2014 and 2015.

Auditee Response and Corrective Action Plan:

Who: General Manager

What: MISC will comply with the Recommendation.

When: Fiscal Year 2017

Unresolved Prior Year Findings
Year Ended September 30, 2016

The status of unresolved prior year findings is disclosed within the Schedule of Findings and Responses sections of this report.