

MARSHALL ISLANDS SHIPPING CORPORATION

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

**INDEPENDENT AUDITORS' REPORT ON
INTERNAL CONTROL AND ON COMPLIANCE**

YEAR ENDED SEPTEMBER 30, 2012

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

Chairman
Board of Directors
Marshall Islands Shipping Corporation:

We have audited the financial statements of the Marshall Islands Shipping Corporation (MISC) as of and for the year ended September 30, 2012, and have issued our report thereon dated May 29, 2013. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

Management of MISC is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered MISC's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of MISC's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of MISC's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying Schedule of Findings and Responses (pages 3 through 9), we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses.

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 2012-1 through 2012-3 to be material weaknesses.

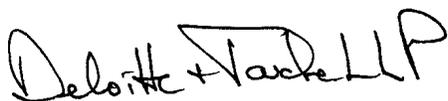
Compliance and Other Matters

As part of obtaining reasonable assurance about whether MISC's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Findings and Responses as items 2012-4 through 2012-7.

We noted certain matters that we reported to management of MISC in a separate letter dated May 29, 2013.

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

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

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

May 29, 2013

MARSHALL ISLANDS SHIPPING CORPORATION

Schedule of Findings and Responses Year Ended September 30, 2012

Finding No. 2012-1

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.

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 misstatement of fixed assets that was corrected through the audit process.

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 year 2007 through 2011

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 2013.

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 assets tags have been initiated and will be part of the Fixed Asset policy and process as noted above.

When: Fiscal Year 2013

MARSHALL ISLANDS SHIPPING CORPORATION

Schedule of Findings and Responses, Continued Year Ended September 30, 2012

Finding No. 2012-2

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. There were several missing bills of lading per the cargo manifests and several passenger manifests were lost.
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 audit of MISC for fiscal year 2007 through 2011.

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 2013. Given the timing of when the FY 2012 was completed, there had not been any sufficient time to develop and implement the policy process. Effective FY 2013, MISC will establish policies and procedures to address the issues identified above.

When: Fiscal Year 2013

MARSHALL ISLANDS SHIPPING CORPORATION

Schedule of Findings and Responses, Continued Year Ended September 30, 2012

Finding No. 2012-3

Purchases /Disbursements

Criteria: Expenses should be supported by adequate documentation such as authorized purchase orders, official receipts or invoices.

Condition: There were no documents supporting cash payments of \$516 to Fiji workers relating to the Ribuuk Ae dry-dock. Further, travel expenses and wire transfers of funds during dry-dock were improperly recorded.

Cause: The cause of the above condition is the lack of established policies and procedures requiring travel disbursements be supported by a receipt or other authoritative documentation.

Effect: The effect of the above condition is the possibility of unauthorized and invalid expenses.

Recommendation: We recommend that management establish policies and procedures to require that expenses are supported by authorizing purchase orders and other supporting documentation.

Prior Year Status: Lack of established policies and procedures over non-payroll expense was reported as finding in the audits of MISC for fiscal years 2007 through 2011.

Auditee Response and Corrective Action Plan:

Who: Head Accounting Officer

What: The Head Accounting Officer will ensure that all non-payroll disbursements are supported by adequate documentation and compliance is adhered to in accordance to the accounts payable policy established during FY 2010.

Furthermore, MISC management would like to note that the number of problematic purchases/disbursements identified in FY 2012 decreased significantly in comparison to the FY11 sample indicating that there has been progress in addressing this audit finding. The Accounting Department recognizes the need for due diligence to ensure purchase order/disbursement process are complete, valid and adequately supported. In

Finally and in addition to due diligence by the staff, the disbursement policy will need to be updated to define what constitutes as the minimum requirements for adequate documentation to include addressing cash transactions.

When: Fiscal Year 2013

MARSHALL ISLANDS SHIPPING CORPORATION

Schedule of Findings and Responses, Continued
Year Ended September 30, 2012

Finding No. 2012-4

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 2011.

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 2013

MARSHALL ISLANDS SHIPPING CORPORATION

Schedule of Findings and Responses, Continued Year Ended September 30, 2012

Finding No. 2012-5

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 item.

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 2011.

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 2013

MARSHALL ISLANDS SHIPPING CORPORATION

Schedule of Findings and Responses, Continued
Year Ended September 30, 2012

Finding No. 2012-6

Local Noncompliance

Criteria: 48 MIRC Chapter 1, Income Tax Act of 1989, Section 105, states that the employer shall once every four (4) weeks or thirteen times per year, pay taxes withheld under Section 104 under Chapter 1. The employer shall, along with the taxes, within two (2) weeks following the preceding four (4) week period make a full, true and correct return showing all wages and salaries paid by the employer to the employees during the preceding four (4) week period and showing the tax due and withheld thereon as provided in Section 104 of the Chapter.

Condition: MISC filed and paid income taxes withheld for the year ended September 30, 2012 in a manner inconsistent with the criteria. Specifically, withholding tax returns for the four-week periods ended November 6, 2011, December 5, 2011, January 13, 2012 and March 12, 2012 were not filed within the 14-day deadline. These returns were filed on February 8, 2012 except for the period ended March 12, 2012 which was filed on April 17, 2012. Payments for taxes withheld for these periods were made on April 26, 2012. At September 30, 2012, MISC was liable to RepMar for \$113,113 of income taxes withheld from employee wages, which represent income taxes withheld for the months of March 2011 through September 2012 plus penalties and interest incurred for the period.

Cause: The cause of the above condition is the lack of policies and procedures to monitor timely filing of returns and payment of withheld income taxes.

Effect: The effect of the above condition is noncompliance with RepMar Income Tax Act of 1989, as amended

Recommendation: We recommend that management establish policies and procedures to comply with the RepMar Income Tax Act of 1989, as amended.

Auditee Response and Corrective Action Plan:

Who: Head Accounting Officer

Delayed payment to RMI Tax was due to Cash Flow. Policies and procedures are in place to ensure payroll clerk file and pay RMI taxes in a timely manner.

When: Fiscal Year 2013

MARSHALL ISLANDS SHIPPING CORPORATION

Schedule of Findings and Responses, Continued
Year Ended September 30, 2012

Finding No. 2012-7

Local Noncompliance

Criteria: 49 MIRC Chapter 1, Social Security Act of 1990, Section 131 states that no later than the tenth (10th) day after the end of each quarter, every employer, including every self-employed worker, shall (a) submit to the Administrator a report of the wages and salaries paid by him and the contributions due from him; and (b) pay into the Fund the contributions due.

Condition: MISC filed and paid employer and employees contributions withheld for the year ended September 30, 2012 in a manner inconsistent with the criteria. Specifically, tax returns for the quarter ended March 31, 2012 were not filed within the 10 day deadline. The March 31, 2012 return was filed on April 26, 2012 and payment was made April 27, 2012. At September 30, 2012, MISC was liable to MISSA for of \$54,666 employer and employees contributions withheld, which represents contributions for the months of September 2011 through September 2012 plus penalties and interest incurred for the period.

Cause: The cause of the above condition appears to be lack of policies and procedures to implement and monitor timely filing of returns and payment of contributions in accordance with the Social Security Act.

Effect: The effect of the above condition is noncompliance with the Social Security Act.

Recommendation: We recommend that management establish policies and procedures to comply with the Social Security Act of 1990.

Auditee Response and Corrective Action Plan:

Who: Head Accounting Officer

Delayed payment to MISSA was due to Cash Flow. Policies & procedures are in place to ensure payroll clerk file and pay MISSA in a timely manner.

When: Fiscal Year 2013

MARSHALL ISLANDS SHIPPING CORPORATION

Unresolved Prior Year Findings
Year Ended September 30, 2012

The status of unresolved prior year findings is disclosed within the schedule of Findings and Responses sections (pages 3 through 9) of this report.