MARSHALL ISLANDS SHIPPING CORPORATION

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

FINANCIAL STATEMENTS AND INDEPENDENT AUDITORS' REPORT

YEARS ENDED SEPTEMBER 30, 2012 AND 2011

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

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

INDEPENDENT AUDITORS' REPORT

Board of Directors
Marshall Islands Shipping Corporation:

We have audited the accompanying statements of net assets (deficiency) of the Marshall Islands Shipping Corporation (MISC), a component unit of the Republic of the Marshall Islands (RepMar), as of September 30, 2012 and 2011, and the related statements of revenues, expenses, and changes in net assets (deficiency) and of cash flows for the years then ended. These financial statements are the responsibility of MISC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of MISC's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of MISC as of September 30, 2012 and 2011, and the changes in its net assets (deficiency) and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated May 29, 2013, on our consideration of internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 3 through 11 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Deloitte & Touche LLP

May 29, 2013

Marshalls Islands Shipping Corporation (MISC) herewith presents a discussion and analysis of the company's financial performance for the financial year ended 30th September 2012. It is to be read in conjunction with the financial statements following this section.

FINANCIAL HIGHLIGHTS

MISC's net assets increased by $230,805 in 2012 compared to a decrease in net assets of $344,131 in 2011. This increase in net assets is attributed mainly to a significant decrease in operating expenses.

MISC has been faced with several major financial and operational losses. In January 2011, MISC's shipping vessel fleet was reduced with the sinking of its only landing craft, Jeljelat AE. The Jeljelat AE was the main source of MISC's chartering revenue and the loss of the landing craft has resulted in a significant decrease of revenue in 2011 and 2012. With the continued deteriorating conditions of its existing shipping fleet, there has been a reduction in the number of field trips in 2011 and 2012 to account for major repairs and dry dock services in Fiji. The Landrik MV was not operating between the months of July to October 2011; the Ribbuk AE was not operating between the months of November 2011 and March 2012; and the Aemman AE was not operating between the months of October and December 2012.

MISC's total net operating revenue slightly decreased by $2,699 (or 0.3%) from $844,307 in 2011 compared to $841,608 in 2012. MISC's cargo revenues increased significantly by $101,877 (or 29%) to $458,347 in 2012 compared to $356,470 in 2011. The significant increase in cargo revenues, however, was offset by decreases in charter revenues and copra fees. With the loss of the landing craft, Jeljelat AE, there were no charter revenues in 2012 compared to $48,474 in 2011. Effective November 2011, MISC ceased purchasing of copra. This resulted in the decrease of copra fees by $48,283 (or 58%) from $83,375 in 2011 to $35,092 in 2012.

Total operating expenses continues to be on a declining trend. Total operating expenses were $2,007,138 in 2012 compared to $2,305,581 in 2011. Overall, MISC decreased its total operating expenses by $298,443 (or 13%). Personnel and petroleum, oil, and lube (POL) expenses continue to remain as MISC's leading operational expenses. Salaries, wages and benefit expenses were reduced by $123,003 (or 11%) from $1,127,409 in 2010 compared to $1,004,406 in 2011 and reduced further by $166,143 (or 17%) to $838,263 in 2012. POL expenses decreased by $112,919 (or 26%) from $426,940 in 2011 compared to $314,021 in 2012.

MISC's operating loss decreased by $295,744 (or 20%) from an operating loss of $1,461,274 in 2011 compared to an operating loss of $1,165,530 in 2012. Although MISC has continued in its efforts to reduce its operating expenses, MISC will always operate at a loss of approximately $1M to $1.5M annually based on the current tariff rate structure that has been in place since the early 1980's. In addition to the current tariff rate structure, which does not allow for full cost recovery, the shortage in its shipping fleet are also a contributing factor to MISC's continuing operating loss.

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

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

FINANCIAL ANALYSIS OF MISC

The Statement of Net Assets and the Statement of Revenues, Expenses and Changes in Net Assets (Deficiency) provide an indication of MISC's financial condition. MISC's net assets (deficiency) reflect the difference between total assets and total liabilities. An increase in net assets over time normally indicates an improvement in financial condition. As illustrated in the figures below MISC's net assets decreased for the year ended 30th September 2012.

The Summary Statements of Net Assets (Deficiency) for MISC are presented below:

	2012	2011	2010
Current and other assets	$ 173,749	$ 226,805	$ 317,346
Capital assets	127,034	164,339	228,839
Total Assets	300,783	391,144	546,185
Current Liabilities	390,827	711,993	522,903
Net assets (deficiency):			
Invested in capital assets	127,034	164,339	228,839
Unrestricted	(217,078)	(485,188)	(205,557)
Total net assets (deficiency)	$ (90,044)	$ (320,849)	$ 23,282

Total assets have decreased from $546,185 in 2010 to $391,144 in 2011 and decreased further to $300,783 in 2012. The decrease in total assets by $155,041 (or 28%) from 2010 to 2011 is due to the decrease in cash by $114,903 (or 75%) from $153,409 in 2010 to $38,506 in 2011; and a decrease in capital assets by $64,500 (or 39%) from $228,839 in 2010 to $164,339 in 2011. In 2012, total assets decreased further by $90,361 (or 23%) primarily due to a decrease in inventory by $47,059 (or 93%) from $50,566 in 2011 to $3,507 in 2012; and a decrease in capital assets by $37,305 (or 23%) from $164,339 in 2011 to $127,034 in 2012.

The significant decrease in inventory is attributed primarily to timing. In 2011, a large amount of inventory was purchased for MISC's entire shipping fleet in preparation to embark on field trips that occurred towards the end of September prior to the year-end for the purpose of ship sale activities. In 2012, all of MISC's shipping fleet returned to port in Majuro prior to year-end, resulting in the significant decrease in inventory. Field trips resumed in October 2012.

Net capital assets decreased from $228,839 in 2010 to $164,339 in 2011 and decreased further to $127,034 in 2012. In 2011, net capital assets decreased by $64,500 (or 28%) as a result of the annual depreciation charge of $81,296 offset by the purchases of furniture and motor boats in the amount of $22,349; by the purchase of vehicles costing $19,750; and a disposal loss on equipment and furniture assets in the amount of $25,303 related to the sinking of one of MISC's shipping vessel. In 2012, net capital assets decreased by $37,305 (or 23%) as a result of the annual depreciation charge of $81,556 offset by the purchases of equipment in the amount of $34,043; by the purchases of vehicles in the amount of $6,308; and by the purchases of furniture in the amount of $3,900. The equipment purchases are mainly part of the asset acquisitions necessary for the major repairs and services that the MISC shipping fleet underwent in Fiji.

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

Total liabilities increased from $522,903 in 2010 to $711,993 in 2011 and decreased significantly to $390,827 in 2012. The $189,090 (or 36%) increase in total liabilities from 2010 to 2011 is primarily due to the increase in its payables to affiliates, representing mainly in part, outstanding taxes due to the Marshall Islands Social Security Administration and to the Ministry of Finance Division of Taxation and Revenue. In 2012, total liabilities decreased significantly by $321,166 (or 45%) due to the decrease in its payables to affiliates, attributing mainly to MISC's efforts to decrease its tax liabilities and re-payment of the $100,000 advance to Tobolar. The Tobolar advance to MISC was for the purpose of assisting MISC with the purchase of copra from growers in the outer islands. The total advance amount was repaid in December 2011 upon termination of the agreement between MISC and Tobolar effective November 2011.

A summary of MISC's Statements of Revenues, Expenses and Changes in Net Assets (Deficiency) are presented below:

	2012	2011	2010
Revenue:			
Operating revenue	$ 841,608	$ 844,307	$ 1,296,317
Expenses:			
Operating expenses	2,007,138	2,305,581	2,368,189
Operating loss	(1,165,530)	(1,461,274)	(1,071,872)
Nonoperating revenues (expenses), net	1,396,335	1,117,143	969,150
Change in net assets (deficiency)	$ 230,805	$ (344,131)	$ (102,722)

The Statements of Revenue, Expenses and Changes in Net Assets (Deficiency) identify the various revenue and expense items that contributed to the change in net assets (deficiency). MISC's total revenue decreased significantly in 2011 by $452,010 (or 35%) to a total of $844,307 compared to $1,296,317 in 2010. In 2012, MISC's total revenue decreased slightly by $2,699 (or 0.3%) to a total of $841,608. The decrease in revenue for 2011 and 2012 is primarily due to the shortage in the MISC shipping fleet resulting from a series of several major events.

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

As the remaining shipping fleet continues to operate beyond the required timeframe for much needed dry dock repairs and services, the continued deteriorating conditions of MISC's shipping vessels impacted its ability to provide frequent shipping services. On more than one occasion, the shipping vessels were taken out of service to undergo minor repairs that were within the limited capacity and resources of MISC to repair. The number of field trips taken during the fiscal year was impacted further due to the absence of at least one of shipping vessels at certain points during the 2011 and 2012 fiscal year to undergo major repairs and services at the dry dock facilities located in Fiji. Landrik MV, was the first ship to be sent to Fiji in July 2011 for approximately two months. In November 2011, Ribbuk AE was sent to Fiji and resumed services in March 2012.

These series of events contributing to MISC's shipping fleet shortages had a significant financial loss impact on MISC's operating revenues during 2012. There were no charter revenues in 2012 compared to $48,474 in 2011 and $277,396 in 2010. In the absence of charter revenues, the total operating revenue has decreased significantly from 2010 to 2011 and stabilized in 2011 to 2012. The total operating revenue trends in 2011 and 2012 is expected to continue into subsequent fiscal years until MISC increases its shipping fleet.

Ship sales revenue decreased slightly by $9,105 (or 3%) from $281,437 in 2011 to $272,332 in 2012; and copra fee decreased by $48,283 (or 58%) from $83,375 in 2011 to $35,092 in 2012. On the other hand, cargo revenue increased by $101,877 (or 29%) from $356,470 in 2011 to $458,347 in 2012; and passenger revenue increased by $16,037 (or 23%) from $70,506 in 2011 to $86,543 in 2012. The decrease in copra fee and increase in cargo revenue is to be expected given the changes in the copra purchasing arrangements between MISC and Tobolar.

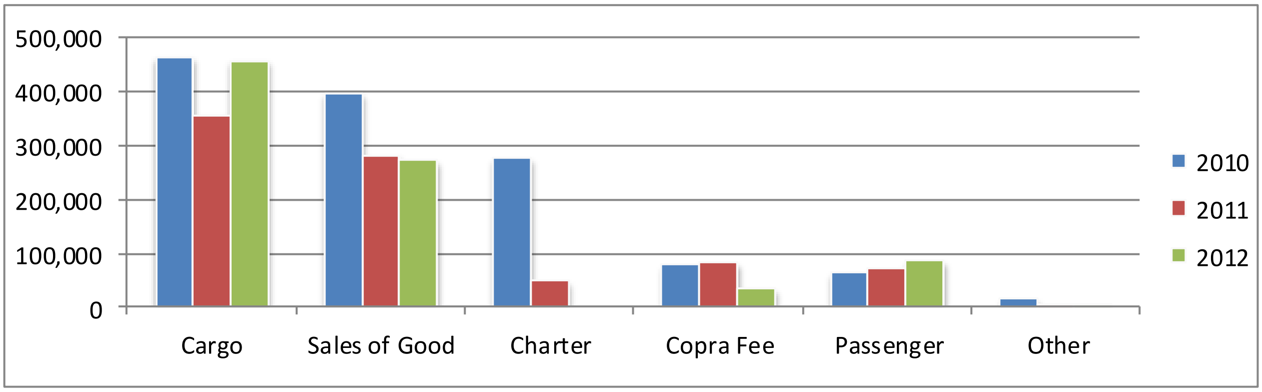
Sale of goods service aboard the shipping vessels to the outer island consumers has been one of MISC's main sources of income to subsidize its operations and was initiated in 2009. As MISC continues to operate with low tariff rates established during the early 1980's and continues to receive a declining subsidization funding from RepMar, the sales of good operation provides an alternative source of revenue and cash flow for MISC. As an indicator of its success to provide an alternative source of income for MISC, the revenue from the sales of goods consist of approximately 31-33% of MISC's operating revenue mix in 2010 - 2013. It is crucial that MISC reviews its sales of good process to identify and remediate any internal control gaps in order to maximize the revenue generation opportunity.

The operating loss before non-operating revenues (i.e. RepMar subsidy) for 2012 was $1.16M compared to $1.46M and $1.07M in 2011 and 2010, respectively. In 2011, the operating loss increased by $389,402 (or 36%) due to the MISC shipping fleet shortages. In 2012, the decrease in operating loss by $295,744 (or 20%) is primarily attributed to MISC efforts to reduce its operational costs primarily in its personnel and POL expenditures.

Operating subsidies of $1,396,335 were received in 2012 compared to $1,142,466 in 2011 and $969,150 in 2010. Of the $1,396,335 subsidy amount received from RepMar, $550,889 was solely for the purpose of the Shipping Vessel Repairs and Maintenance Act and $845,466 is the MISC's operating subsidy.

The operating subsidy received from RepMar in 2010 was reduced by $122,697 (or 11%) compared with 2009, increased in 2011 by $173,296 (or 18%) and decreased in 2012 by $296,980 (or 26%). 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 sustainability and conditions of the MISC shipping fleet will continue to depend on sufficient financial support from RepMar as per the Shipping Vessel Repairs and Maintenance Act established in 2011.

The graph below shows the major components of MISC's operating revenue from 2010 through to 2012:



MISC's total operating expenses have been on a decreasing trend. Total operating expenses decreased by $62,608 (or 3%) from $2.37M in 2010 compared to $2.31M in 2011. In 2012, the total operating expenses decreased significantly by $298,443 (or 13%) to $2.00M. Overall, MISC has successfully and consistently been decreasing its total operating expenses.

For 2012, the top five components of operating expenses are: (1) Salaries, Wages and Benefits, (2) Petroleum, Oil and Lube (POL), (3) Materials and Supplies (4) Cost of Goods Sold and (5) Foodstuff.

Salaries, wages and benefits remain as the leading operational expense and decreased by $123,003 (or 11%) from $1.13M in 2010 to $1.00M in 2011 and decreased further by $166,143 (or 17%) to $0.84M in 2012. The decrease in the salary and wage bill is a result of management efforts to reduce its personnel expenses due to a shortage of workload due to the loss of one its shipping vessels.

POL expenses increased $41,331 (or 11%) from $385,609 in 2010 to $426,940 in 2011, but decreased by $112,919 (or 26%) to $314,021 in 2012. Despite the decrease in the number of field trips taken during 2011, the increase in POL expenses is an indicator that fuel costs were on the steady rise again. In 2011, there were a total of 28 field trips taken (excluding the number of field trips provided by the use of small shipping vessels from the private sector) compared to 43 field trips taken in 2010. In 2012, there were a total of 25 field trips taken. The decrease in fuel cost and slight decrease in field trips taken during 2012 are contributing factors in the decreased POL expenses.

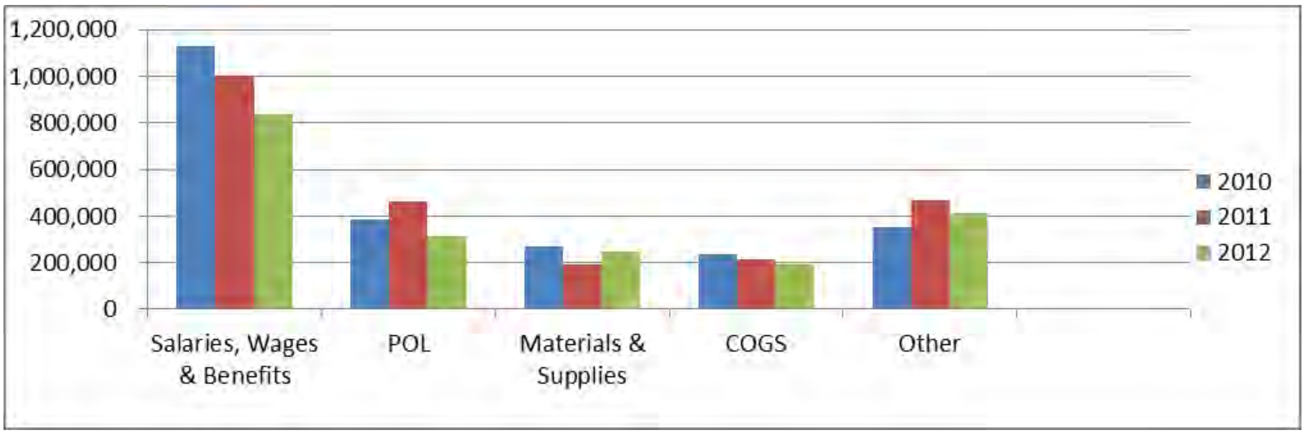
Cost of goods sold (COGS) is an operating expense component introduced in 2009 for the sale of goods service aboard the shipping vessels to the outer island consumers. COGS decreased by $18,043 (or 8%) from $234,785 in 2010 to $216,742 in 2011 and decreased further by $25,917 (or 12%) to $190,825 in 2012. The decrease in cost of goods sold is attributed primarily to controls and processes implemented to mitigate the gaps in the sale of good processes.

Materials and supplies expenses decreased significantly by $78,678 (or 29%) from $269,583 in 2010 to $190,905 in 2011 and increased by $57,675 (or 30%) to $248,580 in 2012. The constraint of limited revenue and funding availability facing MISC today is a main factor for the significant decrease in materials and supplies. With the establishment of the Shipping Vessel Repairs and Maintenance Act in 2011, however, materials and supplies expense is expected to be on the increasing trend and should stabilize once the major repairs of the shipping vessels at a dry dock facility are completed.

Other expenses increased by $115,785 (or 33%) from $350,803 in 2010 to $466,588 in 2011 but decreased by $51,139 (or 11%) in 2012 to $415,449. The repairs and maintenance cost component is the main driver for the increase in other expenses during 2011.

In line with the financial impact of the Shipping Vessel Repairs and Maintenance Act, which funding is provided by RepMar, there was a significant increase in repairs and maintenance expenses by $110,568 (or 1591%) from $6,951 in 2010 to $117,519 in 2011 as a result of the dry dock services performed on one of the shipping vessels during 2011. In 2012, repairs and maintenance decreased by $45,207 (or 38%) to $72,312. Similar to the materials and supplies cost component, there is an expectation that the repairs and maintenance expense will continue to increase and should stabilize once all the MISC's existing shipping fleet have undergone major repairs at a dry dock facility. In 2011 and 2012, all major repairs and maintenance performed on the shipping vessels, with the exception of new movable properties, were expensed rather than capitalized due to the fact that the capital assets of the shipping vessels have yet to be transferred to MISC from the Ministry of Transportation and Communications.

The following graph shows the major components of operating expenses from 2010 through to 2012:



CAPITAL ASSET AND DEBT

Net capital assets decreased by $37,305 (or 23%) in 2012 as a result of the acquisition equipment and furniture for a total cost of $37,943 and for vehicles costing $6,308 less total depreciation for the year of $81,556.

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

MISC did not incur any long-term debt during 2011 or 2012 nor did MISC have any outstanding long-term debt at the end of the year.

CASH FLOW

Net cash used for operating activities for 2012 was $1.31M compared to net cash used for operating activities of $1.22M in 2011 and $1.11M in 2010. The cash provided by operational activities was absorbed entirely by MISC's operational costs. Additionally, injection of cash flow from RepMar subsidies were received in the amount of $1.40M, $1.14M and $0.97M during 2012, 2011 and 2010, respectively. During 2010, RepMar subsidies were utilized by MISC to cover its operational expenses. During 2011 and 2012, RepMar subsidies were utilized by MISC to cover its operational expenses in the amount of $0.84M and for repairs and maintenance expenses in the amount $0.30M and $0.56M, respectively. The increase in the 2012 repairs and maintenance subsidy represents the subsidy short fall in 2011.

FUTURE OUTLOOK ON SUSTAINABILITY

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

As an indicator of MISC's future outlook on sustainability, MISC's has a net deficiency of $90,044 in 2012, compared to a net deficiency of $320,849 in 2011 and net assets of $23,282 in 2010. The improvement in MISC's net deficiency in 2012 is a result of tough management decision to streamline its operational expenses and to significantly reduce its personnel costs. The measures taken by management included non-performing personnel lay-offs and decreases in the salary and wage bill across all MISC active personnel.

With MISC's declining trend in net assets over the years, the resulting MISC's net deficiency is in line with management expectations. In order to revive the MISC operations for future sustainability, MISC must be able to obtain RepMar approval to increase its tariff rates or receive an increase in the subsidy amounts as a community service obligation to absorb the operational losses of MISC to provide affordable sea-transport services to the people.

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

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

The future outlook on sustainability for MISC is threatened further by the deteriorating conditions of the shipping vessels. Due to budget constraints, MISC has not been able to ensure that the shipping vessels undergo major repairs and maintenance at a dry dock facility. In 2011, MISC was forced to scale back on its field trip schedule for necessary repairs and maintenance performed by MISC with its limited capacity and resources. Unfortunately, MISC's efforts could not prevent the loss of one of its shipping vessels in January 2011.

In 2011, RepMar passed the Shipping Vessel Repairs and Maintenance Act to ensure that funding is made available to ensure that major repairs and services are performed regularly. The Act also provides funding provision for safety equipment. As of September 2012, two of MISC's existing fleet have been sent to Fiji's dry dock facilities to undergo major repairs and services. Despite the delays during 2012, the last shipping vessel will be expected to undergo major repairs at the Fiji dry dock facilities in 2013. With the support of the government of Japan, MISC is also expected to receive two new shipping vessels towards the end of 2013 to include a landing craft vessel type.

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

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

MISC FOCUS IN THE COMING FISCAL YEAR

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

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

- With the support of its Board of Directors, MISC will seek/recruit assistance from available resources such as ADB and other developing partners to implement its Strategic Plan for MISC. In April 2012, MISC was one of the state-owned enterprises selected to participate in the ADB Technical Assistance (TA) Supporting the Public Sector Program. The ADB TA provided an opportunity for the MISC management to work closely with an ADB consultant with sea-transport and financial expertise. The outcome of the ADB TA is a completed three to five year strategic plan for MISC, which will address both the operational and financial goals of MISC for future sustainability. The strategic plans include but are not limited to the following:

    - Develop a tariff rate template to incorporate rising cost and fluctuation of fuel and inflation rates;

    - Review of operational processes (such as stevedoring, field trip scheduling, shipping vessel loading and unloading process to reduce downtime and turn ships around more frequently to increase its services to the outer island);

    - Review copra purchasing relationship with Tobolar to reach a mutually beneficial relationship for both state owned entities;

    - Develop and improve management and financial reporting;

    - Address capacity building weaknesses and provide or seek opportunities for capacity building;

    - Ongoing RepMar financial support as a community service obligation;

    - Development and adherence to a repairs and maintenance schedule.

- MISC has implemented the JICA study for MISC shipping vessels repair and maintenance plan. With the sinking of one of MISC's shipping vessels, a team of experts provided by JICA have conducted and completed an assessment study to assess MISC's shipping vessel needs and establish a repairs and maintenance costing schedule. As a successful indicator of this initiative, the Shipping Vessel Repair and Maintenance Act was established in 2011 and two of the shipping vessels have been sent to a dry dock facility in Fiji as of fiscal year-end 2012.

- Ensure remaining MISC shipping fleet complete the major repair and maintenance services at a dry dock facility.

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 2012. 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 Assets (Deficiency)
September 30, 2012 and 2011

ASSETS	2012	2011
Current assets:		
Cash	$ 76,205	$ 38,506
Receivables:		
Affiliates	57,766	132,085
Trade	29,405	17,583
Employees	13,254	9,926
	100,425	159,594
Less allowance for doubtful accounts	(34,447)	(21,861)
Total receivables, net	65,978	137,733
Inventory	3,507	50,566
Prepaid expense	28,059	-
Total current assets	173,749	226,805
Equipment, net	127,034	164,339
	$ 300,783	$ 391,144
LIABILITIES AND NET ASSETS (DEFICIENCY)		
Current liabilities:		
Accounts payable	$ 48,009	$ 98,602
Payable to affiliates	261,333	351,161
Copra purchases payable	-	64,247
Accrued payroll liabilities	81,485	97,983
Advance from Tobolar	-	100,000
Total liabilities	390,827	711,993
Commitment and contingency		
Net assets (deficiency):		
Invested in capital assets	127,034	164,339
Unrestricted	(217,078)	(485,188)
Total net assets (deficiency)	(90,044)	(320,849)
	$ 300,783	$ 391,144

See accompanying notes to financial statements.

MARSHALL ISLANDS SHIPPING CORPORATION

Statements of Revenues, Expenses and Changes in Net Assets (Deficiency)
Years Ended September 30, 2012 and 2011

	2012	2011
Operating revenues:		
Cargo	$ 458,347	$ 356,470
Ship sales	272,332	281,437
Copra fee	35,092	83,375
Passenger	86,543	70,506
Charter	-	48,474
Other	1,879	4,045
Total operating revenues	854,193	844,307
Provision for bad debts	12,585	-
Net operating revenues	841,608	844,307
Operating expenses:		
Salaries, wages and benefits	838,263	1,004,406
Petroleum, oil and lube	314,021	426,940
Material and supplies	248,580	190,905
Cost of goods sold	190,825	216,742
Foodstuffs	84,621	85,956
Depreciation	81,556	81,296
Repairs and maintenance	72,312	117,519
Rent	48,504	56,042
Professional fees	22,912	31,635
Utilities	22,461	10,992
Travel and entertainment	11,939	22,592
Contributions	5,170	4,630
Miscellaneous	65,974	55,926
Total operating expenses	2,007,138	2,305,581
Operating loss	(1,165,530)	(1,461,274)
Nonoperating revenues (expenses):		
Operating subsidies	1,396,335	1,142,446
Loss on disposal of equipment	-	(25,303)
Total nonoperating revenues (expenses), net	1,396,335	1,117,143
Change in net assets	230,805	(344,131)
Net assets (deficiency) at beginning of year	(320,849)	23,282
Net deficiency at end of year	$ (90,044)	$ (320,849)

See accompanying notes to financial statements.

MARSHALL ISLANDS SHIPPING CORPORATION

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

		2012		2011
Cash flows from operating activities:				
Cash received from customers	$	813,363	$	862,155
Cash payments to suppliers for goods and services		(1,275,782)		(1,067,464)
Cash payments to employees for services		(851,966)		(1,009,941)
Net cash used for operating activities		(1,314,385)		(1,215,250)
Cash flows from noncapital financing activities:				
RepMar subsidy received		1,396,335		1,142,446
Cash flows from capital and related financing activities:				
Acquisition of capital assets		(44,251)		(42,099)
Net change in cash		37,699		(114,903)
Cash at beginning of year		38,506		153,409
Cash at end of year	$	76,205	$	38,506
Reconciliation of operating loss to net cash used for operating activities:				
Operating loss	$	(1,165,530)	$	(1,461,274)
Adjustments to reconcile operating loss to net cash used for operating activities:				
Depreciation		81,556		81,296
Provision for bad debts		12,585		-
(Increase) decrease in assets:				
Receivables:				
Affiliates		74,319		26,112
Trade		(11,822)		(1,679)
Employees		(3,328)		(6,585)
Inventory		47,059		(42,210)
Prepayments		(28,059)		-
Increase (decrease) in liabilities:				
Advance from Tobolar		(100,000)		-
Accounts payable		(50,593)		39,270
Payable to affiliates		(89,828)		195,013
Copra purchases payable		(64,247)		(36,643)
Accrued payroll liabilities		(16,497)		(8,550)
Net cash used for operating activities	$	(1,314,385)	$	(1,215,250)

See accompanying notes to financial statements.

(1) Organization

The Marshall Islands Shipping Corporation (MISC), a component unit of the Republic of the Marshall Islands (RepMar), was created under Public Law 2005-41, the Marshall Islands Shipping Corporation Act, 2004. MISC was established to manage and operate RepMar's shipping vessels. MISC's principal line of business is to provide sea transportation services; to carry on business as ship owners; and to build and maintain ships and vessels.

MISC is governed by a five-member Board of Directors, including one official each from the Ministry of Finance and the Marshall Islands Ports Authority and three members appointed by the Cabinet of RepMar.

MISC's financial statements are incorporated into the financial statements of RepMar as a component unit.

(2) Summary of Significant Accounting Policies

The accounting policies of MISC conform to accounting principles generally accepted in the United States of America, as applicable to governmental entities, specifically proprietary funds. Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, requires that proprietary activities apply all applicable GASB pronouncements as well as Statements and Interpretations issued by the Financial Accounting Standards Board (FASB), Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989. MISC has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, 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 asset categories:

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

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

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(2) Summary of Significant Accounting Policies, Continued

Basis of Accounting

Proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operation of the fund are included in the statement of net assets. Proprietary fund operating statements present increases and decreases in net total assets. The accrual basis of accounting is utilized by proprietary funds. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. MISC considers revenues and costs that are directly related to operations of shipping vessels to be operating revenues and expenses. Revenues and expenses related to financing and other activities are reflected as nonoperating.

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 assets and cash flows, cash is defined as cash on hand and cash held in demand accounts. As of September 30, 2012 and 2011, the carrying amount of cash was $76,205 and $38,506, respectively, and the corresponding bank balances were $97,802 and $70,431, respectively, which were maintained in a financial institution subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2012 and 2011, bank deposits were fully FDIC insured.

Receivables

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

Inventory

Inventory consists of items purchased for resale (on the ships) during outer islands voyages. Inventory is valued at the lower of cost (first-in, first out FIFO) or market value (net realized value).

Equipment

MISC has not adopted a formal capitalization policy for equipment; however, items with a cost that equals or exceeds $1,000 are generally capitalized. Depreciation is calculated using the straight-line method based on the estimated useful lives of the respective assets. The estimated useful lives of these assets is 5 years.

(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, 2012 and 2011, the accumulated vacation leave liability totals $53,879 and $67,250, respectively, and is included within the statements of net assets as other liabilities and accruals.

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.

New Accounting Standards

During the year ended September 30, 2012, MISC implemented the following pronouncements:

- GASB Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, which amends Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans,* and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, and addresses issues related to the frequency and timing of measurements for actuarial valuations first used to report funded status information in OPEB plan financial statements. The implementation of this pronouncement did not have a material effect on the accompanying financial statements.

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

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

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

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

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

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

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

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

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

(3) Risk Management

MISC is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. MISC has elected to purchase commercial automobile insurance from independent third parties for the risks of loss to which it is exposed with respect to the use of motor vehicles. Settled claims have not exceeded this commercial coverage for the last three years. MISC does not maintain general liability insurance; maritime insurance; and fire, lightning and typhoon insurance for its office building and contents. In the event of an insurable loss, MISC may be self-insured to a material extent.

(4) Equipment

Capital asset activity during the years ended September 30, 2012 and 2011 is as follows:

	2012			
	October 1, 2011	Additions	Retirements	September 30, 2012
Equipment	$ 252,820	$ 34,043	$ -	$ 286,863
Vehicles	143,322	6,308	-	149,630
Furniture	2,100	3,900	-	6,000
Motor boats	43,188	-	-	43,188
	441,430	44,251	-	485,681
Less accumulated depreciation	(277,091)	(81,556)	-	(358,647)
	$ 164,339	$ (37,305)	$ -	$ 127,033

	2011			
	October 1, 2010	Additions	Retirements	September 30, 2011
Equipment	$ 305,086	$ -	$ (52,266)	$ 252,820
Vehicles	123,572	19,750	-	143,322
Furniture	9,861	2,099	(9,860)	2,100
Motor boats	22,938	20,250	-	43,188
	461,457	42,099	(62,126)	441,430
Less accumulated depreciation	(232,618)	(81,296)	36,823	(277,091)
	$ 228,839	$ (39,197)	$ 25,303	$ 164,339

(5) Related Party Transactions

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

(5) Related Party Transactions, Continued

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

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

	2011			
	Revenues	Expenses	Receivables	Payables
Tobolar	$ 210,629	$ -	$ 96,929	$ -
Marshall Islands Social Security Administration	-	94,231	-	129,930
Marshalls Energy Company, Inc.	-	320,038	-	4,350
RMI Port Authority	-	42,584	-	52,468
Republic of the Marshall Islands	40,399	7,140	35,156	163,801
Other	2,467	7,714	-	612
	$ 253,495	$ 471,707	$ 132,085	$ 351,161

During the years ended September 30, 2012 and 2011, the operations of MISC were funded by appropriations, totaling $1,396,335 and $1,142,446, respectively, from the Nitijela of RepMar.

MISC occupies certain office space and utilizes three 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.

The MV Jeljelat Ae, one of the vessels owned by RepMar, sank on January 1, 2011. No loss was recorded for this event by MISC except for certain onboard equipment purchased by MISC.

During the year ended September 30, 2010, Tobolar advanced $100,000 to MISC for the purpose of assisting MISC with the purchase of copra from growers in the outer islands. The term of the advance is for one year and is non-interest bearing. Subsequently, the agreement was terminated effective on November 1, 2011, and the total amount was repaid on December 22, 2011.

(6) Commitment and Contingencies

Commitment

MISC leases a warehouse for $3,393 per month and revised to $2,905 per month, effective April 1, 2011, from the RMI Ports Authority, which expires on July 31, 2014. In addition, MISC leases garage and storage space for $688 per month, which expires on September 30, 2013. For the years ended September 30, 2012 and 2011, MISC recorded rent expense associated with these leases of $48,504 and $46,034, respectively.

Total minimum future rental payments for non-cancelable lease agreements are as follows:

Year ending September 30,	
2013	$ 43,105
2014	29,046
	$ 72,151

Contingency

MISC receives a substantial amount of its revenue from annual RepMar appropriations. A significant reduction in the level of budgetary support from RepMar, if this were to occur, may have an effect on MISC's programs and activities. For the year ended September 30, 2013, RepMar appropriated $1,235,287 to MISC for the purpose of funding operations.

Legal Claims

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