

**MARSHALL ISLANDS SHIPPING CORPORATION**

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

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

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**YEAR ENDED SEPTEMBER 30, 2011**

**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, 2011, and have issued our report thereon dated March 29, 2012. 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 14), 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 2011-1 through 2011-5 to be material weaknesses.

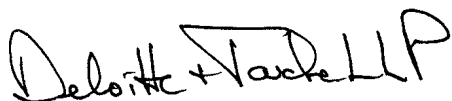
## Compliance and Other Matters

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 2011-6 through 2011-10.

We noted certain matters that we reported to management of MISC in a separate letter dated March 29, 2012.

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

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 + Stark LLP". The signature is written in a cursive, stylized font.

March 29, 2012

# MARSHALL ISLANDS SHIPPING CORPORATION

## Schedule of Findings and Responses Year Ended September 30, 2011

### Finding No. 2011-1

#### Inventory

Criteria: Inventory should be periodically monitored and reconciled.

Condition: Inventory assets are exposed to a high risk of fraud since MISC's warehouse is not secured and can be accessed by anyone. MISC performs periodic inventory counts when vessels return from field trips; however, such balances are not timely reconciled to the general ledger. In addition, MISC did not monitor sales of goods to employees at MISC's warehouse and this condition resulted in an understatement of the sale of goods and receivables from employees of \$5,088 although the cost of goods sold was recorded.

Cause: The cause of above condition is a lack of established policies and procedures pertaining to inventory.

Effect: The effect of the above condition is a possible misstatement of inventory balances and potential unrecorded sales to and receivables from employees. An audit adjustment was proposed to recognize the sales to employees. MISC is additionally unable to effectively monitor and analyze gross profits recorded in interim financial statements.

Recommendation: We recommend that management establish policies and procedures pertaining to the reconciliation of inventory.

Prior Year Status: Lack of policies and procedures over the reconciliation of inventory was reported as a finding in the audits of MISC for fiscal years 2009 and 2010.

#### Auditee Response and Corrective Action Plan:

Who: Head Accounting Officer

What: MISC will utilize the Quickbooks Inventory Module to record inventory activity for recording and posting to the General Ledger. With the implementation of the inventory module at the end of FY 2011, there continues to be process improvements and development of an end to end process that will need to be undertaken for FY 2012.

As part of the process improvement, a physical count of the inventory assets is performed upon the return of the shipping vessels from their field trips. After the physical count of the inventory assets is performed by a separate staff member from the Accounting Department, the Head Accounting Officer will reconcile the inventory balances to the general ledger.

Any gaps in the process to include transfer of inventory items to operations and employee charges will be addressed and documented for proper accounting procedures, reconciliation and treatment for recording to the GL.

The inventory will be physically counted and reconciled upon the return of the vessel at the end of each voyage.

An independent physical count of inventory will also be conducted semi-annually and annually as added internal control for inventory.

When: Fiscal Year 2012

# MARSHALL ISLANDS SHIPPING CORPORATION

## Schedule of Findings and Responses, Continued Year Ended September 30, 2011

### Finding No. 2011-2

#### Fixed Assets

**Criteria:** Adequate internal control policies and procedures should be established to require that the subsidiary fixed asset 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.

Further, fixed assets should be included in the subsidiary register with accurate descriptions and acquisition dates. We noted two line items with the same description but with different acquisition dates that pertain to the same vehicle. Disposals of fixed assets relate to Jeljelat Ae (which sank on January 1, 2011) that were not timely updated and approved by MISC management and were not recorded in the fixed asset register or in the general ledger.

**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 years 2007 through 2010.

#### Auditee Response and Corrective Action Plan:

**Who:** Head Accounting Officer

**What:** A fixed asset policy had been developed in prior fiscal years but has yet to be approved by the Board. Initial attempts were made during the end of FY 2011 to address the FY 2011 audit finding related to fixed assets. However, with the timing of the audit completion for FY 2011, there has not been sufficient time to address this issue during FY 2011 in its entirety.

For FY 2012, 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 2012.

**MARSHALL ISLANDS SHIPPING CORPORATION**

Schedule of Findings and Responses, Continued  
Year Ended September 30, 2011

Finding No. 2011-2, Continued

Fixed Assets, Continued

In addition, the Accounting Department will review the fixed assets subsidiary ledger and address the issues of accurate descriptions and acquisition dates, to include the possible duplicated data as noted above for one vehicle.. Furthermore, initial efforts to have fixed asset tags have been initiated in FY 2011 and will be part of the Fixed Asset policy and process as noted above.

When: Fiscal Year 2012

**MARSHALL ISLANDS SHIPPING CORPORATION**

Schedule of Findings and Responses, Continued  
Year Ended September 30, 2011

Finding No. 2011-3

Copra Purchases

Criteria: Payment of copra purchases should be made directly to individual growers or to authorized representatives of the grower.

Condition: Payments for copra purchases from growers are made based on check payments that are initially made out to a MISC employee who cashes the check and then distributes the cash to the respective growers.

Cause: The cause of the above condition is the lack of established policies and procedures over payments to growers.

Effects: The effect of the above condition is possible misappropriation of funds designated for copra purchases.

Recommendation: We recommended that management establish policies and procedures requiring that payments be made directly to individual growers or to designated, authorized representatives.

Prior Years Status: A lack of policies and procedures pertaining to payments of copra purchases was reported as finding in the audits of MISC for fiscal years 2009 and 2010.

Auditee Response and Corrective Action Plan:

Who: Head Accounting Officer

What: It is the expectation of management that this issue will continue to be an audit finding due to the fact that most growers do not have a bank account to cash their checks in the outer islands. In some cases, growers (especially from the lesser developed outer islands) do not have the appropriate identification required by the banking institution.

Effective November 2011 (FY 2012), the MISC management has terminated its role in the copra purchase business. The copra purchase business will be taken over directly by Tobolar on a go forward. As a result, this issue will no longer be an audit finding for MISC.

When: Fiscal Year 2012

# MARSHALL ISLANDS SHIPPING CORPORATION

## Schedule of Findings and Responses, Continued Year Ended September 30, 2011

### Finding No. 2011-4

#### 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. Pre-numbered charter request forms are not utilized. Charters are invoiced based on information provided by management. In addition, freight is invoiced based on oral declarations from customers without further verification due to lack of adequate space and equipment.
2. The following were not recorded as cargo revenue due to a lack of review of voyage reports.
  - \$1,201.55 of a total of \$1,208.55
  - \$1,395 of a total of \$1,552
3. There were several missing bills of lading per the cargo manifests and several passenger manifests was lost.
4. A cargo and passenger sales analysis per voyage (voyage report vs. recorded revenue) was not performed.
5. A total of \$27,403 of sales of and cost of sales was improperly recorded (The sale of goods was recorded instead of cost of goods sold when merchandise inventory was purchased.)
6. A total of \$5,088 of sales of goods to employees were not monitored and approved by management and were not timely recorded.
7. A \$4,359 provision expense for vessel crew was improperly recorded as Cost of goods sold.
8. A gross profit analysis for merchandise sales per voyage was not performed and MISC was not able to reconcile the significant decrease of FY2011 gross profit margin against FY2010 results.

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

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

**Recommendation:** We recommended 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 maintains and organize cargo and passenger manifests and makes regular back up of the dates on the booking staff's computer. Furthermore, we recommended the performance of a revenue analysis (cargo, passenger, sale of goods) per voyage to verify the reasonableness of recorded revenues against vessel voyage data provided by the booking staff.

**Prior Year Status:** Lack of established policies and procedures pertaining to revenues was reported as a finding in the audits of MISC for fiscal years 2007 through 2010.



**MARSHALL ISLANDS SHIPPING CORPORATION**

Schedule of Findings and Responses, Continued  
Year Ended September 30, 2011

Finding No. 2011-4, Continued

Revenues and Cost of Goods Sold, Continued

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 2012. Given the timing of when the FY 2011 was completed, there had not been any sufficient time to develop and implement the policy process. Effective FY 2012, MISC will establish policies and procedures to address the issues identified above.

When: Fiscal Year 2012

**MARSHALL ISLANDS SHIPPING CORPORATION**

Schedule of Findings and Responses, Continued  
Year Ended September 30, 2011

Finding No. 2011-5

Purchases /Disbursements

Criteria: Expenses should be supported by adequate documentation such as authorizing purchase orders.

Condition: An authorizing purchase order (PO) was not provided for examination for check# 20420 in the amount of \$510. Additionally, there were no documents supporting cash payments of \$1,371 to Fiji workers relating to the Landrik dry-dock. Further, travel expenses and wire transfer funds during dry-dock were improperly recorded.

Cause: The cause of the above condition is the lack of established policies and procedures requiring that non-payroll disbursements be supported by authorizing purchase orders.

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

Recommendation: We recommended that management establish policies and procedures requiring that expenses be supported by authorizing purchase orders.

Prior Year Status: Lack of established policies and procedures over non-payroll expenses was reported as a finding in the audits of MISC for fiscal years 2007 through 2010.

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 2011 decreased significantly in comparison to the FY10 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.

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 2012

# MARSHALL ISLANDS SHIPPING CORPORATION

Schedule of Findings and Responses, Continued  
Year Ended September 30, 2011

## Finding No. 2011-6

### 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 vested 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 2010.

### 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 2012

# MARSHALL ISLANDS SHIPPING CORPORATION

## Schedule of Findings and Responses, Continued Year Ended September 30, 2011

### Finding No. 2011-7

#### Local Noncompliance

Criteria: RepMar's Procurement Code states the following:

- (a) Section 124 – unless otherwise authorized by law, all Government contracts shall be awarded by competitive sealed bidding.
- (b) Section 127 – procurement of goods and services not exceeding \$25,000 may be made in accordance with small purchase procedures promulgated by RepMar's Policy Office. Small purchase procedures are those relatively simple and informal methods for securing services, supplies, or other property that do not cost more than \$25,000. RepMar's Ministry of Finance has previously declared that if small purchase procedures are used, price or rate quotations shall be obtained from an adequate number of qualified sources.
- (c) Section 128 – a contract may be awarded for supply, service, or construction item without completion when it is determined in writing that there is only one source for the required supply, service, or construction them.

Condition: MISC does not have a formal procurement policy requiring documentation indicating the history of procurement to be maintained on file.

Cause: The cause of the above condition is the lack of established policies and procedures requiring documentation of procurement procedures to ensure compliance with RepMar's Procurement Code.

Effect: The effect of the above condition is the lack of established policies and procedures requiring documentation of procurement procedures to ensure compliance with RepMar's Procurement Code.

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

Prior Year Status: Noncompliance with RepMar's Procurement Code was reported as a finding in the audits of MISC for fiscal years 2007 through 2010.

#### 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 2012

# MARSHALL ISLANDS SHIPPING CORPORATION

Schedule of Findings and Responses, Continued  
Year Ended September 30, 2011

## Finding No. 2011-8

### Local Noncompliance

**Criteria:** The Memorandum of Understanding with Tobolar Copra Processing Authority states the following:

Section 1.5 -The proceeds from said note shall be deposited into a bank account operated by the borrower that shall be only used for copra purchasing.

**Condition:** MISC periodically utilized the account by issuing checks to vendors for purchasing fuel, materials and supplies, and other expenses during fiscal year 2011.

**Cause:** The cause of the above condition is there were insufficient funds in the regular checking account, which is usually used for payments for vendors and payroll.

**Effect:** The effect of the above condition is noncompliance with the Memorandum of Understanding.

**Recommendation:** We recommend that management require that MISC complies with the Memorandum of Understanding. However, this matter appears to have been resolved since the agreement was subsequently terminated on November 1, 2011 and the full amount of the advance from Tobolar of \$100,000 was repaid on December 22, 2011.

### Auditee Response and Corrective Action Plan:

Who: Head Accounting Officer

What: There was instance where the funds from the Special Account were taken out and cashed out for one of the trips to the field, as normal. When the vessel returned and underwent the normal proceedings of having the copra weighed and billed to Tobolar, a check was issued to MISC. However, it was deposited into the Regular Checking in its entirety rather than to the Special Account to replenish the funds used (and the difference would have been deposited to the Regular Account as profit). Since the timing of it was when the General Manager was in Fiji, the Accounting staff was waiting for GM's return to approve the transfer of the funds back from the Regular to the Special account. However, the agreement was subsequently terminated on November 1, 2011 and the full amount of the advance from Tobolar \$100,000 was repaid on December 22, 2011. Such noncompliance was cured by the subsequent repayment and the issue will not be repeated thereafter.

When: Fiscal Year 2012

**MARSHALL ISLANDS SHIPPING CORPORATION**

Schedule of Findings and Responses, Continued  
Year Ended September 30, 2011

Finding No. 2011-9

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, 2011 in a manner inconsistent with the criteria. Specifically, withholding tax returns for the four-week periods ended December 4, 2010, February 25, 2011, May, 21, 2011, and August 13, 2011, were not filed within the 14-day deadline. These returns were filed on March 30, 2011, April 7, 2011, June 8, 2011, and September 9, 2011, respectively. Furthermore, no payments have been made for taxes withheld for the entire fiscal year 2011. At September 30, 2011, MISC was liable to RepMar for income taxes withheld from employee wages in the amount of \$163,801, which represented income taxes withheld for the months of March 2010 through September 2011 plus penalty 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 & procedures are in place to ensure payroll clerk file and pay RMI taxes in a timely manner.

When: Fiscal Year 2012

**MARSHALL ISLANDS SHIPPING CORPORATION**

Schedule of Findings and Responses, Continued  
Year Ended September 30, 2011

Finding No. 2011-10

15) Local Noncompliance

Criteria: 49 MIRC Chapter 1, Social Security Act of 1990, Section 131 state 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, 2011 in a manner inconsistent with the criteria. Specifically, tax returns for the quarters ended March 31, 2011 and September 30, 2011 were not filed within the 10 day deadline. The March 31, 2011 return was filed on April 11, 2011 and payment was made in two installments on July 15 and July 25, 2011. The September 30, 2011 return was filed on October 12, 2011 without payment. At September 30, 2011, MISC was liable to MISSA for employer and employees contributions withheld in the amount of \$129,930, which represents contributions withheld for the months of September 2010 through September 2011 plus penalty 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 of 1990.

Effect: The effect of the above condition is noncompliance with the Social Security Act of 1990.

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 2012

**MARSHALL ISLANDS SHIPPING CORPORATION**

Unresolved Prior Year Findings  
Year Ended September 30, 2011

The status of unresolved prior year findings is disclosed within the schedule of Findings and Responses sections (pages 3 through 14) of this report.