MARSHALL ISLANDS SHIPPING CORPORATION

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

FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT

YEARS ENDED SEPTEMBER 30, 2011 and 2010

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, 2011 and 2010, 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, 2011 and 2010, 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.

The Management's Discussion and Analysis on pages 3 through 9 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of MISC's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit such information and we do not express an opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 29, 2012, 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.

Deloitte + Touche LLP

March 29, 2012

Marshalls Islands Shipping Corporation (MISC) herewith presents a discussion and analysis of the company's financial performance for the financial year ended 30th September 2011. It is to be read in conjunction with the financial statements following this section.

FINANCIAL HIGHLIGHTS

MISC's net assets decreased by $344,131 in 2011 compared to a decrease in net assets of $102,722 in 2010. This decrease in net assets is attributed mainly to a significant decrease in operating revenues as a result of the shortage in MISC's shipping fleet due to several major factors.

In January 2011, MISC faced a major financial and operational loss resulting from the sinking of its only landing craft, Jeljelat AE. The Jeljelat AE was the main source of MISC's charter revenue. With the continued deteriorating conditions of its remaining shipping fleet, MISC was also forced to reduce the number of field trips in 2011 by approximately 35% (excluding the utilization of private shipping vessels) for minor repairs and maintenance services that MISC is able to perform with its existing resources without the need of a dry dock facility. In July 2011, MISC's shipping fleet was further reduced as one of the shipping vessels, Landrik, was taken out of service for approximately two months to undergo major repairs and dry dock services in Fiji.

MISC's total net operating revenue decreased significantly by $452,010 (35%) from $1,296,317 in 2010 compared to $844,307 in 2011. MISC's charter revenue was reduced dramatically by 83% from $277,396 in 2010 to $48,474 in 2011 mainly due to the loss of the landing craft, Jeljelat AE. With the shipping fleet shortages, MISC's cargo revenue and sales of goods revenue also suffered significant financial losses of 23% and 29%, respectively.

Total operating expenses continues to be on a declining trend. Total operating expenses were $2,305,581 in 2011 compared to $2,368,189 in 2010. Overall, MISC decreased its total operating expenses by $62,608 (3%). Although salaries, wages and benefits remain to be MISC's leading operational expense, this cost component was reduced by $123,003 (11%) from $1,127,409 in 2010 compared to $1,004,406 in 2011. The petroleum, oil and lube (POL) expenses continue to be the second leading cost factor for MISC and increased by $41,331 (11%). Despite the decrease in the number of field trips taken, fuel costs during 2011 have been steadily on the rise.

MISC's operating loss increased by $389,402 (36%) from an operating loss of $1,071,872 in 2010 compared to an operating loss of $1,461,274 in 2011. Despite efforts to further reduce its operating expenses during 2011, MISC continues to operate at a loss of approximately $1M to $1.5M annually.

With a shortage in its shipping fleet, MISC expects the operating loss to be a continuing trend for the next couple of years. MISC management expects the operating loss to decrease once its existing shipping fleet has completed required major repairs and services at a dry dock facility. 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. In addition, MISC is also 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.

MISC continues to depend on subsidies from RepMar, which account for approximately 58% of MISC's revenue during 2011. The subsidy received from RepMar in 2011 includes the funding to support the Shipping Vessel Repairs and Maintenance Act. Unless management is able to also increase its shipping rates with the approval of RepMar, 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 2011.

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

	2011	2010	2009
Current and other assets	$ 226,805	$ 317,346	$ 297,548
Capital assets	164,339	228,839	283,767
Total assets	391,144	546,185	581,315
Current liabilities	711,993	522,903	455,311
Net assets:			
Invested in capital assets	164,339	228,839	283,767
Unrestricted	(485,188)	(205,557)	(157,763)
Total net assets (deficiency)	$ (320,849)	$ 23,282	$ 126,004

Total assets decreased from $581,315 in 2009 to $546,185 in 2010 and decreased further to $391,144 in 2011. The decrease in total assets by $35,130 (6%) from 2009 to 2010 is due to an increase in current assets by $19,798 (7%) and a decrease in capital assets by $54,928 (19%). In 2011, the decrease in total assets by $155,041 (28%) is attributed mainly to the decrease in cash by $114,903 (75%) from $153,409 in 2010 to $38,506 in 2011; and a decrease in capital assets by $64,500 (28%) from $228,839 in 2010 to $164,339 in 2011.

Net capital assets decreased from $283,767 in 2009 to $228,839 in 2010 and decreased further to $164,339 in 2011. In 2011, net capital assets decreased by $64,500 (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.

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

Total liabilities increased from $455,311 in 2009 to $522,903 in 2010 and increased further to $711,993 in 2011. The $67,592 (15%) increase in total liabilities from 2009 to 2010 is primarily due to the increase in its payables to affiliates. Total liabilities increased further by $189,090 (36%) again due to the increase in its payables to affiliates.

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

	2011	2010	2009
Revenue:			
Operating Revenue	$ 844,307	$ 1,296,317	$ 1,269,407
Expenses:			
Operating Expenses	2,305,581	2,368,189	2,600,523
Operating Income/Loss	(1,461,271)	(1,071,872)	(1,331,116)
Nonoperating Revenues (Expenses), Net	1,117,143	969,150	1,091,847
Change in Net Assets (Deficiency)	$ (344,131)	$ (102,722)	$ (239,269)

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 increased slightly in 2010 by $26,910 (2%) to a total of $1,296,317 compared to $1,269,407 in 2009. In 2011, MISC's total revenue decreased dramatically by $452,010 (35%) to a total of $844,307. The decrease in revenue for 2011 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 was the main source of charter revenue. In addition to the loss of Jeljelat AE, the number of field trips taken during 2011 also decreased. 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. 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. Finally, MISC only had two shipping vessels in operation towards the end of the 2011 fiscal year. In July 2011, one of MISC's shipping vessels, Landrik, was sent to Fiji for approximately two months to undergo major dry dock repairs and services.

These series of events contributing to MISC's shipping fleet shortages had a significant financial impact on MISC's operating revenues during 2011. Charter revenue decreased by $228,922 (83%) from $277,396 in 2010 to $48,474 in 2011; sales revenue decreased by $116,759 (29%) from $398,196 in 2010 to $281,437 in 2011; and cargo revenue decreased by $107,618 (23%) from $464,088 in 2010 to $356,470 in 2011.

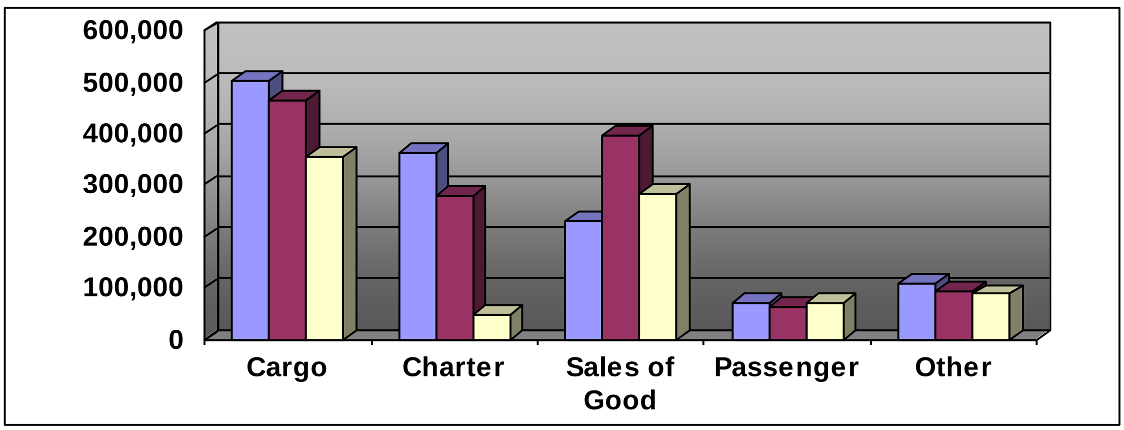
Sale of goods service aboard the shipping vessels to the outer island consumers has been one of MISC's main sources of income to subsidize its operations and was initiated in 2009. As MISC continues to operate with low tariff rates established during the early 1980's and continues to receive declining subsidization funding from RepMar, ship sales provides an alternative source of revenue 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 33%, 31% and 18% of MISC's operating revenue mix in 2011, 2010 and 2009, respectively. The gross margin for the sale of goods increased from 21% to 41% in 2009 and 2010, respectively. In 2011, however, the gross margin for the sale of goods decreased to 23%. It is crucial that MISC review 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 2011 was $1.46M compared to $1.07M and $1.33M in 2010 and 2009, respectively. The decrease in operating loss by $259,244 (19%) in 2010 is primarily due to MISC efforts to reduce its operational costs and its ability to maintain its revenue stream. In 2011, the operating loss increased by $389,402 (36%) due to the MISC shipping fleet shortages.

Operating subsidies of $1,142,446 were received in 2011 compared to $969,150 in 2010 and $1,091,847 in 2009. Of the $1,142,446 subsidy received from RepMar, $297,000 was solely for the purpose of the Shipping Vessel Repairs and Maintenance Act and $845,446 is MISC's operating subsidy.

The operating subsidy received from RepMar in 2010 was reduced by $122,697 (11%) and was further reduced in 2011 by $123,704 (15%). With its current tariff rate structure, MISC is not able 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 2009 through 2011:



MISC's total operating expenses have been on a decreasing trend. Total operating expenses decreased by $232,334 (10%) from $2.60M in 2009 compared to $2.37M in 2010. In 2011, total operating expenses decreased slightly by $62,608 (3%) to $2.30M. Overall, MISC has successfully and consistently been decreasing its total operating expenses.

For 2011, the top five components of operating expenses are: (1) Salaries, Wages and Benefits, (2) Petroleum, Oil and Lube (POL), (3) Cost of Goods Sold (4) Materials and Supplies and (5) Repairs and Maintenance.

Salaries, wages and benefits remain as the leading operational expense and decreased by $41,553 (4%) from $1.17M in 2009 to $1.13M in 2010 and decreased further by $123,003 (11%) to $1.00M in 2011.

POL expenses, on the other hand, decreased by $48,813 (11%) from $434,422 in 2009 to $385,609 in 2010 but increased by $41,331 (11%) to $426,940 in 2011. Despite the decrease in the number of field trips taken during 2011, the increase in POL expenses is an indicator that fuel costs are on the steady rise again. In 2011, there were 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. The fuel costs for the dry dock trip to Fiji is also a driving factor in the increase of POL expenses. The total POL expenses related to the dry dock trip was $43,080.

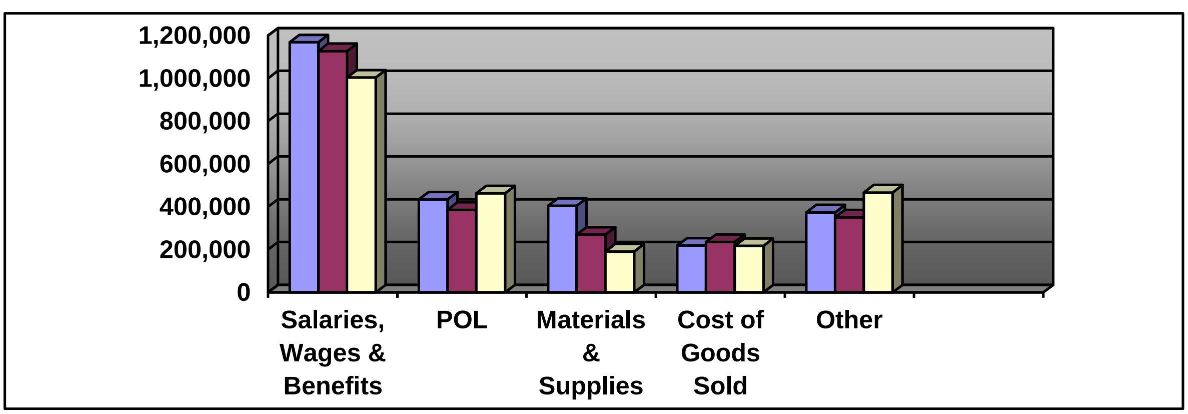
Cost of goods sold (COGS) is an operating expense component introduced in 2009 for the sale of goods service aboard the shipping vessels to the outer island consumers. COGS increased by $15,796 (7%) from $218,989 in 2009 to $234,785 in 2010 and decreased by $18,043 (8%) to $216,742 in 2011.

Materials and supplies expense decreased significantly by $134,798 (33%) from $404,381 in 2009 to $269,583 in 2010 and further decreased by $78,678 (29%) in 2011. 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 decreased by $22,966 (6%) from $373,769 in 2009 to $350,803 in 2010 but increased by $115,785 (33%) in 2011 to $466,588. 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 (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. 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 of MISC's existing shipping fleet have undergone major repairs at a dry dock facility. In 2011, 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 major components of operating expenses from 2009 through 2011:



CAPITAL ASSETS AND DEBT

Net capital assets decreased by $64,500 (28%) in 2011 as a result of the acquisition of motor boats and furniture at a total cost of $22,349 and vehicles costing $19,750 less total depreciation for the year of $81,296 and a disposal loss on equipment and furniture of $25,303.

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

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

CASH FLOWS

Net cash used for operating activities for 2011 was $1.22M compared to net cash used for operating activities of $1.113M in 2010 and $0.99M in 2009. The cash provided by operational activities was absorbed entirely by MISC's operational costs. Additionally, injections of cash flow from RepMar subsidies were received in the amount of $1.14M, $0.97M and $1.09M during 2011, 2010 and 2009, respectively. During 2010 and 2009, RepMar subsidies were utilized by MISC to cover its operational expenses. During 2011, RepMar subsidies were utilized by MISC to cover its operational expenses in the amount of $0.84M and for major repairs and maintenance expenses in the amount $0.30M.

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 $320,849 in 2011. MISC's net assets decreased significantly by $102,722 (82%) from $126,004 in 2009 to $23,282 in 2010 and decreased even further by $344,131 resulting in a net deficiency of $320,849 in 2011. With MISC's declining trend in net assets over the years, the net deficiency status in 2011 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 related expenses necessary to operate the shipping vessels and to provide sea-transportation services. With operating losses over $1M 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 has not increased despite the increase in fuel costs and inflation rates. As a state owned entity, MISC does not have the authority to increase its tariff rates without the approval of RepMar. MISC has made numerous requests to RepMar but has 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. Initiated in 2011, MISC has successfully become a part of the Asian Development Bank (ADB) Technical Assistance supporting the RepMar Public Sector Program. As a result, MISC will have the opportunity to work closely with an ADB consultant in 2012 with sea-transport and financial expertise to develop a three-year strategic plan. In addition, the services of the ADB consultant will be utilized to analyze MISC's financial data to develop a tariff rate template to address fluctuations in fuel costs and inflation rates.

The future outlook on sustainability for MISC is also threatened 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. With the establishment of the Shipping Vessel Repairs and Maintenance Act in 2011, sufficient funding was provided by RepMar to have one of the MISC shipping vessels sent to a dry dock facility in Fiji for a couple of months. Additional funding has also been provided in 2012 to complete the major dry dock repairs and maintenance of MISC's remaining shipping fleet. The Act further requires that sufficient funding be provided by RepMar annually to ensure ongoing and regular repairs and maintenance. 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 on, but not limited to, the following factors:

- Approval from RepMar to increase MISC's tariff rate structure;
- Ongoing receipt 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;
- Seek opportunities to increase 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.

MISC FOCUS IN THE COMING FISCAL YEAR

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

- MISC will submit a proposal and obtain approval from Cabinet to increase 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.

- MISC will seek/recruit assistance from available resources such as ADB and other developing partners to develop a Strategic Plan for MISC. As of 2012, MISC is one of the state owned entities participating in the ADB Technical Assistance (TA) supporting the Public Sector Program. The ADB TA provides an opportunity for MISC management to work closely with an ADB consultant with sea-transport and financial expertise. The outcome of the ADB TA is a development of a 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 one of the shipping vessels was sent to a dry dock facility in Fiji.

- 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 2011. 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, 2011 and 2010

ASSETS	2011	2010
Current assets:		
Cash	$ 38,506	$ 153,409
Receivables:		
Affiliates	132,085	158,197
Trade	17,583	15,904
Employees	9,926	3,341
	159,594	177,442
Less allowance for doubtful accounts	(21,861)	(21,861)
Total receivables, net	137,733	155,581
Inventory	50,566	8,356
Total current assets	226,805	317,346
Equipment, net	164,339	228,839
	$ 391,144	$ 546,185
LIABILITIES AND NET ASSETS (DEFICIENCY)		
Current liabilities:		
Accounts payable	$ 98,602	$ 59,332
Payable to affiliates	351,161	156,148
Copra purchases payable	64,247	100,890
Accrued payroll liabilities	97,983	106,533
Advance from Tobolar	100,000	100,000
Total liabilities	711,993	522,903
Commitment and contingency		
Net assets (deficiency):		
Invested in capital assets	164,339	228,839
Unrestricted	(485,188)	(205,557)
Total net assets (deficiency)	(320,849)	23,282
	$ 391,144	$ 546,185

See accompanying notes to financial statements.

MARSHALL ISLANDS SHIPPING CORPORATION

Statements of Revenues, Expenses and Changes in Net Assets (Deficiency)
Years Ended September 30, 2011 and 2010

	2011	2010
Operating revenues:		
Cargo	$ 356,470	$ 464,088
Ship sales	281,437	398,196
Copra fee	83,375	78,067
Passenger	70,506	63,948
Charter	48,474	277,396
Other	4,045	14,622
Total operating revenues	844,307	1,296,317
Operating expenses:		
Salaries, wages and benefits	1,004,406	1,127,409
Petroleum, oil and lube	426,940	385,609
Cost of goods sold	216,742	234,785
Material and supplies	190,905	269,583
Repairs and maintenance	117,519	6,951
Foodstuffs	85,956	130,961
Depreciation	81,296	84,572
Rent	56,042	42,942
Professional fees	31,635	5,428
Travel and entertainment	22,592	9,847
Utilities	10,992	23,336
Contributions	4,630	4,266
Miscellaneous	55,926	42,500
Total operating expenses	2,305,581	2,368,189
Operating loss	(1,461,274)	(1,071,872)
Nonoperating revenues (expenses):		
Operating subsidies	1,142,446	969,150
Loss on disposal of equipment	(25,303)	-
Total nonoperating revenues (expenses), net	1,117,143	969,150
Change in net assets	(344,131)	(102,722)
Net assets at beginning of year	23,282	126,004
Net assets (deficiency) at end of year	$ (320,849)	$ 23,282

See accompanying notes to financial statements.

MARSHALL ISLANDS SHIPPING CORPORATION

Statements of Cash Flows
Years Ended September 30, 2011 and 2010

	2011	2010
Cash flows from operating activities:		
Cash received from customers	$ 862,155	$ 1,202,532
Cash payments to suppliers for goods and services	(1,067,464)	(1,190,024)
Cash payments to employees for services	(1,009,941)	(1,125,385)
Net cash used for operating activities	(1,215,250)	(1,112,877)
Cash flows from noncapital financing activities:		
RepMar subsidy received	1,142,446	969,150
Advance from Tobolar	-	100,000
Net cash provided by noncapital financing activities	1,142,446	1,069,150
Cash flows from capital and related financing activities:		
Acquisition of capital assets	(42,099)	(29,644)
Net change in cash	(114,903)	(73,371)
Cash at beginning of year	153,409	226,780
Cash at end of year	$ 38,506	$ 153,409
Reconciliation of operating loss to net cash used for operating activities:		
Operating loss	$ (1,461,274)	$ (1,071,872)
Adjustments to reconcile operating loss to net cash used for operating activities:		
Depreciation	81,296	84,572
(Increase) decrease in assets:		
Receivables:		
Affiliates	26,112	(120,743)
Trade	(1,679)	27,132
Employees	(6,585)	(174)
Inventory	(42,210)	616
Increase (decrease) in liabilities:		
Accounts payable	39,270	(20,495)
Payable to affiliates	195,013	85,810
Copra purchases payable	(36,643)	(99,747)
Accrued payroll liabilities	(8,550)	2,024
Net cash used for operating activities	$ (1,215,250)	$ (1,112,877)

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, 2011 and 2010, the carrying amount of cash was $38,506 and $153,409, respectively, and the corresponding bank balances were $70,431 and $139,730, respectively, which were maintained in a financial institution subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2011 and 2010, 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, 2011 and 2010, the accumulated vacation leave liability totals $67,250 and $69,779, 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 fiscal year 2011, MISC implemented the following pronouncements:

- GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, which enhances the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions.

- GASB Statement No. 59, *Financial Instruments Omnibus,* which updates and improves existing standards regarding financial reporting of certain financial instruments and external investments pools.

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

In December 2009, GASB issued 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 measurement of OPEB obligations by certain employers participating in agent multiple-employer OPEB plans. The provisions of Statement 57 related to the use and reporting of the alternative measurement method are effective immediately. The provisions related to the frequency and timing of measurements are effective for actuarial valuations first used to report funded status information in OPEB plan financial statements for periods beginning after June 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. 60, *Accounting and Financial Reporting for Service Concession Arrangement*, 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.

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 Financial Accounting Standards Board (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 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. 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 provisions of this statement are effective for periods beginning after June 15, 2011. Management does not believe that the implementation of this statement will have a material effect 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, 2011 and 2010 is as follows:

	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

	2010			
	October 1, 2009	Additions	Retirements	September 30, 2010
Equipment	$ 300,369	$ 4,717	$ -	$ 305,086
Vehicles	108,949	14,623	-	123,572
Furniture	8,495	1,366	-	9,861
Motor boats	14,000	8,938	-	22,938
	431,813	29,644	-	461,457
Less accumulated depreciation	(148,046)	(84,572)	-	(232,618)
	$ 283,767	$ (54,928)	$ -	$ 228,839

(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, 2011 and 2010 is as follows:

	2011			
	Revenues	Expenses	Receivables	Payables
Tobolar	$ 210,629	$ -	$ 96,929	$ -
Marshall Islands Social Security Administration	-	189,168	-	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	$ 566,644	$ 132,085	$ 351,161

	2010			
	Revenues	Expenses	Receivables	Payables
Tobolar	$ 444,545	$ -	$ 138,116	$ -
Marshall Islands Social Security Administration	-	209,376	-	74,250
Marshalls Energy Company, Inc.	_-	317,607	-	7,858
Majuro Water and Sewer Company, Inc.	-	6,483	-	1,200
Republic of the Marshall Islands	57,645	17,761	20,081	55,399
Other	1,089	49,487	-	17,441
	$ 503,279	$ 600,714	$ 158,197	$ 156,148

During the years ended September 30, 2011 and 2010, the operations of MISC were funded by appropriations, totaling $1,142,446 and $969,150, 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, 2011 and 2010, MISC recorded rent expense associated with these leases of $46,034 and $40,714, respectively.

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

Year ending September 30,	
2012	$ 43,105
2013	43,105
2014	29,046
	$ 115,256

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, 2012, RepMar appropriated $1,407,596 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.