

MAJURO WATER AND SEWER COMPANY, INC.

FINANCIAL STATEMENTS  
AND  
INDEPENDENT AUDITORS' REPORT

YEARS ENDED SEPTEMBER 30, 2003 AND 2002

INDEPENDENT AUDITORS' REPORT

Board of Directors  
Majuro Water and Sewer Company, Inc.:

We have audited the accompanying statements of net assets of Majuro Water and Sewer Company, Inc. (MWSC), a component unit of the Republic of the Marshall Islands, as of September 30, 2003 and 2002, and the related statements of revenue, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of MWSC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

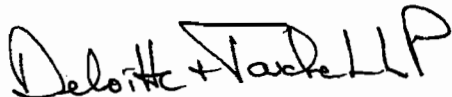
We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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, such financial statements present fairly, in all material respects, the financial position of MWSC as of September 30, 2003 and 2002, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As described in note 2 to the accompanying financial statements, MWSC adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*.

The Management's Discussion and Analysis on pages 3 through 5 is not a required part of the basic financial statements but is supplementary information required by GASB. 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 the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 16, 2004, on our consideration of MWSC's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

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

February 16, 2004

# MAJURO WATER AND SEWER COMPANY, INC.

## Management's Discussion and Analysis Year Ended September 30, 2003

This section of the Majuro Water and Sewer Company, Inc. (MWSC) annual financial report presents our discussion and analysis of MWSC's financial performance during the fiscal year that ended on September 30, 2003. Please read it in conjunction with the financial statements, which follow this section.

### FINANCIAL HIGHLIGHTS

MWSC's net assets decreased by \$1,720 or 0.5% from \$(334,031) in 2002 to \$(335,751) in 2003. Operating revenues increased by \$13,011 or 1.1% from \$1,147,585 in 2002 to \$1,160,596 in 2003. Within operating revenues, utility billings decreased by \$107,629 or 10.4% from \$1,038,191 in 2002 to \$930,562 in 2003 as a result of supply side constraints in the availability of water for sale. This was offset by an increase in water deliveries and hook-ups of \$92,701 or 101.4% from \$91,459 in 2002 to \$184,160 in 2003. This was primarily the result of increased demand from fishing vessels at the Majuro port. Operating expenses decreased by \$68,682 or 5.6% from \$1,235,944 in 2002 to \$1,167,262 in 2003 reflecting management's strict adherence to budgetary controls and commitment to live within tight cash flow constraints. Operating subsidies from the General Fund of the Republic of the Marshall Islands (RepMar) decreased by \$1,415,741 or 96.7% from \$1,464,493 in 2002 to \$48,752 in 2003.

### FINANCIAL ANALYSIS OF MWSC

The Statement of Net Assets (page 6) and the Statement of Revenues, Expenses and Changes in Net Assets (page 7) provide an indication of MWSC's financial condition. MWSC's net assets reflect the difference between assets and liabilities. An increase in net assets over time typically indicates an improvement in financial condition.

A summary of MWSC's Statement of Net Assets is presented below:

	<u>2003</u>	<u>2002</u>
Current and other assets	\$ 499,936	\$ 638,521
Capital assets	<u>92,949</u>	<u>47,738</u>
Total assets	<u>592,885</u>	<u>686,259</u>
Noncurrent liabilities	366,713	-
Current liabilities	<u>561,923</u>	<u>1,020,290</u>
Total liabilities	<u>928,636</u>	<u>1,020,290</u>
Net assets:		
Invested in capital assets	92,949	47,738
Unrestricted	<u>(428,700)</u>	<u>(381,769)</u>
Total net assets	<u>\$ (335,751)</u>	<u>\$ (334,031)</u>

As indicated above, total assets decreased by \$93,374 or 13.6% from \$686,259 in 2002 to \$592,885 in 2003. This is comprised of a decrease of \$138,585 in current and other assets and an increase of \$45,211 in capital assets. The decrease in current and other assets reflects increased collections of utility receivables.

Total liabilities reflect a decrease of \$91,654 or 9.0% from \$1,020,290 in 2002 to \$928,636 in 2003. This decrease reflects improved cash collections resulting in MWSC being able to settle certain delinquent liabilities owed to both RepMar and the Marshall Islands Social Security Administration (MISSA).

**MAJURO WATER AND SEWER COMPANY, INC.**

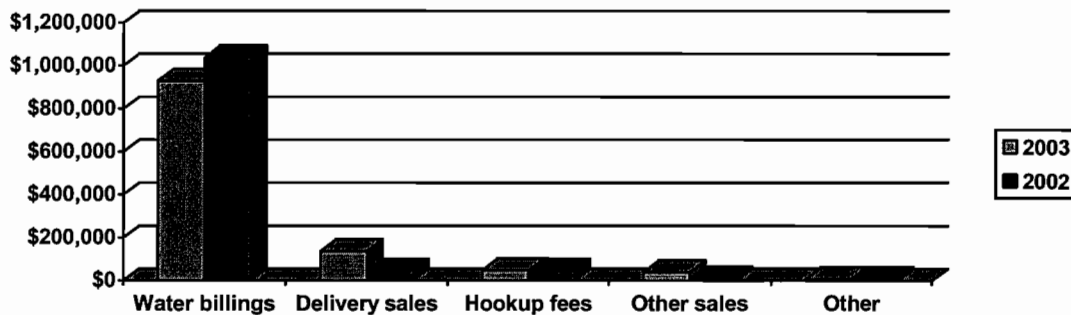
**Management's Discussion and Analysis, Continued  
Year Ended September 30, 2003**

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

	<u>2003</u>	<u>2002</u>
Revenues:		
Operating revenues	\$ 1,160,596	\$ 1,147,585
Nonoperating revenues	<u>48,752</u>	<u>1,715,756</u>
Total revenues	<u>1,209,348</u>	<u>2,863,341</u>
Expenses:		
Operating expenses	1,167,262	1,235,944
Nonoperating expenses	<u>43,806</u>	<u>201,575</u>
Total expenses	<u>1,211,068</u>	<u>1,437,519</u>
Income (loss) before capital contributions	(1,720)	1,425,822
Capital contributions - gain on forgiveness of debt	<u>-</u>	<u>1,474,986</u>
Change in net assets	<u>\$ (1,720)</u>	<u>\$ 2,900,808</u>

The Statement of Revenues, Expenses and Changes in Net Assets identifies the various revenue and expense items that impact the change in net assets. As indicated above, MWSC's total revenues decreased by \$1,653,993 or 57.8% from \$2,863,341 in 2002 to \$1,209,348 in 2003. This decrease reflects a reduction in operating subsidies received by MWSC from the General Fund of RepMar.

The graph below shows the major components of operating revenues for 2003 compared with 2002:

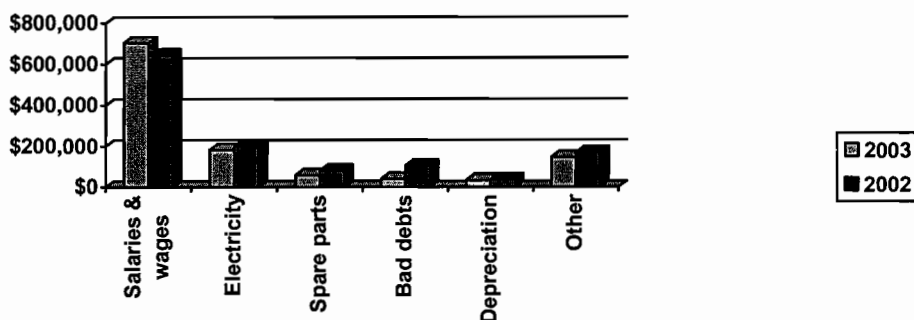


Total expenses decreased by \$226,451 or 15.8% from \$1,437,519 in 2002 to \$1,211,068 in 2003. This was the result of a decrease in penalties and interest expenses relating to certain delinquent taxes payable to RepMar and MISSA. On February 7, 2003, MWSC entered into a promissory note agreement with MISSA whereby MWSC pays \$10,000 per month, inclusive of interest, to liquidate a prior delinquent liability of \$427,950 for Social Security and Health Fund taxes. This arrangement, on which MWSC remains current, has allowed for significant reductions in yearly accruals for penalties and interest.

## MAJURO WATER AND SEWER COMPANY, INC.

### Management's Discussion and Analysis, Continued Year Ended September 30, 2003

The graph below shows the major components of operating expenses for 2003 compared with 2002:



### CAPITAL ASSETS

Net capital assets increased by \$45,211 in 2003 primarily as a result of the acquisition of motor vehicles and machinery and equipment. A summary of MWSC's capital assets is presented below:

	<u>2003</u>	<u>2002</u>
Motor vehicles	\$ 137,904	\$ 123,733
Machinery and equipment	103,387	66,772
Office equipment	94,346	82,950
Buildings and leasehold improvements	<u>54,317</u>	<u>54,317</u>
	389,954	327,772
Less accumulated depreciation	<u>(297,005)</u>	<u>(280,034)</u>
	<u>\$ 92,949</u>	<u>\$ 47,738</u>

### ECONOMIC FACTORS AND NEXT YEAR'S RATES

MWSC will continue to monitor operating expenses under tight fiscal constraints and maintain a tight control over utility receivables in order to improve cash collections. MWSC does not anticipate any changes in its water tariffs. The ongoing viability of MWSC as a going concern will continue to be dependent upon future financial support of RepMar, compensation by RepMar for the cost of actual utility service provided, the collection of long outstanding utility receivables, and/or significant improvements in operations.

### ADDITIONAL FINANCIAL INFORMATION

This discussion and analysis is designed to provide MWSC's customers and other interested parties with an overview of MWSC's financial operations and financial condition. Should the reader have questions regarding the information included in this report or wish to request additional financial information, please contact the Majuro Water and Sewer Company, Inc. General Manager at P.O. Box 1751, Majuro MH 96960.

**MAJURO WATER AND SEWER COMPANY, INC.**

Statements of Net Assets  
September 30, 2003 and 2002

<u>ASSETS</u>	<u>2003</u>	<u>2002</u>
Current assets:		
Cash	\$ 43,971	\$ 81,221
Receivables:		
Utility	1,301,478	1,557,060
Affiliates	432,343	397,592
Other	11,442	12,297
	<u>1,745,263</u>	<u>1,966,949</u>
Less allowance for doubtful accounts	<u>(1,429,576)</u>	<u>(1,506,837)</u>
	<u>315,687</u>	<u>460,112</u>
Inventory	<u>138,238</u>	<u>92,451</u>
Prepaid expenses	<u>2,040</u>	<u>4,737</u>
Total current assets	499,936	638,521
Plant and equipment, net	<u>92,949</u>	<u>47,738</u>
	<u>\$ 592,885</u>	<u>\$ 686,259</u>
 <u>LIABILITIES AND NET ASSETS</u> 		
Current liabilities:		
Accounts payable	\$ 36,599	\$ 53,218
Social security taxes payable	121,806	492,950
Withholding taxes payable	89,735	234,632
Payable to affiliates	258,013	191,923
Other accrued liabilities	55,770	47,567
Total current liabilities	<u>561,923</u>	<u>1,020,290</u>
Noncurrent liabilities:		
Social security taxes payable	281,283	-
Withholding taxes payable	85,430	-
Total noncurrent liabilities	<u>366,713</u>	<u>-</u>
Total liabilities	<u>928,636</u>	<u>1,020,290</u>
Commitment and contingency		
Net assets:		
Investment in capital assets	92,949	47,738
Unrestricted	<u>(428,700)</u>	<u>(381,769)</u>
Total net assets	<u>(335,751)</u>	<u>(334,031)</u>
	<u>\$ 592,885</u>	<u>\$ 686,259</u>

See accompanying notes to financial statements.

**MAJURO WATER AND SEWER COMPANY, INC.**

Statements of Revenues, Expenses and Changes in Net Assets  
Years Ended September 30, 2003 and 2002

	2003	2002
Operating revenues:		
Utility billings	\$ 930,562	\$ 1,038,191
Hook-up and deliveries	184,160	91,459
Other	45,874	17,935
Total operating revenues	1,160,596	1,147,585
Operating expenses:		
Salaries, wages and benefits	705,542	643,609
Electricity	182,906	199,332
Spare parts	58,685	81,697
Bad debts	40,021	105,317
Depreciation and amortization	33,904	38,029
Petroleum, oil and lubricants	30,725	28,566
Communications	27,063	24,331
Office supplies	14,141	16,241
Insurance	13,661	18,762
Travel	9,347	4,207
Repairs and maintenance	3,876	2,484
Chlorine	2,150	15,411
Uniforms	1,042	10,176
Contractual services	500	8,167
Miscellaneous	43,699	39,615
Total operating expenses	1,167,262	1,235,944
Operating loss	(6,666)	(88,359)
Nonoperating revenues (expenses):		
Operating subsidy from RepMar	48,752	1,464,493
Gain on forgiveness of debt	-	251,263
Income tax and MISSA penalties and interest	(43,806)	(201,185)
Interest expense	-	(390)
Total nonoperating revenues (expenses), net	4,946	1,514,181
(Loss) income before capital contributions	(1,720)	1,425,822
Capital contributions:		
Gain on forgiveness of debt	-	1,474,986
Change in net assets	(1,720)	2,900,808
Net assets at beginning of year	(334,031)	(3,234,839)
Net assets at end of year	\$ (335,751)	\$ (334,031)

See accompanying notes to financial statements.

**MAJURO WATER AND SEWER COMPANY, INC.**

Statements of Cash Flows  
Years Ended September 30, 2003 and 2002

	2003	2002
Cash flows from operating activities:		
Cash received from customers	\$ 1,265,000	\$ 905,957
Cash payments to suppliers for goods and services	(530,742)	(761,134)
Cash payments to employees for services	(697,339)	(639,987)
Net cash provided by (used for) operating activities	36,919	(495,164)
Cash flows from noncapital financing activities:		
Operating subsidy from RepMar	48,752	750,000
Interest paid	(43,806)	(201,575)
Net cash provided by noncapital financing activities	4,946	548,425
Cash flows from capital and related financing activities:		
Acquisition of capital assets	(79,115)	(15,017)
Net cash used for capital and related financing activities	(79,115)	(15,017)
Net (decrease) increase in cash	(37,250)	38,244
Cash at beginning of year	81,221	42,977
Cash at end of year	\$ 43,971	\$ 81,221
Reconciliation of operating loss to net cash used for operating activities:		
Operating loss	\$ (6,666)	\$ (88,359)
Adjustments to reconcile operating loss to net cash provided by (used for) operating activities:		
Depreciation and amortization	33,904	38,029
Bad debts	40,021	105,317
(Increase) decrease in assets:		
Receivables:		
Utility	138,300	(68,865)
Affiliates	(34,751)	(172,456)
Other	855	(307)
Inventory	(45,787)	29,748
Prepaid expenses	2,697	(3,281)
Increase (decrease) in liabilities:		
Accounts payable	(16,619)	(34,730)
Payable to affiliates	(83,238)	(303,882)
Other accrued liabilities	8,203	3,622
Net cash provided by (used for) operating activities	\$ 36,919	\$ (495,164)

See accompanying notes to financial statements.

**MAJURO WATER AND SEWER COMPANY, INC.**

Statements of Cash Flows, Continued  
Years Ended September 30, 2003 and 2002

	<u>2003</u>	<u>2002</u>
Supplemental schedule of noncash capital and related financing activities:		
RepMar and MWSC entered into agreements which forgave loans and interest payable and transferred related water system infrastructure to RepMar.		
Decrease in water system infrastructure, net	\$ -	\$ (8,375,638)
Decrease in loans payable	-	8,540,756
Decrease in interest payable	-	2,275,624
Increase in gain on forgiveness of debt	-	(1,726,249)
Increase in operating subsidy from RepMar	-	(714,493)
	<u>                    </u>	<u>                    </u>
	\$ -	\$ -

See accompanying notes to financial statements.

## MAJURO WATER AND SEWER COMPANY, INC.

Notes to Financial Statements  
September 30, 2003 and 2002

### (1) Organization

Majuro Water and Sewer Company, Inc. (MWSC) was granted a corporate charter by the Cabinet of the Republic of the Marshall Islands (RepMar) on January 26, 1989. MWSC's principal lines of business are predominantly the collection and distribution of fresh water and wastewater. The principal markets for the collection and distribution of fresh water and wastewater are government agencies, businesses and residential customers located on the atoll of Majuro.

An exclusive franchise to construct, maintain and operate the fresh water, waste water and sewer system within Majuro Atoll was granted to MWSC by RepMar on March 9, 1989. Simultaneously, RepMar leased to MWSC, at no cost, the Majuro Atoll fresh water, waste water and sewer system. The term of both the lease and the franchise was for a ten year period commencing on March 9, 1989, and was to continue thereafter unless terminated by either party six months after written notice to the other.

On February 19, 2003, RepMar and MWSC entered into a Water and Sewer Franchise Agreement (the Agreement) to provide water and sewer service to the atoll of Majuro. The Agreement incorporates a lease agreement for MWSC to lease from RepMar the water and sewer system for a period of ten years at a rate of \$100,000 per annum, commencing three years after the lease is in effect (February 19, 2006). The Agreement also forgave loans related to the construction of the water and sewer system and transferred the water system infrastructure to RepMar. RepMar and MWSC elected to record the forgiveness of these loans, and the related transfer of the water and sewer system asset from MWSC to RepMar, during the year ended September 30, 2002.

MWSC's financial statements are incorporated into the general purpose financial statements of RepMar as a component unit.

### (2) Summary of Significant Accounting Policies

The accounting policies of MWSC 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. MWSC has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

#### 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.

# MAJURO WATER AND SEWER COMPANY, INC.

Notes to Financial Statements  
September 30, 2003 and 2002

## (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 statements 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.

### Cash

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, 2003 and 2002, cash was \$43,971 and \$81,221, respectively, and the corresponding bank balances were \$59,949 and \$75,990, respectively, which are maintained in two financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2003 and 2002, bank deposits were fully FDIC insured.

### Receivables

All receivables are due from government agencies, businesses and individuals located within the Republic of the Marshall Islands and are interest free and uncollateralized. 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 evaluations of the collectibility of these accounts and prior collection experience. The allowance is established through a provision for bad debts charged to expense.

### Inventory

Inventory is valued at the lower of cost (first-in, first-out) or market (net realizable value).

### Plant and Equipment

Plant and equipment are stated at cost. Depreciation of plant and equipment and amortization of leasehold improvements are calculated on the straight-line method based on the estimated useful lives of the respective assets. The estimated useful lives of these assets are as follows:

Vehicles	2 - 4 years
Office equipment	3 - 8 years
Buildings and leasehold improvements	4 years
Machinery and equipment	5 - 10 years

### 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 revenue tax of 3% on revenues. Pursuant to the Income Tax Act of 1989, as amended, sales of water and sewer services by public utility companies are exempt from gross revenue tax. Accordingly, MWSC is exempt from this tax relating to gross revenue from sales of water and sewer services.

# MAJURO WATER AND SEWER COMPANY, INC.

Notes to Financial Statements  
September 30, 2003 and 2002

## (2) Summary of Significant Accounting Policies, Continued

### New Accounting Standards

GASB has issued Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, which was subsequently amended by Statement No. 37, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, and modified by Statement No. 38, *Certain Financial Statement Disclosures*. These statements 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. MWSC is required to adopt GASB Statement No. 34, as amended by GASB Statement No. 37, and certain provisions of GASB Statement No. 38 in fiscal year 2003.

To conform to the requirements of GASB 34, the following changes have been made to MWSC's financial statements:

- Retained earnings have been reclassified into the following net assets categories:
  - Investment 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.
- The statement of cash flows has been presented using the direct method.

## (3) Risk Management

MWSC 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. MWSC has elected not to purchase commercial insurance for the risks of loss to which it is exposed. Instead, MWSC believes it is more economical to manage its risks internally. Claims expenses and liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. No losses as a result of these risks have occurred in any of the past three years.

**MAJURO WATER AND SEWER COMPANY, INC.**

Notes to Financial Statements  
September 30, 2003 and 2002

(4) Capital Assets

Capital asset activity for the years ended September 30, 2003 and 2002, was as follows:

	2003			
	October 1, <u>2002</u>	<u>Additions</u>	<u>Retirements</u>	September 30, <u>2003</u>
Vehicles	\$ 123,733	\$ 31,104	\$ (16,933)	\$ 137,904
Machinery and equipment	66,772	36,615	-	103,387
Office equipment	82,950	11,396	-	94,346
Buildings and leasehold improvements	<u>54,317</u>	<u>-</u>	<u>-</u>	<u>54,317</u>
	327,772	79,115	(16,933)	389,954
Less accumulated depreciation and amortization	<u>(280,034)</u>	<u>(33,904)</u>	<u>16,933</u>	<u>(297,005)</u>
	<u>\$ 47,738</u>	<u>\$ 45,211</u>	<u>\$ -</u>	<u>\$ 92,949</u>
	2002			
	October 1, <u>2001</u>	<u>Additions</u>	<u>Retirements</u>	September 30, <u>2002</u>
Vehicles	\$ 123,733	\$ -	\$ -	\$ 123,733
Machinery and equipment	53,995	12,777	-	66,772
Office equipment	80,710	2,240	-	82,950
Buildings and leasehold improvements	54,317	-	-	54,317
Water system infrastructure	<u>9,110,479</u>	<u>-</u>	<u>(9,110,479)</u>	<u>-</u>
	9,423,234	15,017	(9,110,479)	327,772
Less accumulated depreciation and amortization	<u>(976,846)</u>	<u>(38,029)</u>	<u>734,841</u>	<u>(280,034)</u>
	<u>\$ 8,446,388</u>	<u>\$ (23,012)</u>	<u>\$ (8,375,638)</u>	<u>\$ 47,738</u>

RepMar and MWSC entered into a Water and Sewer System Franchise Agreement which transferred the water system infrastructure, and cancelled related loan agreements to RepMar. Management of MWSC and RepMar have elected to record this transaction during the year ended September 30, 2002. As such, \$7,826,263 of principal and \$2,024,361 of related accrued interest, less \$8,375,638 of net water system infrastructure, has been recorded as gain from forgiveness of debt, for the year ended September 30, 2002, in the accompanying financial statements.

# MAJURO WATER AND SEWER COMPANY, INC.

Notes to Financial Statements  
September 30, 2003 and 2002

## (5) Loans Payable

### Majuro Water Supply Project ADB Loan #1

On March 24, 1994, the Board of Directors of MWSC obtained a loan from RepMar in an amount equivalent to 503,000 Special Drawing Rights, from which MWSC had drawn \$714,493 against this loan.

RepMar Cabinet Minute 248 (2000) forgave the loan principal through a transfer to MWSC. Management of MWSC and RepMar elected to record this transfer during the year ended September 30, 2002. As such, in 2002, \$714,493 has been recorded as an operating subsidy from RepMar, and \$251,263 of related accrued interest has been recorded as gain from forgiveness of debt.

### Majuro Water Supply Project ADB Loan #2

On September 18, 1996, the Board of Directors of MWSC obtained another loan from RepMar in an amount equivalent to 6,062,000 Special Drawing Rights, from which MWSC had drawn \$7,826,263 against this loan.

RepMar and MWSC entered into a Water and Sewer System Franchise Agreement which cancelled the loan agreement and transferred the related water system infrastructure to RepMar. Management of MWSC and RepMar elected to record this transaction during the year ended September 30, 2002. As such, \$7,826,263 of principal and \$2,024,361 of related accrued interest, less \$8,375,638 of net water system infrastructure, have been recorded as gain from forgiveness of debt in 2002.

## (6) Social Security Taxes Payable

At September 30, 2003 and 2002, MWSC was liable for taxes payable to the Marshall Islands Social Security Administration (MISSA) in the amount of \$403,089 and \$492,950, respectively. On February 7, 2003, MWSC and MISSA entered into a promissory note for the repayment of certain delinquent taxes payable in the amount of \$427,774. The terms of the agreement include monthly payments of \$10,000, inclusive of interest at 12% per annum, commencing March 30, 2003.

Future repayment commitments under this arrangement are as follows:

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2004	\$ 80,906	\$ 39,094	\$ 120,000
2005	91,153	28,847	120,000
2006	102,713	17,287	120,000
2007	<u>87,417</u>	<u>4,521</u>	<u>91,938</u>
	\$ <u>362,189</u>	\$ <u>89,749</u>	\$ <u>451,938</u>

## MAJURO WATER AND SEWER COMPANY, INC.

Notes to Financial Statements  
September 30, 2003 and 2002

### (7) Withholding Taxes Payable

At September 30, 2003 and 2002, MWSC was liable for withholding taxes payable to RepMar in the amount of \$175,165 and \$234,632, respectively. On October 5, 2003, MWSC entered into a promissory note agreement for the repayment of certain delinquent taxes payable in the amount of \$138,601. The terms of the agreement include interest at 6% per annum to be repaid over a period of twenty-four months commencing October 30, 2003. MWSC has elected to reflect the impact of this transaction within the accompanying financial statements.

Future repayment commitments under this arrangement are as follows:

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2004	\$ 53,171	\$ 35,052	\$ 88,223
2005	<u>85,430</u>	<u>2,793</u>	<u>88,223</u>
	<u>\$ 138,601</u>	<u>\$ 37,845</u>	<u>\$ 176,446</u>

### (8) Related Party Transactions

MWSC is wholly-owned by the Marshall Islands Development Authority (MIDA), a component unit of RepMar, and is therefore affiliated with all RepMar-owned and affiliated entities.

MWSC's utility service is provided to RepMar and all RepMar-owned and affiliated entities. Services are extended to these entities at the same terms and conditions provided to third parties.

MWSC utilizes services from certain affiliated entities at substantially more favorable terms and conditions than those incurred from third parties.

A summary of related party transactions for the years ended September 30, 2003 and 2002, and related receivable and payable balances as of September 30, 2003 and 2002, is as follows:

	<u>2003</u>			
	<u>Revenues</u>	<u>Expenses</u>	<u>Receivables</u>	<u>Payables</u>
RepMar	\$ 103,674	\$ 103,217	\$ 237,176	\$ 175,165
Marshalls Energy Company, Inc.	46,643	102,651	36,481	254,672
Marshall Islands National Telecommunications Authority	13,392	15,582	17,994	3,341
Marshall Islands Social Security Administration	992	164,353	49,091	403,089
Majuro Resort, Inc.	39,491	4,009	40,215	-
Other	<u>49,695</u>	<u>11,035</u>	<u>51,386</u>	<u>-</u>
	<u>\$ 253,887</u>	<u>\$ 400,847</u>	<u>\$ 432,343</u>	<u>\$ 836,267</u>

**MAJURO WATER AND SEWER COMPANY, INC.**

Notes to Financial Statements  
September 30, 2003 and 2002

(8) Related Party Transactions, Continued

	2002			
	Revenues	Expenses	Receivables	Payables
RepMar	\$ 101,624	\$ 40,260	\$ 374,897	\$ 234,632
Marshall's Energy Company, Inc.	4,066	201,249	3,449	173,548
Marshall Islands National Telecommunications Authority	10,362	13,191	995	1,716
Marshall Islands Social Security Administration	6,615	216,973	413	492,950
Majuro Resort, Inc.	40,673	4,487	6,534	-
Other	<u>35,561</u>	<u>9,894</u>	<u>11,304</u>	<u>16,659</u>
	<u>\$ 198,901</u>	<u>\$ 486,054</u>	<u>\$ 397,592</u>	<u>\$ 919,505</u>

Receivables from and payables to affiliates are uncollateralized, interest free and have no set repayment terms.

(9) Commitment

On February 19, 2003, RepMar and MWSC entered into a franchise agreement to provide water and sewer service to the atoll of Majuro. The agreement incorporates a lease agreement for MWSC to lease from RepMar the water and sewer system for a period of ten years at a rate of \$100,000 per annum, commencing three years after the lease is in effect (February 19, 2006).

Total future minimum lease payments for subsequent years ending September 30, are as follows:

<u>Year ending</u> <u>September 30,</u>	
2004	\$ -
2005	-
2006	66,667
2007	100,000
2008	100,000
2009 - 2013	500,000
2014 - 2016	<u>233,333</u>
	<u>\$ 1,000,000</u>

(10) Contingency

MWSC has incurred losses from operations of \$6,666 and \$88,359 during the years ended September 30, 2003 and 2002, respectively, and as of those dates, has working capital deficiencies of \$147,417 and \$381,769, respectively, and deficits of \$335,751 and \$334,031, respectively. MWSC received cash subsidies from RepMar during the years ended September 30, 2003 and 2002 of \$48,752 and \$750,000, respectively. Management believes that the continuation of MWSC's operations is dependent upon the future financial support of RepMar, compensation by RepMar for the cost of actual utility service provided, the collection of long outstanding utility receivables, and/or significant improvements in operations.