MARSHALLS ENERGY COMPANY, INC.

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

FINANCIAL STATEMENTS, ADDITIONAL INFORMATION AND INDEPENDENT AUDITORS' REPORT

YEARS ENDED SEPTEMBER 30, 2011 AND 2010

Deloitte.

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INDEPENDENT AUDITORS' REPORT

Board of Directors
Marshalls Energy Company, Inc.:

We have audited the accompanying statements of net deficiency of Marshalls Energy Company, Inc. (MEC), a component unit of the Republic of the Marshall Islands, as of September 30, 2011 and 2010, and the related statements of revenues, expenses and changes in net deficiency and of cash flows for the years then ended. These financial statements are the responsibility of MEC'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 MEC'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 above present fairly, in all material respects, the financial position of MEC as of September 30, 2011 and 2010, and the changes in its net deficiency and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 15, 2012, on our consideration of MEC's 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.

The Management's Discussion and Analysis on pages 3 through 10 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 MEC'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 the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements of MEC taken as a whole. The accompanying Schedule of Revenues, Expenses and Changes in Net Deficiency by Source for the year ended September 30, 2011 (page 27) is presented for purposes of additional analysis and is not a required part of the basic financial statements of MEC. This schedule is the responsibility of MEC's management. Such information has been subjected to the auditing procedures applied in our audit of the basic financial statements for the year ended September 30, 2011 and, in our opinion, is fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

Deloitte + Touche LLP

August 15, 2012

Marshalls Energy Company, Inc. (MEC) herewith presents a discussion and analysis of the company's financial performance for the financial year ended September 30, 2011. It is to be read in conjunction with the financial statements following this section.

FINANCIAL HIGHLIGHTS

MEC's net assets decreased by $1.21 million in 2011 compared to a decrease of $1.36 million in 2010. This decrease in net assets is attributed to the following factors:

- Increase in provision for doubtful accounts by $1.10 million
- Increase in fuel prices
- Overall increase in the tariff rates by 28%

In 2011, total net utility operating revenues were $18.05 million, an increase of $3.08 million in comparison to $14.97 million in net utility operating revenues in 2010. The increase in utility revenue is attributable to the increase in tariffs, which is a result of the increase in world fuel prices, and a whole year effect of the tariff template increase of 22%, which was implemented in March 2010.

Total utility operating expenses were $20.30 million and $17.90 million in 2011 and 2010, respectively. The increase in the amount of $2.40 million is attributed to the fuel cost component and is in line with expectations due to the increase in world fuel prices. The increase in fuel costs to MEC meant an increase in fuel and lubricant costs used for generation. The most significant component of generation operating costs continues to be fuel and lubricants, the cost of which for 2011 represented 64% of total generation costs compared to 62% in 2010.

Total net operating revenues for non-utility operations, fuel sales being the major component, were $27.26 million and $19.77 million in 2011 and 2010, respectively. Total non-utility operating expenses increased by $7.28 million, with $25.78 million and $18.50 million in 2011 and 2010, respectively. This significant increase is a result of an increase in fuel sales by 38%. In addition, this is a positive indicator that MEC is able to maintain pricing competitiveness and increase market share despite stiff competition in the high seas market.

Slight decrease in net deficiency is a result of overall efficiency and effectiveness experienced during the year.

No grants were received by MEC throughout 2011; however, MEC received subsidies of $0.86 million in 2011 compared to subsidies of $0.93 million in 2010. Without any grant funding to prop up MEC's financial position, together with under recovery of cost in its tariff structure, resulted in a decrease in total assets for 2011. Subsidy received during the year from RepMar in the amount of $0.86 million is cost recovery for the operations of Wotje and Jaluit power plants.

It is also important to mention that the audit performed for year ended September 30, 2011 continued to be impacted by several factors:

1.) MEC migrated to a new financial and accounting system – Sage Software (MIP) and a new billing system - Able Software (UTP), which was implemented in June 2011. Following are several challenges experienced by MEC management.

    - Migration to new accounting software was done on the first day of the fiscal year, while the billing system was implemented during the fiscal year in June 2011.

    - The necessary system reconciliations were not completed, thereby resulting in additional workload, process inefficiencies and higher risk of exposure for financial statement misstatement.

2.) MEC continues to go through its reform efforts with major changes in key management positions and creation of new positions to address the demand of the organization's evolving needs.

3.) MEC has also implemented its Comprehensive Recovery Plan – a three year revolving plan, in which its aim is to fundamentally reform MEC.

FINANCIAL ANALYSIS OF MEC

The Statement of Net Deficiency and the Statement of Revenues, Expenses and Changes in Net Deficiency provide an indication of MEC's financial condition. MEC's net deficiency reflects the difference between total assets and total liabilities. A decrease in net deficiency over time normally indicates an improvement in financial condition. As illustrated in the figures below, MEC's net deficiency increased for the year ended September 30, 2011.

The Summary Statement of Net Deficiency for MEC is presented below:

	2011	2010	2009
Current and other assets	$ 16,283,319	$ 7,335,348	$ 11,262,802
Capital assets	7,657,924	8,721,864	8,840,097
Total assets	23,941,243	16,057,212	20,102,899
Current liabilities	22,415,766	13,393,374	15,488,339
Non-current liabilities	13,925,892	13,858,805	14,445,281
Total liabilities	36,341,658	27,252,179	29,933,620
Net assets:			
Invested in capital assets	2,041,690	2,394,234	1,844,155
Deficiency	(14,442,105)	(13,589,201)	(11,674,876)
Total net deficiency	$ (12,400,414)	$ (11,194,967)	$ (9,830,721)

Total assets decreased from $20.10 million in 2009 to $16.06 million in 2010 and increased to $23.94 million in 2011. The decrease in total assets by $4.04 million (or 20%) from 2009 to 2010 is primarily due to the decrease in Fuel and Supplies by $3.63 million, increase in net accounts receivable of $0.51 million, decrease in cash of $0.81 million and decrease in capital assets of $0.12 million. The increase in total assets by $7.88 million (or 49%) is primarily attributable to the increase in net accounts receivable of $2.89 million, increase in Fuel and Supplies by $6.12 million for a fuel shipment received in September 2011, and decrease in capital assets of $1.06 million.

Net capital assets decreased from $8.72 million in 2010 to $7.66 million in 2011. Decrease is mainly a result of annual depreciation. During the year, Engine#6 (Deutz) was overhauled and restored back online resulting in an increase in Electric Plant in Service of $1.09 million.

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

Total liabilities decreased slightly from $29.93 million in 2009 to $27.25 million in 2010 and increased by $9.09 million to $36.34 million in 2011. The overall increase of $9.09 million (or 33%) experienced in 2011 is primarily due to increase in Long-term debt of $0.07 million and increase in current liabilities of $9.02 million primarily due to liabilities associated with year-end fuel purchase.

Current liabilities increased by $9.02 million. Increase is primarily due to increase in short-term debt of $2.86 million, Account payable - fuel of $6.58 million, decrease in Advances from Repmar of $0.76 million due to offsetting of RepMar electricity charges throughout 2011, and further net increase of $0.51 million in other current liabilities.

Refer to note #5 to the accompanying financial statements for additional information relating to long-term debt.

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

	2011	2010	2009
Revenue:			
Utility revenue	$ 18,047,014	$ 14,965,401	$ 14,105,966
Non-utility revenue	27,258,015	19,766,821	12,953,650
Total revenue	45,305,029	34,732,222	27,059,616
Expenses:			
Utility expenses	20,294,239	17,897,398	16,626,305
Non-utility expenses	25,779,427	18,495,781	11,510,021
Total expenses	46,073,666	36,393,179	28,136,326
Operating loss	(768,637)	(1,660,957)	(1,076,710)
RMI subsidy	862,243	926,204	937,730
Other grants	-	-	1,911,000
Payments to RepMar	(495,545)	(165,181)	-
Loss on write-off of capital assets	-	(129,914)	-
Interest expense	(803,509)	(1,118,185)	(1,144,912)
Capital contributions	-	783,787	521,103
	(436,811)	296,711	2,224,921
Change in net deficiency	$ (1,205,448)	$ (1,364,246)	$ 1,148,211

The Statements of Revenue, Expenses and Changes in Net Deficiency identify the various revenue and expense items that contributed to the change in net deficiency. MEC's total revenue increased in 2010 by $7.67 million (or 28%) to a total of $34.73 million compared to $27.06 million in 2009. In 2011, MEC's total revenue further increased by $10.58 million (or 30%) to a total of $45.31 million. The increase in revenue experienced during 2010 is due to the increase in fuel prices which were passed on to both electricity and fuel customers. In 2011, increase in revenue is mainly due to the increase in world fuel prices and increase in volume of fuel sales.

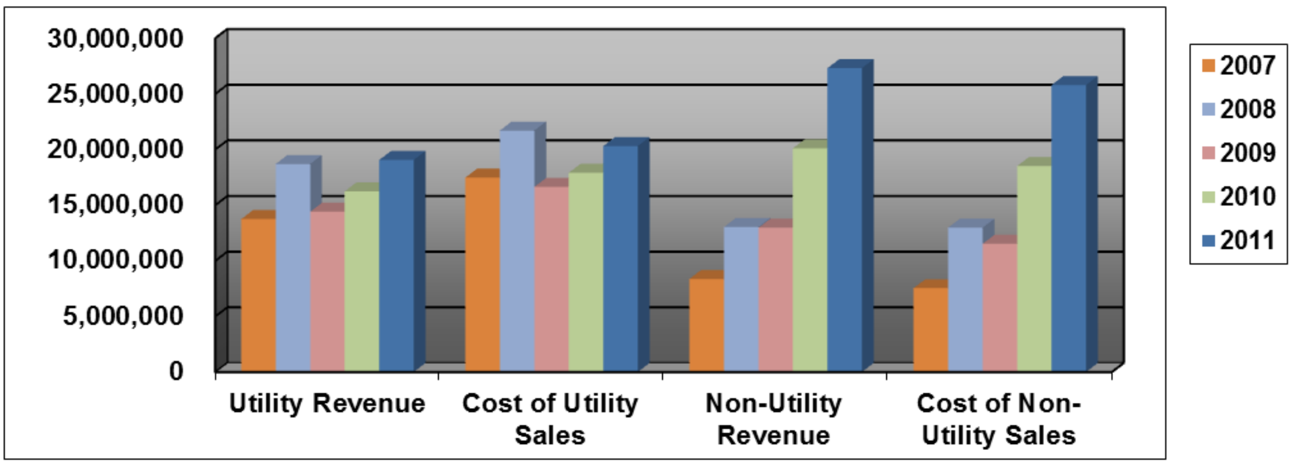
Electricity billings increased by $0.86 million (or 6%) from $14.11 million in 2009 to $14.97 million in 2010 and increased by $3.08 million (or 21%) in 2011 to $18.05 million, of which $1.08 million pertains to doubtful accounts. Non-Utility revenue is mainly fuel sales. Non-utility revenue increased by $6.81 million (or 53%) from $12.96 million in 2009 to $19.77 million in 2010. In 2011, there was an increase of $7.49 million (or 38%). Increase is due to the increase in fuel prices and fuel volume sales in 2011.

The operating loss for 2011 was $0.77 million compared to $1.66 million and $1.08 million in 2010 and 2009, respectively. The improvement in operating losses by $0.89 million in 2011 is a result of overall efficiency and effectiveness practiced organization wide.

No capital contributions were received during 2011 from RepMar.

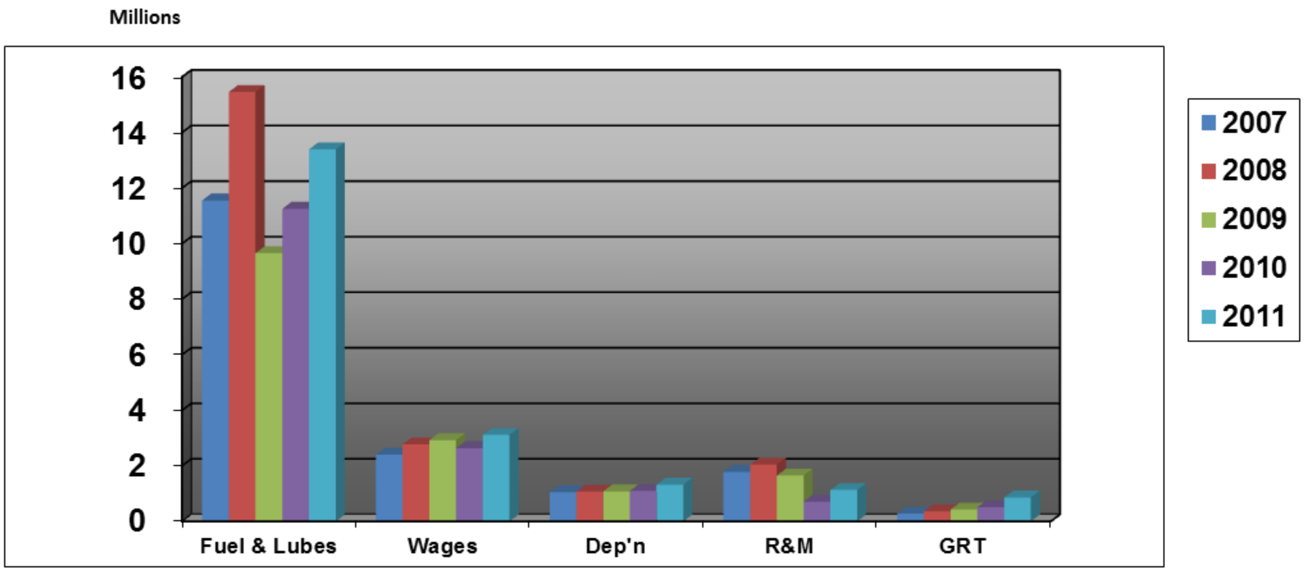
Operating subsidies of $0.86 million were received in 2011 compared to $0.93 million in 2010 and $0.34 million in 2009. Subsidy received during the year is cost recovery for the operations of Wotje and Jaluit power plants.

The graphic below shows the major components of revenue from 2007 through to 2011:



Total expenses increased from $28.14 million in 2009 to $36.39 million in 2010 and increased to $46.07 million in 2011 due almost entirely to changes in fuel costs. The cost of fuel as a percentage of total generation operating costs increased from 70% in 2009 to 78% in 2010 and increased from 78% in 2010 to 79% in 2011. Total fuel costs for generation did not increase proportionately to the price increases due to the reduction in fuel consumption for generation because of overhaul work done on engines#5 and #6 therefore making power generation more fuel efficient. The cost of fuel and lubricants used for generation increased to $13.39 million in 2011 compared to $11.25 million in 2010 and $9.65 million in 2009.

The following graphic shows the major components of operating expenses, excluding the cost of fuel sold, from 2007 through to 2011:



CASH FLOW

Net cash used by operating activities for 2011 was $2.47 million compared to net cash provided by operating activities of $0.75 million in 2010. In 2010, the source of cash used for fuel purchases was supplemented by RepMar subsidy of $0.93 million. In 2011, the source of cash used for fuel purchases were Repmar subsidy of $0.86 million and proceeds from short-term debt of $2.63 million.

FUTURE OUTLOOK ON SUSTAINABILITY

In spite of MEC's net deficiency position, the future outlook on sustainability for MEC is promising, as a wholly state-owned entity. With the development and implementation of the Comprehensive Recovery Plan (CRP), MEC anticipates that the road to recovery, both operationally and financially, will be challenging yet achievable. The CRP, a three year roadmap initiated during the year, plays a significant and positive role towards MEC's road to recovery and efforts to secure a viable and sustainable future for MEC. The MEC CRP goals are:

a. Strengthen MEC and Energy Sector Governance
b. Improve Organizational Policies, Performance and Capacity
c. Strengthen and Stabilize Company Finances

Key activities or objectives to support the MEC CRP goals include, but are not limited to, the following:

- Develop and adopt a full cost recovery tariff template and appropriate pricing structures for all goods and services. With the approval of the MEC Tariff Rate template from Cabinet, MEC is authorized to increase/decrease tariff rates in sync with the fluctuating cost of world fuel prices. Although the tariff template does not allow for full cost recovery, at a minimum MEC is provided with the opportunity to recover the cost of fuel, the main cost driver for producing electricity.

- Renegotiate the terms of the Rural Utilities Services (RUS) loan with the aim of deferring loan servicing payments. On an annual basis, MEC pays approximately $1.10 million towards MEC's debt to RUS. A deferment of the loan will allow for a much needed cash flow injection to rehabilitate the MEC power plant and other operations. As of September 30, 2011, the RUS loan balance is approximately $6.00 million. MEC finalized a 2 year deferment agreement in June 2012.

- Continue Majuro atoll-wide conversion to pre-paid metering system to improve cash flow and reduce receivables accumulation. As a recipient of grant funding from the US Department of the Interior, MEC will be converting all residential customers to a pre-pay meter. The conversion is expected to be completed within a two-three (2-3) year timeframe. The installation of the pre-pay meters will improve cash flow and reduce MEC's exposure to bad debt. As of September 30, 2011, MEC's Accounts Receivable Balance is $12.16 million.

- Conduct full system loss survey to locate and quantify key loss areas/sources. According to the FY 2008 audit report, the overall system loss was around 25%, which is equivalent to $3.2M in revenue loss per annum. The goal is to reduce the system loss to the industry standard of 9%-12%. The result of this exercise will identify losses, where the loss is occurring, and what steps are necessary to mitigate the losses. The survey will also clearly identify technical losses versus non-technical issues.

- Aggressively explore options to reduce generation cost factors, including exploration of alternative fuel sources and grid-connected alternative generation technologies. For FY 2011, 64% of MEC's operating cost was attributed to fossil fuel to run the generators compared to 62% in FY 2010. There is a great need for MEC to identify alternative measures to reduce its complete dependency on fossil fuel to generate electricity. As such, the aim under the CRP is to explore options to reduce power generation cost by venturing into Clean Development Mechanism (CDM) technologies that should reduce the consumption of fossil fuel and increase efficiencies. Other viable options include the implementation of a solar to grid concept and a hybrid system (Solar, Wind, Diesel Generator combined).

- Rehabilitate power plants, prioritizing full rehabilitation of the two Deutz generators. The total megawatt (MW) output from these two generators is 12MW at maximum efficiency. In March 2011, engine#6, one of the two Deutz engines, was restored back online after undergoing a major overhaul. The successful execution and approval of the RUS deferment program is critical to the rehabilitation efforts of the power plant. MEC has been awarded a grant agreement of $2.3 million for the rehabilitation of engine#7 (Deutz engine).

- Develop and adopt new financial management and reporting policies. Financial reporting is a key resource that is needed to assist MEC management and the MEC Board of Directors to make appropriate and timely decisions in the best interest of MEC. It is extremely critical that the financial data is accurate, valid, relevant and timely for financial statement reporting and management reporting. MEC must develop and foster a more internally controlled financial environment, identify process gaps/opportunities, and implement process improvement to mitigate the risks. Furthermore, there is a great need for a fully integrated financial and accounting system and required capacity training that will need to be addressed in fiscal year 2012.

  A key accounting policy and procedure that will be a priority for fiscal year 2012 is the general ledger account reconciliations. Initially, a list of the account reconciliations will be compiled and will include the appropriate due dates and frequency. In addition, all reconciliations completed will require a more thorough review and approval process to be performed by MEC management or designee that would require strict adherence and compliance in order for the internal control of reconciliations to be working properly as intended.

In addition to the goals and objectives/key activities set forth by the CRP, MEC will continue to closely monitor operating expenses and maintain tight fiscal constraints and control over utility receivables in order to further improve cash collections and the net asset position. MEC, as a viable going concern, will continue to be dependent on the financial support of RepMar in the form of:

a. Timely payment by RepMar for services provided,
b. Collection of long outstanding utility receivables,
c. Continuing improvements in operations and financial condition.

During fiscal year 2011, there were three tariff increases. These took effect in January 2011, February 2011 and April 2011, which is in line with the increase in world fuel price trend. Despite the wildly fluctuating world fuel prices, studies indicate that MEC has been able to maintain electricity tariffs at levels which are one of the lowest in the Pacific.

MEC FOCUS IN THE COMING FISCAL YEAR

The increase in world fuel prices and increase in provision for allowance for doubtful accounts were key factors in MEC's change in net deficiency position of $1.20 million for the year ended September 30, 2011. To improve the company's future sustainability and viability, MEC expects the upcoming fiscal year 2012 to be the start of a challenging and exciting journey to recovery.

MEC's focus in the coming fiscal year includes, but not limited to:

- Implement and monitor MEC's CRP. As indicated above, the CRP is an aggressive roadmap in MEC's efforts to revive the company's core operations and financials within a three year timeframe. During the year, various objectives were in stages of progress and completion.

- Improve/increase cash flow to support the CRP goals and objectives through the RUS deferment program. MEC management and MEC Board of Directors must actively lead and pursue the opportunities identified for a favorable outcome and without any further delays.

  As MEC works diligently towards securing the RUS deferment and steps to aggressively pursue Accounts Receivable collections is a necessity to sustain MEC's operations in the interim period. Disconnection policy needs to be enforced without delay or prejudice. As long as MEC allows outstanding accounts receivable balances to age, the greater MEC's risk and exposure is to bad debt and continued cash flow constraints.

- Strengthen financial processes through the promotion of an internally controlled environment, development and adherence to accounting policies, implementation of a new financial and accounting software, and capacity building. MEC's financial processes are crucial to the company's future. Alongside MEC's core operation rehabilitation of the power plant, financial processing is also a key priority area to ensure financial data are recorded accurately, properly and timely for financial statement reporting and management reporting. Management reporting is necessary to ensure that MEC management and Board of Directors are provided the tools and resources to make an informed decision.

- Promote energy efficiency and conservation among consumers. In support of RepMar's National Energy Plan to provide affordable, reliable, clean energy and to sustain quality of life, MEC must start to play an active role in creating awareness and providing consumers with the resources to conserve energy. Although energy conservation will result in decreased annual revenue, the more significant and lasting impact will be the power generation cost savings and social responsibility to educate consumers to be more energy efficient.

Management's Discussion and Analysis for the year ended September 30, 2010 is set forth in the report on the audit of MEC's financial statements dated February 29, 2012. That Discussion and Analysis explains the major factors impacting the 2010 financial statements and may be obtained from the contact information below.

ADDITIONAL FINANCIAL INFORMATION

This discussion and analysis is designed to provide MEC's customers and other stake holders with an overview of the company's operations and financial condition as at September 30, 2011. Should the reader have questions regarding the information included in this report, or wish to request additional financial information, please contact the Marshalls Energy Company, Inc. General Manager at P.O. Box 1439, Majuro, Marshall Islands, MH 96960.

MARSHALLS ENERGY COMPANY, INC.

Statements of Net Deficiency
September 30, 2011 and 2010

ASSETS		2011		2010
Utility plant:				
Electric plant in service	$	22,286,841	$	21,066,221
Construction work in progress		22,700		977,273
Total utility plant		22,309,541		22,043,494
Less accumulated depreciation and amortization		(14,677,078)		(13,353,446)
Net utility plant		7,632,463		8,690,048
Other non-current assets:				
Nonutility property		181,862		181,862
Less accumulated depreciation		(156,401)		(150,046)
Nonutility property, net		25,461		31,816
Total capital assets		7,657,924		8,721,864
Current assets:				
Cash		592,436		650,013
Accounts receivable:				
Electricity		7,083,943		5,332,805
RepMar and other affiliates		4,177,863		2,296,934
Other		894,873		520,651
Total accounts receivable		12,156,679		8,150,390
Less allowance for uncollectible accounts		(5,438,696)		(4,322,591)
Net accounts receivable		6,717,983		3,827,799
Fuel and supplies		8,972,900		2,857,536
Total current assets		16,283,319		7,335,348
Total assets	$	23,941,243	$	16,057,212

See accompanying notes to financial statements.

MARSHALLS ENERGY COMPANY, INC.

Statements of Net Deficiency, Continued
September 30, 2011 and 2010

NET DEFICIENCY AND LIABILITIES	2011	2010
Net deficiency:		
Invested in capital assets, net of related debt	$ 2,041,690	$ 2,394,234
Deficiency	(14,442,105)	(13,589,201)
Total net deficiency	(12,400,415)	(11,194,967)
Commitment and contingencies		
Noncurrent liabilities:		
Long-term debt	13,925,892	13,858,805
Current liabilities:		
Short-term debt	3,577,014	948,118
Current portion of long-term debt	1,191,779	963,722
Accounts payable - fuel	12,350,811	5,772,944
Accounts payable - other	1,213,145	828,423
Advances from RepMar	-	764,961
Payable to affiliates	499,533	561,425
Accrued building and engine repairs	2,140,822	2,140,822
Accrued taxes	555,628	293,639
Other accrued liabilities	326,613	92,821
Deferred revenue	560,421	1,026,499
Total current liabilities	22,415,766	13,393,374
Total liabilities	36,341,658	27,252,179
Total net deficiency and liabilities	$ 23,941,243	$ 16,057,212

See accompanying notes to financial statements.

MARSHALLS ENERGY COMPANY, INC.

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

	2011	2010
Utility operations:		
Operating revenues:		
Electricity sales	$ 19,045,398	$ 16,226,770
Other	78,862	63,503
	19,124,260	16,290,273
Less provision for doubtful accounts	(1,077,246)	(1,324,872)
Total net operating revenues	18,047,014	14,965,401
Operating expenses:		
Cost of fuel	13,024,474	11,074,061
Cost of power	3,390,621	3,204,558
Administrative and general	1,232,460	1,283,832
Distribution operations	1,326,092	1,240,687
Depreciation and amortization	1,320,592	1,094,260
Total operating expenses	20,294,239	17,897,398
Operating loss from utility operations	(2,247,225)	(2,931,997)
Nonutility operations:		
Operating revenues:		
Fuel sales	26,481,063	19,175,180
Propane sales	652,280	629,010
Lubricants sales	27,209	65,511
Other	136,322	230,853
	27,296,874	20,100,554
Less provision for doubtful accounts	(38,859)	(333,733)
Total net operating revenues	27,258,015	19,766,821
Operating expenses:		
Cost of fuel	24,527,690	17,607,177
Cost of propane	365,153	325,578
Other	886,584	563,026
Total operating expenses	25,779,427	18,495,781
Operating income from nonutility operations	1,478,588	1,271,040
Operating loss	(768,637)	(1,660,957)
Nonoperating income (expense):		
RepMar subsidy	862,243	926,204
Payments to RepMar	(495,545)	(165,181)
Loss on write-off of capital assets	-	(129,914)
Other grants	-	-
Interest expense	(803,509)	(1,118,185)
Total nonoperating income (expense), net	(436,811)	(487,076)
Capital contributions - RepMar	-	783,787
Change in net deficiency	(1,205,448)	(1,364,246)
Net deficiency at beginning of year	(11,194,967)	(9,830,721)
Net deficiency at end of year	$ (12,400,415)	$ (11,194,967)

See accompanying notes to financial statements.

MARSHALLS ENERGY COMPANY, INC.

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

	2011	2010
Cash flows from operating activities:		
Cash received from customers	$ 41,183,605	$ 30,945,612
Cash payments to suppliers for goods and services	(40,973,007)	(27,535,409)
Cash payments to employees for services	(2,680,069)	(2,662,151)
Net cash provided by (used for) operating activities	(2,469,471)	748,052
Cash flows from noncapital financing activities:		
Subsidy from RepMar	862,243	874,281
Payments to RepMar	(495,545)	(165,181)
Grants received	251,530	-
Net proceeds from short-term debt	2,628,896	948,118
Interest paid on short-term debt	(236,686)	(89,822)
Principal paid on long-term debt	(8,762,131)	(977,064)
Interest paid on long-term debt	(243,784)	(489,952)
Proceeds from long-term debt	9,494,897	-
Net cash provided by noncapital financing activities	3,499,420	100,380
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets	(266,047)	(510,327)
Capital contributions received	-	-
Principal paid on long-term debt	(437,622)	(668,312)
Interest paid on long-term debt	(383,857)	(477,593)
Net cash used for capital and related financing activities	(1,087,526)	(1,656,232)
Net change in cash	(57,577)	(807,800)
Cash at beginning of year	650,013	1,457,813
Cash at end of year	$ 592,436	$ 650,013
Reconciliation of operating loss to net cash provided by (used for) operating activities:		
Operating loss	$ (768,637)	$ (1,660,957)
Adjustments to reconcile operating loss to net cash provided by (used for) operating activities:		
Depreciation and amortization	1,329,987	1,104,676
Provision for doubtful accounts	1,116,105	1,658,605
(Increase) decrease in assets:		
Accounts receivable:		
Electricity	(1,751,138)	(2,281,845)
Affiliates	(2,645,890)	(2,011,436)
Other	(374,222)	(181,556)
Fuel and supplies	(6,115,364)	3,627,507
Prepayments	-	-
Increase (decrease) in liabilities:		
Accounts payable - fuel	6,577,867	1,453,348
Accounts payable - other	384,722	364,456
Payable to affiliates	(61,892)	127,440
Accrued building and engine repairs	-	-
Accrued taxes	261,989	(30,852)
Other accrued liabilities	43,080	(450,956)
Deferred revenue	(466,078)	(970,378)
Net cash provided by (used for) operating activities	$ (2,469,471)	$ 748,052

See accompanying notes to financial statements.

MARSHALLS ENERGY COMPANY, INC.

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

		2011		2010
Summary disclosure of noncash activities:				
Off-set of advances from RepMar:				
Electricity receivables	$	764,961	$	1,234,007
Receivables from affiliates		-		1,304,052
Advances from RepMar		(764,961)		(2,538,059)
	$	-	$	-
Contributed utility plant:				
Construction work-in-progress	$	-	$	684,751
Electric plant in service		-		99,036
Capital contributions from RepMar		-		(783,787)
	$	-	$	-

See accompanying notes to financial statements.

(1) Organization

The Marshalls Energy Company, Inc. (MEC) was granted a corporate charter by the Cabinet of the Republic of the Marshall Islands (RepMar) on February 2, 1984. MEC's principal lines of business are predominantly the generation and transmission of electricity and the buying and selling of petroleum products. Other lines of business include the rental of equipment and accommodation facilities. The principal markets for the generation and transmission of electricity are government agencies, businesses and residential customers located on the atolls of Majuro, Jaluit and Wotje. Petroleum products are sold primarily to foreign and domestic fishing vessels.

An exclusive franchise to construct, maintain and operate a distribution system for furnishing electrical power within Majuro Atoll was granted to MEC by RepMar on March 8, 1983. Simultaneously, RepMar leased to MEC, for a nominal amount, a 12-megawatt power plant, a six million gallon capacity fuel storage facility, electrical transmission systems and related facilities on Majuro Atoll. The term of both the lease and the franchise is for a fifty year period commencing on December 1, 1996.

Pursuant to Cabinet Minute C.M. 162(93), RepMar leased to MEC, for a nominal amount, the right to operate and manage the power generating and distribution system in Jaluit Atoll effective November 1, 1993. The term of the lease is for a fifty year period commencing on December 1, 1996.

Through Cabinet action in October 2000, RepMar contracted MEC to develop, operate and maintain power generation systems on Wotje Atoll.

MEC'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 MEC 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. MEC has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

MEC considers utility and nonutility revenues and costs that are directly related to the generation, transmission and distribution of electricity and fuel sale operations to be operating revenues and expenses. Revenues and expenses related to financing and other activities are reflected as nonoperating.

GASB 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: Omnibus*, and modified by 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.

(2) Summary of Significant Accounting Policies, Continued

To conform to the requirements of GASB Statement No. 34, equity is presented in the following net asset categories:

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

- Restricted net assets - resources in which MEC is legally or contractually obligated to spend resources in accordance with restrictions either externally imposed by creditors, grantors, contributors, and the like, or imposed by law.

- 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.

When both restricted and unrestricted resources are available for use for the same purpose, it is MEC's policy to use unrestricted resources first, then restricted resources as they are needed.

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.

Revenue Recognition

Sales of electricity are recorded as billed to customers on a monthly billing cycle basis. Unbilled revenues are not accrued as the most recent meter reading date approximates the end of the reporting period.

Revenue from fuel and propane sales is billed to customers on a daily basis based on the actual quantity of fuel and propane delivered.

Cash

Custodial credit risk is the risk that in the event of a bank failure, MEC'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. MEC does not have a deposit policy for custodial credit risk.

For purposes of the statements of net deficiency and cash flows, cash is defined as cash on hand and cash held in demand accounts. As of September 30, 2011 and 2010, cash was $592,436 and $650,013, respectively, and the corresponding bank balances were $1,028,757 and $619,480, respectively, of which $999,777 and $566,774, respectively, were maintained in a financial institution subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2011 and 2010, bank deposits in the amount of $981,536 and $250,000, respectively, were FDIC insured. MEC does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC coverage are uncollateralized. Accordingly, these deposits were exposed to custodial credit risk.

(2) Summary of Significant Accounting Policies, Continued

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 uncollectible 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. Management determines the adequacy of the allowance for uncollectible accounts based upon review of the aged accounts receivable. The allowance is established through a provision for bad debts charged to expense.

Fuel and Supplies

Fuel and supplies are valued at the lower of cost (first-in, first-out) or market (net realizable value).

Plant and Nonutility Property

Plant and nonutility property with a cost that equals or exceeds $500 is capitalized. Such assets are stated at cost. Depreciation of plant and nonutility property and amortization of leasehold land and residences 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:

Power plant engines	20 years
Plant and machinery	3 - 10 years
Vehicles	2 - 4 years
Leasehold improvements	20 years
Residences	20 years
Fences and seawalls	10 years
Leasehold land	20 years
Solar power system	15 years
Furniture and fixtures	3 - 5 years

Costs pertaining to distribution and line supplies are expensed during the year of installation as MEC considers the estimated useful lives of these supplies to be less than one year.

New Accounting Standards

During fiscal year 2011, MEC 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 investment pools.

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

(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 Arrangements,* which addresses how to account for and report service concession arrangements (SCAs), a type of public-private or public-public partnership that state and local governments are increasingly entering into. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of MEC.

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 MEC.

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 MEC.

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 MEC.

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 MEC.

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.

(3) Fuel and Supplies

Fuel and supplies at September 30, 2011 and 2010, consist of the following:

	2011	2010
Distribution and power plant supplies	$ 1,682,486	$ 1,490,788
Fuel	7,199,602	1,274,157
Lubricants	90,812	92,591
	$ 8,972,900	$ 2,857,536

(4) Capital Assets

Capital asset activity for the years ended September 30, 2011 and 2010 was as follows:

	2011			
	October 1, 2010	Additions	Deletions	September 30, 2011
Utility Plant:				
Power plant engines	$ 14,909,948	$ 1,085,344	$ -	$ 15,995,292
Plant and machinery	1,876,968	875	-	1,877,843
Solar power systems	1,110,417	-	-	1,110,417
Vehicles	1,023,244	15,000	-	1,038,244
Leasehold improvements	641,012	-	-	641,012
Residences	561,073	-	-	561,073
Fences and seawalls	371,702	-	-	371,702
Leasehold land	330,000	-	-	330,000
Furniture and fixtures	241,857	119,401	-	361,258
Nonutility Plant:				
LPG terminal	181,862	-	-	181,862
	21,248,083	1,220,620	-	22,468,703
Less accumulated depreciation and amortization	(13,503,492)	(1,329,987)	-	(14,833,479)
	7,744,591	(109,367)	-	7,635,224
Construction work-in-progress	977,273	224,054	(1,178,627)	22,700
	$ 8,721,864	$ 114,687	$ (1,178,627)	$ 7,657,924

(4) Capital Assets, Continued

	2010			
	October 1, 2009	Additions	Deletions	September 30, 2010
Utility Plant:				
Power plant engines	$ 14,720,739	$ 189,209	$ -	$ 14,909,948
Plant and machinery	1,867,713	9,255	-	1,876,968
Solar power systems	1,110,417	-	-	1,110,417
Vehicles	884,976	156,768	(18,500)	1,023,244
Leasehold improvements	641,012	-	-	641,012
Residences	561,073	-	-	561,073
Fences and seawalls	371,702	-	-	371,702
Leasehold land	330,000	-	-	330,000
Furniture and fixtures	229,895	11,962	-	241,857
Nonutility Plant:				
LPG terminal	181,862	-	-	181,862
	20,899,389	367,194	(18,500)	21,248,083
Less accumulated depreciation and amortization	(12,413,352)	(1,104,676)	14,536	(13,503,492)
	8,486,037	(737,482)	(3,964)	7,744,591
Construction work-in-progress	354,060	926,920	(303,707)	977,273
	$ 8,840,097	$ 189,438	$ (307,671)	$ 8,721,864

MEC created a separate cash in bank account dedicated to repair and maintenance funds (R&M Fund), as required by the Subsidiary Loan Agreement between RepMar and the Asian Development Bank (ADB). Starting October 1, 2010, MEC made automatic $35,000 monthly transfers into the R&M Fund from its revenue accounts. Cash in the R&M Fund shall be used exclusively for repair, maintenance, procurement of spare parts, materials and equipment (and related labor costs) directly related to power generation and distribution. The R&M fund has a balance of $53,085 as of September 30, 2011.

(5) Long-Term Debt

Long-term debt at September 30, 2011 and 2010 is as follows:

	2011	2010
On November 18, 1997, MEC entered into a loan agreement with the Federal Financing Bank (FFB) in the amount of $12.5 million for the construction of a new power plant, with loan repayments guaranteed by the Rural Utilities Service (RUS). MEC is required to submit drawdown requests to RUS for approval of loan advances. Interest rates are calculated based on the FFB rates at the date of the loan advances and range from 5.49% to 7.25% per annum. Principal and interest are payable in quarterly installments of $273,770 through January 2, 2018. The mortgage notes have been unconditionally guaranteed by RepMar, under which RepMar will make debt service payments to RUS in the event of default by MEC, and have been collateralized by a leasehold mortgage and security agreement over the assets of MEC. These notes are subject to certain coverage ratio requirements. MEC is not in compliance with these ratio requirements as of September 30, 2011 and 2010.	$ 5,890,008	$ 6,327,630

(5) Long-Term Debt, Continued

	2011	2010
On May 25, 2007, MEC obtained a bank loan of $12 million to refinance debts to a fuel supplier and a commercial bank and to finance working capital requirements. This loan was refinanced on June 1, 2010 and was to be amortized over a period of 10 years and mature in 3 years. Interest was calculated at 1.75% over the bank's reference rate with a minimum rate of 6.5% per annum. As of September 30, 2010, interest rate was 6.5% per annum. Principal and interest were payable in monthly equal payments of $99,300. The remaining principal and interest balance were originally due on June 1, 2013. The loan was guaranteed, unconditionally and absolutely, by RepMar. This loan was paid in full on October 8, 2010 through acquisition of a subsidiary loan executed with RepMar on September 8, 2010.	-	8,494,897
On September 8, 2010, MEC obtained a subsidiary loan from the ADB, through RepMar, of $10 million to pay off the bank loan described above. This loan will mature on May 31, 2034. Interest is calculated at 1.0% per annum through September 30, 2018 and at 1.5% per annum thereafter. Principal and interest are payable in monthly equal payments of $34,758.	9,227,663	-
	15,117,671	14,822,527
Less current installments	(1,191,779)	(963,722)
Long-term debt	$ 13,925,892	$ 13,858,805

Changes in long-term debt during the years ended September 30, 2011 and 2010 are as follows:

2011	Balance October 1, 2010	Additions	Reductions	Balance September 30, 2011	Balance due in One Year
RUS loan	$ 6,327,630	$ -	$ (437,622)	$ 5,890,008	$ 835,583
Commercial bank loan	8,494,897	-	(8,494,897)	-	-
Subsidiary loan	-	9,555,715	(328,052)	9,227,663	356,196
	$14,822,527	$ 9,555,715	$ (9,260,571)	$ 15,117,671	$ 1,191,779

2010	Balance October 1, 2009	Additions	Reductions	Balance September 30, 2010	Balance due in One Year
RUS loan	$ 6,995,942	$ -	$ (668,312)	$ 6,327,630	$ 711,396
Commercial bank loan	9,471,961	-	(977,064)	8,494,897	252,326
	$16,467,903	$ -	$ (1,645,376)	$ 14,822,527	$ 963,722

(5) Long-Term Debt, Continued

Annual repayment requirements to maturity for principal and interest are as follows:

Year ending September 30,	Principal	Interest	Total
2012	$ 1,191,779	$ 350,207	$ 1,541,986
2013	1,370,272	454,120	1,824,392
2014	1,230,978	319,635	1,550,613
2015	1,290,338	260,278	1,550,616
2016	1,353,227	197,391	1,550,618
2017-2021	3,172,805	473,663	3,646,468
2022-2026	1,934,924	342,676	2,277,600
2027-2031	2,085,526	192,074	2,277,600
2032-2034	1,487,822	37,141	1,524,963
	$ 15,117,671	$ 2,627,185	$ 17,744,856

Events that impact the above debt maturity that occurred subsequent to September 30, 2011 are discussed in note 11.

(6) Short-Term Debt

During the year ended September 30, 2011, MEC obtained three ninety-day or less term loans with interest rates at 7.5% per annum from a financial institution to finance fuel purchases. Short-term debt outstanding as of September 30, 2011 and 2010 was $3,577,014 and $948,118, respectively.

Changes in short-term debt during the years ended September 30, 2011 and 2010 are as follows:

2011			
Balance October 1, 2010	Additions	Reductions	Balance September 30, 2011
$ 948,118	$ 11,000,000	$ (8,371,104)	$ 3,577,014

2010			
Balance October 1, 2009	Additions	Reductions	Balance September 30, 2010
$ -	$ 6,500,000	$ (5,551,882)	$ 948,118

(7) Employee Retirement Plan

MEC has implemented a defined contribution retirement savings plan (the Plan) for its employees. Employees eighteen years and older are eligible upon one year of employment with MEC. Plan participants may contribute any amount of their salaries to be matched 100% by MEC up to 5% of base salaries. Withdrawal from the Plan occurs upon termination of employment, death, or financial hardship. Plan assets are held in a trust fund administered by a trustee in accordance with the trust agreement. Management has the authority to establish or amend Plan provisions and contribution requirements. MEC contributed $44,454 and $29,256 to Plan participant accounts during the years ended September 30, 2011 and 2010, respectively.

(8) Related Party Transactions

MEC is wholly-owned by RepMar and is therefore affiliated with all RepMar-owned and affiliated entities. RepMar subscribes for electricity generated by MEC and is charged for electricity usage at substantially the same rates as those charged to commercial establishments. In addition, RepMar purchases fuel from MEC at the same commercial terms and conditions as afforded to third parties. MEC's receivables from related parties are afforded more favorable payment terms than those extended to unrelated parties.

Pursuant to the Income Tax Act of 1989, as amended by the Income Tax Amendment Act of 1991, sales of electricity by public utility companies are exempt from gross revenue tax. MEC is therefore required to pay gross revenue tax on all revenue with the exception of electricity sales at the rate of 3%. As of September 30, 2011 and 2010, MEC is liable for gross revenue tax to RepMar amounting to $445,002 and $183,013, respectively.

Pursuant to the Import Duties (MEC Exemption) Act of 2008, enacted on October 6, 2008, MEC is exempt from paying import duty on all types of fuel imported into RepMar, including fuel imported for power generation and for commercial resale. Previously, pursuant to the Import Duties (Amendment) Act, 2005, no import duty was levied on residual fuel oils and diesel fuel imported by MEC solely for the purpose of power generation. MEC was, however, required to pay import duty on diesel fuel imported for commercial resale. As of September 30, 2011 and 2010, MEC is liable for import duties to RepMar amounting to $110,626, respectively, representing import duty owed prior to October 6, 2008.

Transactions for the years ended September 30, 2011 and 2010, and the related receivables from and payables to affiliates, are as follows:

	2011			
	Revenues	Expenses	Receivables	Payables
RepMar	$ 3,701,402	$ 971,912	$ 1,372,869	$ 306,967
Kwajalein Atoll Joint Utilities Resources, Inc.	3,527,300	-	582,526	-
Majuro Water and Sewer Company, Inc.	393,100	1,272	326,490	4,896
Marshall Islands Social Security Administration	64,108	637,099	3,514	123,554
Majuro Resort, Inc.	554,438	104,526	1,365,271	57,275
Other	1,981,344	274,835	527,193	6,841
	$ 10,221,692	$ 1,989,644	$ 4,177,863	$ 499,533

	2010			
	Revenues	Expenses	Receivables	Payables
RepMar	$ 3,625,595	$ 356,691	$ 927,932	$ 331,335
Kwajalein Atoll Joint Utilities Resources, Inc.	3,920,407	-	74,491	2,482
Majuro Water and Sewer Company, Inc.	360,423	28,511	55,720	13,326
Marshall Islands Social Security Administration	11,817	464,134	-	152,257
Majuro Resort, Inc.	397,117	6,747	845,102	4,574
Other	1,508,051	198,663	393,689	57,451
	$ 9,823,410	$ 1,054,746	$ 2,296,934	$ 561,425

Allowance for uncollectable accounts pertaining to receivables from affiliates amounted to $1,473,666 and $1,031,934 as of September 30, 2011 and 2010, respectively.

(8) Related Party Transactions, Continued

Changes in the advances from RepMar account during the years ended September 30, 2011 and 2010, are as follows:

	2011	2010
Balance at beginning of year	$ 764,961	$ 3,303,020
Utility billings offset	(764,961)	(2,538,059)
	$ -	$ 764,961

As of September 30, 2010, MEC recorded deferred revenue from Kwajalein Atoll Joint Utilities Resources, Inc. of $242,156 related to diesel fuel sales paid in advance.

During the years ended September 30, 2011 and 2010, MEC received operating subsidies from RepMar of $862,243 and $926,204, respectively. During the year ended September 30, 2010, MEC received capital contributions from RepMar of $783,787.

During the years ended September 30, 2011 and 2010, MEC deposited $495,545 and $165,181, respectively into a RepMar bank account in accordance with the terms of a grant passed through RepMar during fiscal year 2009 from an international donor.

(9) Commitment and Contingencies

Commitment

On June 22, 2006, MEC entered into a five-year fuel supply contract with SK Networks Co., Ltd. commencing January 2007 through December 2011. Under the fuel supply contract, MEC's minimum purchase obligation shall be 13,000,000 U.S. gallons per year. MEC did not renew the fuel supply contract with SK Networks Co., Ltd. after its expiration.

Contingencies

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplates the continuation of MEC as a going concern. MEC has sustained substantial operating losses during the years ended September 30, 2011 and 2010 of $768,637 and $1,660,957, respectively, and has used a substantial amount of working capital in its operations resulting in a working capital deficiency of $6,064,026 at September 30, 2011. Furthermore, at September 30, 2011, total liabilities exceed total assets by $12,400,415. Management acknowledges that it is currently dependent on RepMar for cash advances to fund operations and on its affiliates to pay for actual services rendered in order to maintain MEC as a going concern. Should RepMar and its affiliates choose to discontinue cash advances and payment for services rendered, MEC management may have to consider alternative measures including, among other possibilities, an increase in electricity and fuel rates to maintain MEC as a going concern.

(9) Commitment and Contingencies, Continued

Contingencies, Continued

In view of these matters, realization of a major portion of the assets in the accompanying statement of net assets at September 30, 2011, is dependent upon continued operations of MEC, which in turn is dependent upon MEC's ability to meet its future debt service requirements, and the success of future operations. Management believes that actions presently being taken to revise MEC's operating requirements, which include entering into new fuel supply contracts with fishing companies, aggressively collecting past due accounts, and maintaining the approved pricing template allowing MEC to automatically adjust tariffs for movements in world oil prices, provide the opportunity for MEC to continue as a going concern.

In the efforts to maintain MEC as a going concern, MEC management implemented its Comprehensive Recovery Plan (CRP) during fiscal year 2010. The CRP is a three (3) year strategic plan or road map designed to a) Strengthen MEC and Energy Sector Governance; (b) Improve Organizational Policies, Performance and Capacity; and (c) Strengthen and Stabilize Company Finances.

MEC is a party to several legal proceedings arising from its operations; however, no provision for any liability was made in the accompanying financial statements due to the uncertainty of the legal proceeding outcomes. Although the financial exposure is yet to be determined, MEC's management believes that the provision for any liability will be minimal.

(10) Risk Management

MEC 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. MEC has elected to purchase commercial insurance from independent third parties for the risks of loss to which it is exposed. Settled claims from these risks have not exceeded commercial insurance coverage for the past three years.

Insurance proceeds of $3,410,336 received in 2007 for fire damages to MEC's power plant building and engines were netted against estimated repair costs to put the assets back into service. Accrued building and engine repairs expense as of September 30, 2011 and 2010 amounted to $2,140,822.

(11) Subsequent Events

On June 22, 2012, RUS and MEC agreed to a combined grant and loan deferment package of $4.3 million. RUS granted a two-year $2 million loan deferment giving MEC a two-year break from having to make payments to RUS. A separate $2.3 million grant was awarded for the purpose of funding the purchase of parts for engine overhaul.

On July 12, 2012, MEC and a commercial local bank agreed to extend the maturity of the short term loan from September 20, 2012 to July 20, 2015.

MARSHALLS ENERGY COMPANY, INC.

Statement of Revenues, Expenses and Changes in Net Deficiency by Source
Year Ended September 30, 2011

	Generation	Distribution	Tank Farm	Jaluit	Wotje	Solar	MEC Gas	Admin.	TOTAL
Operating revenues:									
Fuel, propane and lube sales	$ -	$ -	$ 26,508,271	$ -	$ -	$ -	$ 652,280	$ -	$ 27,160,551
Cost of sales	-	-	24,527,690	-	-	-	365,153	-	24,892,843
Gross profit on sales	-	-	1,980,581	-	-	-	287,127	-	2,267,708
Electric and service billings	17,839,706	-	-	863,993	235,480	106,219	-	-	19,045,398
Service and other income	9,303	65,117	90,834	4,442		523	3,098	41,867	215,184
Less provision for doubtful accounts	(1,077,246)	-	(38,859)	-	-	-	-	-	(1,116,105)
Total electricity sales and other income	16,771,763	65,117	51,975	868,435	235,480	106,742	3,098	41,867	18,144,477
Total net operating revenue	16,771,763	65,117	2,032,556	868,435	235,480	106,742	290,225	41,867	20,412,185
Operating expenses:									
Advertising	-	-	-	-	-	-	-	14,977	14,977
Auto POL and maintenance	60,134	86,481	9,570	800	293	180	1,065	42,736	201,259
Bank charges	830	-	29,050	-	525	-	225	6,522	37,152
Communications	12,641	14,017	2,710	400	340	-	1,176	33,075	64,359
Depreciation and amortization	1,072,499	61,111	19,978	239	-	91,942	9,394	74,824	1,329,987
Donations	188	770	-	800	-	-	-	6,429	8,187
Entertainment	474	461	-	381	-	-	-	9,196	10,512
Equipment rental	4,266	(74)	2,378	5,500	650	-	1,364	320	14,404
Freight and handling	110,939	35,826	-	23,127	28,117	980	-	3,925	202,914
Fuel and lubes	12,955,483	3,889	-	230,227	201,946	-	-	-	13,391,545
Gross revenue tax	39,011	199	800,961	81	-	-	17,750	1,015	859,017
Import tax	67	21,650	-	-	-	-	-	549	22,266
Insurance	95,934	5,049	50,492	5,049	5,049	-	1,683	5,049	168,305
Lease rental	3,675	-	-	8,992	5,989	-	-	5,447	24,103
Membership and other fees	-	50	160	(3,750)	-	-	-	34,505	30,965
Miscellaneous	5,818	10,182	17,408	803	-	69,857	-	43,238	147,306
Office	32,153	4,326	2,775	-	596	14,650	2,036	51,207	107,743
Professional and consulting fees	-	-	-	-	-	-	-	68,004	68,004
Repairs and maintenance	684,842	360,813	33,618	22,140	-	315	618	23,729	1,126,075
Safety and uniforms	3,030	414	-	-	16,666	-	-	437	20,547
Salaries, wages and benefits	1,146,128	658,222	144,160	239,057	166,140	75,293	37,614	647,621	3,114,235
Security services	36,584	-	17,104	-	-		17,104	-	70,792
Staff training	75	-	-	-	-	-	-	18,322	18,397
Travel	8,140	5,235	-	3,060	2,067	52	-	48,589	67,143
Utility	348	986	91	10,305	-	-	-	48,898	60,628
Total operating expenses	16,273,259	1,269,607	1,130,455	547,211	428,378	253,269	90,029	1,188,614	21,180,822
Operating income (loss)	498,504	(1,204,490)	902,101	321,224	(192,898)	(146,527)	200,196	(1,146,747)	(768,637)
Nonoperating income (expense):									
RepMar subsidy	-	-	-	431,121	431,121	-	-		862,242
Payments to RepMar	-	-	-	-	-	-	-	(495,545)	(495,545)
Interest expense	(398,581)	-	(236,686)	-	-	-	-	(168,241)	(803,508)
	(398,581)	-	(236,686)	431,121	431,121	-	-	(663,786)	(436,811)
Capital contributions - RepMar	-	-	-	-	-	-	-	-	-
Change in net deficiency	$ 99,923	$ (1,204,490)	$ 665,415	$ 752,345	$ 238,223	$ (146,527)	$ 200,196	$ (1,810,533)	$ (1,205,448)

See accompanying independent auditors' report.