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, 2013 AND 2012

MARSHALLS ENERGY COMPANY, INC.
(A Component Unit of the Republic of the Marshall Islands)

Years Ended September 30, 2013 and 2012
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INDEPENDENT AUDITORS' REPORT

Board of Directors
Marshalls Energy Company, Inc.:

Report on the Financial Statements

We have audited the accompanying financial statements of the Marshalls Energy Company, Inc. (MEC), a component unit of the Republic of the Marshall Islands, which comprise the statements of net position as of September 30, 2013 and 2012, and the related statements of revenues, expenses and changes in net position and of cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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, 2013 and 2012, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 to 7 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audits were conducted for the purpose of forming an opinion on the financial statements that collectively comprise MEC's basic financial statements. The Other Supplementary Information listed in the accompanying table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements.

The Other Supplementary Information is the responsibility of MEC's management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Other Supplementary Information is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated May 26, 2014, 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* in considering MEC's internal control over financial reporting and compliance.

Deloitte + Touche LLP

May 26, 2014

Marshalls Energy Company, Inc. (MEC) herewith presents a discussion and analysis of the company's financial performance for the fiscal year ended 30th September, 2013. It is to be read in conjunction with the financial statements following this section.

FINANCIAL HIGHLIGHTS

MEC's net position increased by $7.5 million in fiscal year 2013 compared to an increase of $0.7 million in fiscal year 2012.

The significant change in net position in fiscal year 2013 relates to the following:

- The net effect of $1.5 million on the recovery of long outstanding debt of $2.4 million and additional allowance for doubtful accounts of $0.9 million
- The realization of other income of $1.6 million relating to Accrued building and engine repairs
- The receipt of grant funding of $3.3 million

In 2013, total net utility operating revenues were $22.1 million, an increase of $3.4 million in comparison to $18.7 million in net utility operating revenues in 2012. The increase relates to the recovery of doubtful accounts of $1.5 million.

Total utility operating expenses were $21.6 million and $20.9 million in 2013 and 2012, respectively. The net increase in the amount of $0.7 million mainly relates to repair and maintenance works done on the generators and other operations during the year.

Total net operating revenues for non-utility operations, fuel sales being the major component, were $31.1 million and $31.4 million in 2013 and 2012, respectively. Total non-utility operating expenses decreased by $0.2 million, with $29.4 million and $29.6 million in 2013 and 2012, respectively.

MEC received a total of $3.3 million in grants during the year. $0.28 million was received from Ausaid for the purchase of prepaid meters, and $0.96 million was received from ADB for Peilstick engine parts, and $2.1 million from RUS for the rehabilitation of Engine#7.

MEC received subsidies of $0.8 million in 2013 compared to subsidies of $0.9 million in 2012 as cost recovery for the operations of Wotje and Jaluit power plants. Subsidies for Jaluit and Wotje amounted to $400,000 and $400,000, respectively.

FINANCIAL ANALYSIS OF MEC

The Statement of Net Position and the Statement of Revenues, Expenses and Changes in Net Position provide an indication of MEC's financial condition. MEC's net position reflect the difference between total assets and total liabilities. An increase in net position over time normally indicates an improvement in financial condition. As illustrated in the figures below, MEC's net position increased for the year ended 30th September, 2013.

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

	2013	2012	2011
Current and other assets	$ 10,793,135	$ 10,006,679	$ 16,283,319
Capital assets	10,265,146	7,294,148	7,657,924
Total assets	21,058,281	17,300,827	23,941,243
Current liabilities	11,790,255	14,595,841	22,415,766
Non-current liabilities	13,495,449	14,399,733	13,925,892
Total liabilities	25,285,704	28,995,574	36,341,658
Net position:			
Net investment in capital assets	3,361,388	1,936,445	2,041,690
Restricted	404,006	-	-
Deficiency	(7,992,817)	(13,631,192)	(14,442,105)
Total net position	$ (4,227,423)	$ (11,694,747)	$ (12,400,415)

Total assets increased by $3.8 million (or 22%) from 2012 to 2013 and decreased by $6.6 million from 2011 to $17.3 million in 2012. The increase in total assets by $3.8 million in 2013 is mainly attributable to an increase in the construction work in progress of $2.4 million for engine #3 (under the ADB grant) and engine #7 (under the RUS grant) and a deposit to vendor of $1.2 million for engine #7 parts.

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

Total liabilities decreased from $29.0 million in 2012 to $25.3 million in 2013. The overall decrease of $3.7 million (or 13%) is mainly due to the settlement of Advance from related party of $2.0 million and decrease of $1.6 million for Accrued building and engine repairs.

On June 22, 2012, MEC entered into a debt deferral agreement with RUS whereby MEC received a two-year loan payment deferral. 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 Position is presented below:

	2013	2012	2011
Revenue:			
Utility revenue	$ 22,109,307	$ 18,674,599	$ 18,047,014
Non-utility revenue	31,058,754	31,383,640	27,258,015
Total Revenue	53,168,061	50,058,239	45,305,029
Expenses:			
Utility expenses	21,576,592	20,919,743	20,294,239
Non-utility expenses	29,393,776	29,590,490	25,779,427
Total expenses	50,970,368	50,510,233	46,073,666
Operating profit / (loss)	2,197,693	(451,994)	(768,637)
RMI subsidy	800,000	874,944	862,243
Other grants	284,062	689,697	-
Payments to RepMar	-	(165,182)	(495,545)
Other income	1,630,394	210,428	-
Interest expense	(468,121)	(870,297)	(803,509)
Capital contributions	3,023,296	418,072	-
	5,269,631	1,157,662	(436,811)
Change in net position	$ 7,467,324	$ 705,668	$ (1,205,448)

The Statements of Revenue, Expenses and Changes in Net Position identify the various revenue and expense items that contributed to the change in net position. MEC's total revenue increased in 2013 by $3.1 million (or 6%) to a total of $53.2 million compared to $50.1 million in 2012.

Utility revenue increased by $3.4 million (or 18%) from $18.7 million in 2012 to $22.1 million in 2013. The increase during the year relates to the net effect of $1.5 million on the recovery of long outstanding debt of $2.4 million and additional allowance for doubtful accounts of $0.9 million. In fiscal year 2012, provision for doubtful accounts amounted to $2.2 million.

Non-Utility revenue is mainly fuel sales. Non-utility revenue decreased by $0.3 million (or -1%) in 2013 to $31.1 million compared to $31.4 million in 2012. The slight decrease relates to decrease in sales volume during the year when compared to fiscal year 2012.

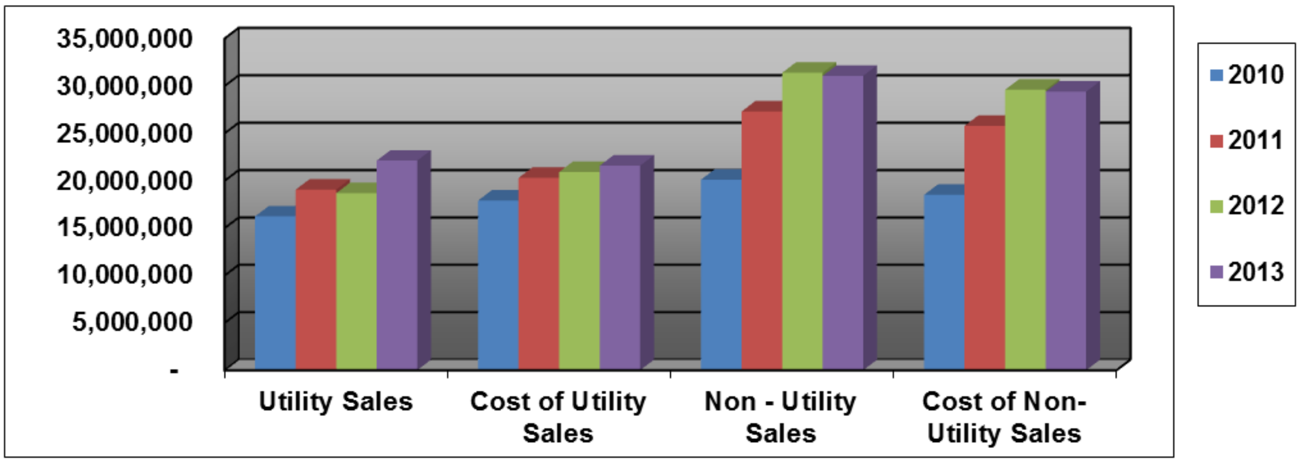
The operating income in 2013 was $2.2 million compared to an operating loss of $0.5 million and $0.8 million in 2012 and 2011, respectively.

The overall shift from operating losses in 2011 and 2012 to operating income in 2013 is a result of the recovery of doubtful accounts of $1.5 million.

Total expenses increased by $0.5 million from $50.5 million in 2012 to $51.0 million in 2013. Non-utility expenses decreased by $0.2 million while utility expenses increased by $0.7 million. The increase in utility expenses relates entirely to increased expenditure on repair and maintenance work done on generators during the year.

Efficiency in engine operations resulted in the decrease of cost of fuel used for generation, which decreased by $0.25 million from $13.3 million in 2012 to $13.05 million in 2013.

The graphic below shows the major components of revenue from 2010 through to 2013:



FUTURE OUTLOOK ON SUSTAINABILITY

In spite of MEC's net deficient 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 in 2011, 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

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.

MEC FOCUS IN THE COMING FISCAL YEAR

The recovery of long outstanding debt and grants received during the year were a key factor in MEC's positive change in net deficient position of $7.5 million for the year ended September 30, 2013.

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

- 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.

- 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, 2012 is set forth in the report on the audit of MEC's financial statements dated August 14, 2013. That Discussion and Analysis explains the major factors impacting the 2012 financial statements.

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, 2013. 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 Position
September 30, 2013 and 2012

ASSETS	2013	2012
Utility plant:		
Electric plant in service	$ 23,129,496	$ 22,634,906
Less accumulated depreciation and amortization	(17,092,357)	(15,801,693)
	6,037,139	6,833,213
Construction work in progress	2,856,785	441,828
Net utility plant	8,893,924	7,275,041
Nonutility property	181,862	181,862
Less accumulated depreciation	(169,110)	(162,755)
Nonutility property, net	12,752	19,107
Total capital assets	8,906,676	7,294,148
Due from employees, net of current portion	106,379	-
Deposit for capital asset acquisitions	1,152,091	-
Other non-current assets	100,000	100,000
Total non-current assets	10,265,146	7,394,148
Current assets:		
Cash	928,818	686,696
Time certificates of deposit	500,000	-
Accounts receivable:		
Electricity	6,870,263	7,249,255
RepMar and other affiliates	3,544,222	3,985,264
Due from employees, net of long-term portion	28,744	7,325
Other	2,195,573	1,112,116
Total accounts receivable	12,638,802	12,353,960
Less allowance for uncollectible accounts	(5,147,506)	(5,256,420)
Net accounts receivable	7,491,296	7,097,540
Fuel and supplies	1,827,991	1,740,265
Prepayments	45,030	382,178
Total current assets	10,793,135	9,906,679
Total assets	$ 21,058,281	$ 17,300,827

See accompanying notes to financial statements.

MARSHALLS ENERGY COMPANY, INC.

Statements of Net Position, Continued
September 30, 2013 and 2012

NET POSITION AND LIABILITIES	2013	2012
Net position:		
Net investment in capital assets	$ 3,361,388	$ 1,936,445
Restricted - expendable for capital acquisitions	404,006	-
Unrestricted	(7,992,817)	(13,631,192)
Total net position	(4,227,423)	(11,694,747)
Commitment and contingencies		
Noncurrent liabilities:		
Long-term debt	13,495,449	14,399,733
Current liabilities:		
Short-term debt	161,588	-
Current portion of long-term debt	1,063,186	655,968
Accounts payable - fuel	6,152,640	7,359,557
Accounts payable - other	1,319,741	1,082,682
Advances from related party	-	2,000,000
Payable to affiliates	689,536	577,279
Accrued building and engine repairs	300,000	1,930,394
Accrued taxes	344,162	344,162
Other accrued liabilities	329,430	498,979
Unearned income	1,429,972	146,820
Total current liabilities	11,790,255	14,595,841
Total liabilities	25,285,704	28,995,574
Total net position and liabilities	$ 21,058,281	$ 17,300,827

See accompanying notes to financial statements.

MARSHALLS ENERGY COMPANY, INC.

Statements of Revenues, Expenses and Changes in Net Position
Years Ended September 30, 2013 and 2012

	2013	2012
Utility operations:		
Operating revenues:		
Electricity sales	$ 20,557,502	$ 20,794,441
Other	84,403	95,829
	20,641,905	20,890,270
Recovery of (provision for) doubtful accounts	1,467,402	(2,215,671)
Total net operating revenues	22,109,307	18,674,599
Operating expenses:		
Cost of fuel	13,050,322	13,323,084
Cost of power	4,149,384	3,291,979
Administrative and general	1,381,917	1,475,185
Distribution operations	1,696,132	1,603,211
Depreciation and amortization	1,298,837	1,226,284
Total operating expenses	21,576,592	20,919,743
Operating earnings (loss) from utility operations	532,715	(2,245,144)
Nonutility operations:		
Operating revenues:		
Fuel sales	30,154,384	30,474,856
Propane sales	730,538	701,372
Lubricants sales	66,947	66,904
Other	106,885	140,508
Total net operating revenues	31,058,754	31,383,640
Operating expenses:		
Cost of fuel	27,852,348	28,181,218
Cost of propane and lubricants	500,317	411,609
Other	1,041,111	997,663
Total operating expenses	29,393,776	29,590,490
Operating income from nonutility operations	1,664,978	1,793,150
Operating earnings (loss)	2,197,693	(451,994)
Nonoperating income (expense):		
RepMar subsidy	800,000	874,944
Payments to RepMar	-	(165,182)
Other income	1,630,394	210,428
Other grants	284,062	689,697
Interest expense	(468,121)	(870,297)
Total nonoperating income (expense), net	2,246,335	739,590
Capital contributions:		
Rural Utilities Service	2,062,310	-
Asian Development Bank	960,986	418,072
	3,023,296	418,072
Change in net position	7,467,324	705,668
Net position at beginning of year	(11,694,747)	(12,400,415)
Net position at end of year	$ (4,227,423)	$ (11,694,747)

See accompanying notes to financial statements.

MARSHALLS ENERGY COMPANY, INC.

Statements of Cash Flows
Years Ended September 30, 2013 and 2012

	2013	2012
Cash flows from operating activities:		
Cash received from customers	$ 52,078,876	$ 49,265,081
Cash payments to suppliers for goods and services	(47,623,770)	(45,092,926)
Cash payments to employees for services	(2,886,027)	(2,842,410)
Net cash provided by operating activities	1,569,079	1,329,745
Cash flows from noncapital financing activities:		
Subsidy from RepMar	800,000	874,944
Payments to RepMar	-	(165,182)
Grants received	284,062	689,697
Proceeds from advances from related party	-	2,000,000
Net proceeds from (payments of) short-term debt	161,588	(2,760,404)
Interest paid on short-term debt	-	(121,955)
Principal paid on long-term debt	(684,650)	(346,275)
Interest paid on long-term debt	(247,797)	(90,498)
Net cash provided by noncapital financing activities	313,203	80,327
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets	(2,911,365)	(862,508)
Deposits for capital assets acquisition	(1,152,091)	-
Capital contributions received	3,023,296	418,072
Principal paid on long-term debt	-	(644,319)
Interest paid on long-term debt	(100,000)	(227,057)
Net cash used for capital and related financing activities	(1,140,160)	(1,315,812)
Cash flows from investing activities:		
Net investment in time certificates of deposit	(500,000)	-
Net change in cash	242,122	94,260
Cash at beginning of year	686,696	592,436
Cash at end of year	$ 928,818	$ 686,696
Reconciliation of operating earnings (loss) to net cash provided by operating activities:		
Operating earnings (loss)	$ 2,197,693	$ (451,994)
Adjustments to reconcile operating earnings (loss) to net cash provided by operating activities:		
Depreciation and amortization	1,298,837	1,226,284
(Recovery of) provision for doubtful accounts	(1,467,402)	2,215,671
(Increase) decrease in assets:		
Accounts receivable:		
Electricity	(262,520)	(2,563,259)
Affiliates	441,042	192,599
Due from employees	(127,798)	-
Other	(1,083,457)	(224,568)
Fuel and supplies	(87,726)	7,232,635
Prepayments	337,148	(382,178)
Other assets	-	(100,000)
Increase (decrease) in liabilities:		
Accounts payable - fuel	(1,206,917)	(4,991,254)
Accounts payable - other	237,059	(130,463)
Payable to affiliates	112,257	77,746
Accrued taxes	-	(211,466)
Other accrued liabilities	(102,289)	(146,407)
Deferred revenue	1,283,152	(413,601)
Net cash provided by operating activities	$ 1,569,079	$ 1,329,745

See accompanying notes to financial statements.

MARSHALLS ENERGY COMPANY, INC.

Statements of Cash Flows, Continued
Years Ended September 30, 2013 and 2012

	2013	2012
Summary disclosure of noncash activities:		
Reversal of prior year accrual for building and engine repairs:		
Accrued building and engine repairs	$ (1,630,394)	$ (210,428)
Other income	1,630,394	210,428
	$ -	$ -
Deferred loan payments under RUS debt settlement agreement:		
Long-term debt	$ 187,584	$ 112,014
Interest expense	(187,584)	(112,014)
	$ -	$ -
Off-set of advances from RepMar:		
Electricity receivables	$ 2,000,000	$ -
Advances from RepMar	(2,000,000)	-
	$ -	$ -

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 (GAAP) as applicable to governmental entities, specifically proprietary funds.

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 position categories:

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

- Restricted - result when constraints placed on asset use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law.

- Unrestricted - net position that is not subject to externally imposed stipulations. Unrestricted net position 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 position. Proprietary fund operating statements present increases and decreases in net total position. 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 and Time Certificates of Deposit

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.

(2) Summary of Significant Accounting Policies, Continued

Cash and Time Certificates of Deposit, Continued

For purposes of the statements of net position and cash flows, cash is defined as cash on hand and cash held in demand accounts. Deposits maintained in time certificates of deposit with original maturity dates greater than three months are separately classified. As of September 30, 2013 and 2012, the carrying amount of cash and time certificates of deposit was $1,428,818 and $686,696, respectively, and the corresponding bank balances were $1,572,213 and $897,749, respectively. Of the bank balance amounts, $716,099 and $817,927, respectively, were maintained in a financial institution subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2013 and 2012, bank deposits in the amount of $250,000 and $817,927, respectively, were FDIC insured. The remaining bank deposits of $856,114 and $79,822, respectively, were maintained in financial institutions not subject to depository insurance. 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.

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 collectability 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. Bad debts are written off against the allowance on the specific identification method.

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 systems	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.

(2) Summary of Significant Accounting Policies, Continued

Deferred Outflows of Resources

In addition to assets, the statement of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources represents a consumption of net position that applies to a future period and so will not be recognized as an outflow of resources (deduction of net position) until then. MEC has no items that qualify for reporting in this category.

Deferred Inflows of Resources

In addition to liabilities, the statement of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources represents an acquisition of net position that applies to a future period and so will not be recognized as an inflow of resources (additions to net position) until then. MEC has no items that qualify for reporting in this category.

Reclassifications

Certain balances in the 2012 presentation have been reclassified to conform to the 2013 presentation.

New Accounting Standards

During the year ended September 30, 2013, MEC implemented the following pronouncements:

- GASB Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements,* which addressed 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 implementation of this statement did not have a material effect on the accompanying financial statements.

- GASB Statement No. 61, *The Financial Reporting Entity: Omnibus,* which improved 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 implementation of this statement did not have a material effect on the accompanying financial statements.

- GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements,* which enhanced 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 issued on or before November 30, 1989, which does not conflict or contradict GASB pronouncements. GASB Statement No. 62 superseded GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*. The implementation of this statement did not have a material effect on the accompanying financial statements.

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

- GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which established guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position, and GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities,* which clarifies the appropriate reporting of deferred outflows of resources and deferred inflows of resources to ensure consistency in financial reporting. These Statements amend the net asset reporting requirements in Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments,* and other pronouncements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets. With the implementation of GASB Statement No. 63 and Statement No. 65, the Statement of Net Assets was renamed the Statement of Net Position. In addition, the Statement of Net Position includes two new classifications separate from assets and liabilities. Amounts reported as deferred outflows of resources are reported in a separate section following assets. Likewise, amounts reported as deferred inflows of resources are reported in a separate section following liabilities.

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

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

In January 2013, GASB issued Statement No. 69, *Government Combinations and Disposals of Government Operations*, which improves accounting and financial reporting for state and local governments' combinations and disposals of government operations. Government combinations include mergers, acquisitions, and transfers of operations. A disposal of government operations can occur through a transfer to another government or a sale. The provisions in Statement 69 are effective for fiscal years beginning after December 15, 2013. Management has not yet determined the effect of implementation of these statements on the financial statements of MEC.

In April 2013, GASB issued Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees,* which requires a state or local government guarantor that offers a nonexchange financial guarantee to another organization or government to recognize a liability on its financial statements when it is more likely than not that the guarantor will be required to make a payment to the obligation holders under the agreement. The provisions in Statement 70 are effective for fiscal years beginning after June 15, 2013. Management has not yet determined the effect of implementation of these statements on the financial statements of MEC.

(2) Summary of Significant Accounting Policies, Continued

Estimates

The preparation of financial statements in conformity with GAAP 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, 2013 and 2012, consist of the following:

	2013	2012
Distribution and power plant supplies	$ 1,460,988	$ 1,589,438
Fuel	304,187	126,446
Lubricants	62,816	24,381
	$ 1,827,991	$ 1,740,265

(4) Capital Assets

Capital asset activity for the years ended September 30, 2013 and 2012 is as follows:

	2013			
	October 1, 2012	Additions	Deletions	September 30, 2013
Utility Plant:				
Power plant engines	$ 15,995,292	$ -	$ -	$ 15,995,292
Plant and machinery	1,986,110	188,785	(375)	2,174,520
Solar power systems	1,110,417	-	-	1,110,417
Vehicles	1,073,154	169,995	-	1,243,149
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	566,146	137,628	(1,443)	702,331
	22,634,906	496,408	(1,818)	23,129,496
Less accumulated depreciation and amortization	(15,801,693)	(1,292,482)	1,818	(17,092,357)
	6,833,213	(796,074)	-	6,037,139
Construction work-in-progress	441,828	2,414,957	-	2,856,785
	7,275,041	1,618,883	-	8,893,924
Nonutility Plant:				
LPG terminal	181,862	-	-	181,862
Less accumulated depreciation and amortization	(162,755)	(6,355)	-	(169,110)
	19,107	(6,355)	-	12,752
	$ 7,294,148	$ 1,612,528	$ -	$ 8,906,676

(4) Capital Assets, Continued

	2012			
	October 1, 2011	Additions	Deletions	September 30, 2012
Utility Plant:				
Power plant engines	$ 15,995,292	$ -	$ -	$ 15,995,292
Plant and machinery	1,877,843	108,267	-	1,986,110
Solar power systems	1,110,417	-	-	1,110,417
Vehicles	1,038,244	130,225	(95,315)	1,073,154
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	361,258	204,888	-	566,146
	22,286,841	443,380	(95,315)	22,634,906
Less accumulated depreciation and amortization	(14,677,078)	(1,219,930)	95,315	(15,801,693)
	7,609,763	(776,550)	-	6,833,213
Construction work-in-progress	22,700	419,128	-	441,828
	7,632,463	(357,422)	-	7,275,041
Nonutility Plant:				
LPG terminal	181,862	-	-	181,862
Less accumulated depreciation and amortization	(156,401)	(6,354)	-	(162,755)
	25,461	(6,354)	-	19,107
	$ 7,657,924	$ (363,776)	$ -	$ 7,294,148

In accordance with the Subsidiary Loan Agreement between RepMar and the Asian Development Bank (ADB), MEC created a separate bank account dedicated for repair and maintenance funds (R&M Fund). Starting October 1, 2010, MEC made automatic $35,000 monthly transfers into the R&M Fund from its revenue accounts. Amounts 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. As of September 30, 2013 and 2012, the R&M Fund has a balance of $98,474 and $34,980, respectively.

(5) Long-Term Debt

Long-term debt at September 30, 2013 and 2012 is as follows:

	2013	2012
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. Originally, principal and interest are payable in quarterly installments of $273,770 through January 2, 2018. On June 22, 2012, RUS granted a two-year $2 million loan deferment giving MEC a two-year break from having to make payments to RUS. Effective June 22, 2012 through March 31, 2014, interest payments of $25,000 are due quarterly. Thereafter, quarterly payments of $299,121 are due. The loan will mature on December 31, 2019. 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, 2013 and 2012.	$ 5,545,287	$ 5,357,703
On September 8, 2010, MEC obtained a subsidiary loan from the Asian Development Bank, through RepMar, of $10 million to pay off a bank loan. 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.	8,474,656	8,881,388
Short-term loan renegotiated to mature on July 20, 2015. Interest is calculated at 7.5% per annum. Principal and interest are payable in monthly equal payments of $27,444 (see Note 6).	538,692	816,610
	14,558,635	15,055,701
Less current installments	(1,063,186)	(655,968)
Long-term debt	$ 13,495,449	$ 14,399,733

On June 22, 2012, MEC entered into a debt deferral agreement with RUS wherein RUS and MEC agreed to a combined grant and loan deferment package of $4,300,000. RUS granted MEC a two-year $2,000,000 loan deferment giving MEC a two-year break from having to make certain principal and interest payments. During the years ended September 30, 2013 and 2012, deferred interest payments of $187,584 and $112,014, respectively, were recognized by MEC and added to the principal balance outstanding and payable. A separate $2,300,000 grant was awarded for the purpose of funding the purchase of parts for an engine overhaul. During the year ended September 30, 2013, grant funds in the amount of $2,062,310 were drawn down and expended by MEC.

(5) Long-Term Debt, Continued

Changes in long-term debt during the years ended September 30, 2013 and 2012 are as follows:

	2013				
	Balance October 1, 2012	Additions/ Reclassification	Reductions	Balance September 30, 2013	Balance due in One Year
RUS loan	$ 5,357,703	$ 187,584	$ -	$ 5,545,287	$ 420,089
Commercial bank loan	816,610	-	(277,918)	538,692	299,224
ADB Subsidiary loan	8,881,388	-	(406,732)	8,474,656	343,873
	$ 15,055,701	$ 187,584	$ (684,650)	$ 14,558,635	$ 1,063,186

	2012				
	Balance October 1, 2011	Additions/ Reclassification	Reductions	Balance September 30, 2012	Balance due in One Year
RUS loan	$ 5,890,008	$ 112,014	$ (644,319)	$ 5,357,703	$ -
Commercial bank loan	-	3,577,014	(2,760,404)	816,610	277,556
ADB Subsidiary loan	9,227,663	-	(346,275)	8,881,388	378,412
	$ 5,117,671	$ 3,689,028	$ (3,750,998)	$ 15,055,701	$ 655,968

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

Year ending September 30,	Principal	Interest	Total
2014	$ 1,063,186	$ 341,578	$ 1,404,764
2015	1,497,419	402,696	1,899,115
2016	1,318,359	333,644	1,652,003
2017	1,383,205	268,798	1,652,003
2018	1,483,944	168,059	1,652,003
2019-2023	3,060,861	487,096	3,547,957
2024-2028	1,993,814	313,452	2,307,266
2029-2033	2,149,000	160,575	2,309,575
2034-2035	1,608,847	17,814	626,661
	$ 14,558,635	$ 2,492,712	$ 17,051,347

(6) Short-Term Debt

On May 9, 2013, MEC obtained a short-term loan facility to finance fuel purchases in the amount of $1,000,000 from a financial institution, interest at 4.5% per annum, payable in monthly installments of principal and interest of $170,000, due October 31, 2013.

In 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. On July 12, 2012, MEC and the financial institution agreed to extend the maturity of the short- term loan from September 20, 2012 to July 20, 2015 (see Note 5).

(6) Short-Term Debt, Continued

Changes in short-term debt during the years ended September 30, 2013 and 2012, are as follows:

2013			
Balance October 1, 2012	Additions	Reductions	Balance September 30, 2013
$ -	$ 1,000,000	$ (838,412)	$ 161,588

2012			
Balance October 1, 2011	Additions	Reductions	Balance September 30, 2012
$ 3,577,014	$ -	$ (3,577,014)	$ -

(7) Employee Retirement Plan

MEC has implemented a defined contribution retirement savings plan (the Plan) for its employees whereby employees eighteen years and older are eligible to participate upon one year of employment. 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 $77,497 and $46,241 to Plan participant accounts during the years ended September 30, 2013 and 2012, respectively and total plan assets were $443,299 and $290,741 as of September 30, 2013 and 2012, 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, 2013 and 2012, MEC is liable for gross revenue tax to RepMar amounting to $233,686 and $233,686, 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, 2013 and 2012, MEC is liable for import duties to RepMar amounting to $110,477 and $110,477, respectively, representing import duty owed prior to October 6, 2008.

(8) Related Party Transactions, Continued

Transactions for the years ended September 30, 2013 and 2012, and the related receivables from and payables to affiliates, are as follows:

	2013			
	Revenues	Expenses	Receivables	Payables
RepMar	$ 4,305,223	$ 1,052,961	$ 333,201	$ 451,801
Kwajalein Atoll Joint Utilities Resources, Inc.	4,323,344	-	1,910,364	-
Majuro Water and Sewer Company, Inc.	541,751	5,680	1,094,442	7,068
Marshall Islands Social Security Administration	58,928	276,826	4,495	119,836
Majuro Resort, Inc.	570,184	60,360	325	81,393
Other	2,004,030	243,812	201,395	8,724
	$ 11,803,459	$ 1,639,639	$ 3,544,222	$ 689,536

	2012			
	Revenues	Expenses	Receivables	Payables
RepMar	$ 4,334,341	$ 1,033,712	$1,664,002	$ 246,005
Kwajalein Atoll Joint Utilities Resources, Inc.	4,963,507	-	539,552	-
Majuro Water and Sewer Company, Inc.	475,548	1,014	666,612	1,389
Marshall Islands Social Security Administration	51,977	239,517	-	244,571
Majuro Resort, Inc.	638,792	51,889	577,087	57,257
Other	2,566,726	187,602	538,011	28,057
	$ 13,030,891	$ 1,513,734	$ 3,985,264	$ 577,279

The allowance for uncollectable accounts pertaining to receivables from affiliates amounted to $1,083,163 and $1,726,520 as of September 30, 2013 and 2012, respectively.

During the years ended September 30, 2013 and 2012, MEC received operating subsidies from RepMar of $800,000 and $874,944, respectively.

During the years ended September 30, 2013 and 2012, MEC deposited $0 and $165,182, 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.

On August 6, 2010, the Asian Development Bank (ADB) approved a grant to RepMar in the amount of $1,760,000 to be financed by the Japan Fund for Poverty Reduction. The purpose of the grant is to extend access to clean electricity to disconnected and unconnected poor households through the Improved Energy Supply For Poor Households Project. MEC is the Implementing Agency and administers grant funds drawn down against the grant. During the years ended September 30, 2013 and 2012, grant funds in the amount of $960,986 and $418,072, respectively, were drawn down and expended by MEC.

(8) Related Party Transactions, Continued

During the year ended September 30, 2013, MEC entered into an agreement with RepMar to reconcile reciprocal accounts receivable and liability balances, offsetting such balances in lieu of cash payment for settlement. The agreement resulted in forgiveness of MEC's $1.9 million outstanding liability to MIMRA, a $500,000 advance from RepMar, and $1,162,871 of unpaid withholding taxes and gross receipt taxes. In return, MEC offset receivables from RepMar aggregating $784,719 and $271,865 of utility billings and fuel receivables, respectively. In addition, MEC's receivable from Marshall Islands Resort, Inc. of $2,365,635 was also settled. This transaction resulted in a recovery of previously allowed for accounting receivables of $1,467,402.

(9) Commitment and Contingencies

Commitment

MEC purchases petroleum products from Winson Oil International (HK) Ltd. (Winson) on a consignment basis whereby Winson continues to hold ownership and title to the product while it is held in storage at the MEC terminal storage tanks. Title and risk on the product remains with Winson until the product passes the boundary of the MEC terminal. The value of consignment petroleum products as of September 30, 2013 is approximately $4,746,622. MEC assumes responsibility for the proper and safe storage/handling of the product while under MEC storage. However, MEC carries insurance coverage on such consignment inventories.

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. 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.

In view of these matters, realization of a major portion of the assets in the accompanying statement of net assets at September 30, 2012, 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.

(9) Commitment and Contingencies, Continued

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 damage to MEC’s power plant building and engines were netted against the estimated repair costs to put the assets back into service. Accrued building and engine repairs expense as of September 30, 2013 and 2012 amounted to $300,000 and $1,930,394, respectively.

(11) Other Income

During the year ended September 30, 2013, MEC wrote-off a prior bad debt for building and engine repairs of $1,630,394.

MARSHALLS ENERGY COMPANY, INC.

Schedule of Revenues, Expenses and Changes in Net Position by Division
Year Ended September 30, 2013

	Generation	Distribution	Tank Farm	Jaluit	Wotje	Solar	MEC Gas	Admin.	TOTAL
Operating revenues:									
Fuel, propane and lube sales	$ -	$ -	$ 30,203,845	$ 6,529	$ 2,010	$ -	$ 730,538	$ -	$ 30,942,922
Cost of sales	-	-	27,909,300	-	-	-	455,247	-	28,364,547
Gross profit on sales	-	-	2,294,545	6,529	2,010	-	275,291	-	2,578,375
Electric and service billings	19,992,771	-	-	278,629	191,407	94,695	8,810	-	20,566,312
Service and other income	-	65,545	57,429	6,524	76	100	500	61,252	191,426
Less provision for doubtful accounts	-	-	-	-	-	-	-	1,467,402	1,467,402
Total electricity sales and other income	19,992,771	65,545	57,429	285,153	191,483	94,795	9,310	1,528,654	22,225,140
Total net operating revenue	19,992,771	65,545	2,351,974	291,682	193,493	94,795	284,601	1,528,654	24,803,515
Operating expenses:									
Advertising	527	-	-	-	-	-	1,028	8,830	10,385
Auto POL and maintenance	38,931	96,104	10,898	704	445	2,023	4,729	45,681	199,515
Bank charges	613	-	450	-	-	-	-	11,386	12,449
Communications	20,874	22,730	978	780	770	-	697	29,941	76,770
Depreciation and amortization	980,362	55,732	25,626	4,889	5,430	74,028	18,747	134,023	1,298,837
Donations	1,150	660	-	783	234	-	20	12,203	15,050
Entertainment	1,307	5,116	3,043	-	-	54	-	36,697	46,217
Equipment rental	616	3,523	140	20,000	-	-	-	2,704	26,983
Freight and handling	56,689	15,010	88,817	37,430	33,459	1,077	-	10,441	242,923
Fuel and lubes	13,121,290	(3,717)	-	195,290	237,998	-	-	-	13,550,861
Gross revenue tax	120	1,409	906,092	364	78	3	22,119	1,809	931,994
Import tax	16,650	6,139	1,406	552	3,785	200	-	488	29,220
Insurance	152,074	12,792	80,510	8,044	7,856	-	2,807	9,608	273,691
Lease rental	4,950	9,000	-	5,858	4,791	-	-	3,511	28,110
Membership and other fees	45	541	-	-	-	-	-	30,374	30,960
Office	280,598	8,523	113,856	5,962	6,200	4,800	18,498	(35,125)	403,312
Professional and consulting fees	16,980	-	-	-	-	-	-	39,577	56,557
Repairs and maintenance	638,112	882,225	18,199	45,672	25,990	8,215	7,754	15,247	1,641,414
Safety and uniforms	11,806	409	701	-	-	570	-	234	13,720
Salaries, wages and benefits	1,206,044	568,469	131,995	184,830	138,021	74,834	44,386	907,711	3,256,290
Security services	15,679	-	17,104	-	-	-	17,104	1,162	51,049
Staff training	-	3,091	2,620	1,750	2,150	-	214	12,516	22,341
Travel	29,914	3,550	3,137	10,765	5,915	1,390	-	97,472	152,143
Utility	122,237	11,836	493	14,799	-	-	-	85,666	235,031
Total operating expenses	16,717,568	1,703,142	1,406,065	538,472	473,122	167,194	138,103	1,462,156	22,605,822
Operating income (loss)	3,275,203	(1,637,597)	945,909	(246,790)	(279,629)	(72,399)	146,498	66,498	2,197,693
Nonoperating income (expense):									
RepMar subsidy	-	-	-	400,000	400,000	-	-	-	800,000
Other Grants	284,062	-	-	-	-	-	-	-	284,062
Reversal of accrual for building and engine repairs	-	-	-	-	-	-	-	1,630,394	1,630,394
Interest expense	-	-	-	-	-	-	-	(468,121)	(468,121)
	284,062	-	-	400,000	400,000	-	-	1,162,273	2,246,335
Capital contributions - RepMar	3,023,296	-	-	-	-	-	-	-	3,023,296
Change in net position	$ 6,582,561	$ (1,637,597)	$ 945,909	$ 153,210	$ 120,371	$ (72,399)	$ 146,498	$ 1,228,771	$ 7,467,324

See accompanying independent auditors' report.

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INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

Board of Directors
Marshalls Energy Company, Inc.:

We have audited, in accordance with the 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, the financial statements of the Marshalls Energy Company, Inc. (MEC), which comprise the statement of net position as of September 30, 2013, and the related statements of revenues, expenses, and changes in net position and of cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated May 26, 2014.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered MEC's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of MEC's internal control. Accordingly, we do not express an opinion on the effectiveness of MEC's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether MEC's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Findings and Responses as items 2013-001 and 2013-002.

MEC's Response to Findings

MEC's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Responses. MEC's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Deloitte & Touche LLP

May 26, 2014

Finding No. 2013-001

RUS

Questioned Costs: $309,714

Criteria: The Grant Agreement states the following:

1. *Section 10.4*. The Grant Award requires a matching contribution of 21% of the total project cost or $631,000 of preferred match, whichever is less. The grant funds will be advanced on a pro rata basis with the expenditure of matching contributions over the life of the project or until the matching contribution is reached.

2. *Section 10.6*. The Grantee shall report on the expenditure of Grant Funds and any non-Federal project funds in semi-annual financial reports and progress reports during the term of the grant. The Grantee shall attach Form SF 425 "Federal Financial Report" for these reports. Quarterly reports shall be due 30 days from the end of each quarter ending March 31, June 30, September 30, and December 31, of each year.

   Furthermore, adequate internal control policy should be adopted and established to facilitate compliance on Federal laws and regulations.

Condition:

1. No information was available to support that MEC made a matching contribution as of September 30, 2013 except for the quarter ending June 30, 2013, which reflected of $37,826. Based on actual disbursements as of September 30, 2013, MEC should have matched $347,540, which is an understatement of $309,714.

2. A SF 425 at September 30, 2013 was not available during the audit. In addition, no semi-annual financial or progress reports appear to have been submitted during the year.

3. WT # 105400 and 168260 were without formal invoices. Instead, a quotation previously received from the vendor supported the disbursement.

4. No procedure is in place to monitor receipt of delivered orders. Receiving reports are not filed.

5. The entity does not appear to have minimized the time elapsed between the transfer of funds from the grantor and payment to vendors as required by 31 CFR Part 205.10 of the US Department of Treasury. Payments to vendors range from 10 to 196 days after grant cash was received. Furthermore, $404,006 of drawn cash is unexpended as of September 30, 2013.

6. The Company's fixed asset register does not provide sufficient information relative to monitoring management of Federal-funded fixed assets as required by 2 CFR Section 215.34. Furthermore, the Company does not have a formal accounting policy governing physical verification of fixed assets.

Finding No. 2013-001, Continued

RUS, Continued

Cause: The cause of the above conditions is inadequate controls to comply with the grant and Federal laws and regulations.

Effect: The effect of the above condition is noncompliance with grant conditions and Federal laws and regulations.

Recommendation: We recommend management strengthen and improve internal control policies that govern compliance with required grant conditions.

Auditee Response and Corrective Action Plan:

1. Matching contributions up until June 30, 2013 consisted of office time accrued by the MEC Chief Technical Officer and the MEC Advisor for the procurement of equipment and materials necessary for the rebuild of the Deutz #7 engine. With procurement complete, no further matching contributions relating to the rebuild of the engine have been made since June 30, 2013 for the following reasons.

   The rebuild of the Deutz #7 engine has effectively been put on hold until system reliability considerations have been addressed; namely having sufficient serviceable diesel generators available to meet the Majuro energy demand before starting the rebuild.

   What has brought this situation about was the discovery over 12 months ago of deteriorating stator windings in both alternators of the Deutz #6 and #7 machines. This has warranted the purchase of a new stator winding from ABB Finland amounting to some $600K of unbudgeted MEC funds. This stator has now been installed in the #6 alternator and the faulty stator shipped to ABB Australia for repair. Once returned, the Deutz #7 can be taken out of service, the repaired stator winding installed and the rebuild can commence.

   In all, the problems with the two Deutz alternators has put the rebuild of the #7 engine project back around 18 months and the earliest MEC can envisage the work commencing is now the third quarter 2014. Once this work is underway, MEC will again commence making matching contributions until the required target is met.

2. Form SF 425 had not been filed during the time of the audit but has since been filed. MEC is now current with the filing of this form for all quarters for fiscal year 2013 and 2014.

3. For these two disbursements, formal invoices were requested from each of these vendors but were not received in time for payment. Since quoted prices had already been agreed upon by MEC and the vendors, MEC went ahead and processed the payments. Since time of the audit, MEC has received original invoices which have been filed together with the wire transfer payments.

4. Receiving reports for delivered goods were available however, they were not properly filed. MEC has implemented a more systematic format for receiving and filling of all documents relating to the project which will ensure the completeness, accuracy and timeliness of all records.

Finding No. 2013-001, Continued

RUS, Continued

Auditee Response and Corrective Action Plan, Continued:

5. For each of the several vendors individual payment schedules were negotiated, with most agreeing to a three-stage payment schedule were milestone payments were made on the signing of the contract between MEC and the vendor, the notification that the goods were ready to ship and on safe delivery of the goods into MEC stores. Payments for goods readily available of the shelf were made expeditiously whereas goods that required considerable manufacturing time and freightage from as far as the UK and Germany resulted in many months between milestone payments. To highlight this point, the last consignment of goods for the project was only received in February 2014.

   There were, however, occasions when MEC's available cash flow did not permit timely payments to vendors or necessitated making partial payments only, when all available funds in any given month were needed to secure sufficient stocks of diesel fuel. To MEC this was fully justified as the alternative would have resulted in load-shedding throughout Majuro, causing considerable disruption of electricity services to MEC's customers.

Finding No. 2013-002

Coverage Ratios

Criteria: Section 5.4 of the RUS loan contract requires MEC to establish rates to provide revenue sufficient to meet average coverage ratio requirements as follows:

Times Interest Earned Ratio (TIER)	=	1.50
Operating Times Interest Earned Ratio (OTIER)	=	1.10
Operating Debt Service Coverage (ODSC)	=	1.10

Condition: During the year ended September 30, 2013, MEC achieved the following average coverage ratios:

TIER	=	0.8
OTIER	=	(0.8)
ODSC	=	0.5

Cause: The cause of the above condition is that utility rates are not sufficient to provide adequate revenues to comply with the prescribed ratio requirements.

Effect: The effect of the above condition is noncompliance with the average coverage ratio requirements as prescribed by Section 5.4 of the RUS loan contract.

Recommendation: We recommend that management review MEC's rates to comply with average coverage ratio requirements.

Prior Year Status: Noncompliance with the average coverage ratio requirements as prescribed by Section 5.4 of the RUS loan contract was reported as a finding in the audits of MEC for fiscal years 2000 through 2012.

Auditee Response and Corrective Action Plan:

MEC is in agreement with this finding. As wholly owned government entity, MEC is not able to fully obtain and achieve full cost recovery. However, with the approval by the RMI Cabinet, the tariff pricing template has been revised to allow MEC management the flexibility to increase (and decrease) the electricity tariff based on the variable fuel cost component in line with each shipment received.

Until MEC is allowed to achieve full cost recovery, this finding will continue to be an audit finding. It is essential that RepMar continues to provide financial support to the MEC operations. MEC's Comprehensive Recovery Plan (CRP) is an aggressive plan to revive and sustain the MEC's core and financial operations. The CRP includes goals and objectives towards reducing generation costs through initiatives such as alternative power generation solutions, system efficiencies and energy conservations. The CRP milestones reached and impact to the average coverage ratio requirement required by section 5.4 of the RUS loan will be evident in subsequent audit years.

MARSHALLS ENERGY COMPANY, INC.

Unresolved Prior Year Findings
Year Ended September 30, 2013

The status of unresolved prior year findings is disclosed within the Schedule of Findings and Responses section of this report.