

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, 2014 AND 2013

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

Years Ended September 30, 2014 and 2013
Table of Contents

	<u>Page No.</u>
I. INDEPENDENT AUDITORS' REPORT	1
II. MANAGEMENT'S DISCUSSION AND ANALYSIS	3
III. FINANCIAL STATEMENTS:	
Statements of Net Position	7
Statements of Revenues, Expenses and Changes in Net Position	9
Statements of Cash Flows	10
Notes to Financial Statements	12
IV. OTHER SUPPLEMENTARY INFORMATION:	
Schedule of Revenues, Expenses and Changes in Net Position by Division	25
V. INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS	
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 <i>Government Auditing Standards</i>	26
Schedule of Findings and Responses	28
Unresolved Prior Year Findings	30

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, 2014 and 2013, 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, 2014 and 2013, 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

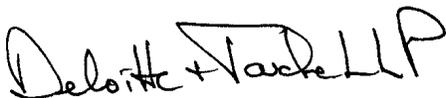
Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 to 6 be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the 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 financial statements, and other knowledge we obtained during our audit of the 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 as a whole. 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 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 financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the 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 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 September 22, 2015, 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.



September 22, 2015

MARSHALLS ENERGY COMPANY, INC.
(A COMPONENT UNIT OF THE REPUBLIC OF THE MARSHALL ISLANDS)

Management's Discussion and Analysis
Years Ended September 30, 2014 and 2013

Marshalls Energy Company, Inc. (MEC) herewith presents a discussion and analysis of the company's financial performance for the fiscal year ended September 30, 2014. It is to be read in conjunction with the financial statements following this section.

FINANCIAL HIGHLIGHTS

MEC's net position increased by \$0.29 million in fiscal year 2014 compared to an increase of \$7.5 million in fiscal year 2013.

In 2014, total net utility operating revenues were \$19.4 million, a decrease of \$2.7 million in comparison to \$22.1 million in net utility operating revenues in 2013.

Total utility operating expenses were \$21.5 million and \$21.6 million in 2014 and 2013, respectively. A decrease of \$0.1 million from 2013 to 2014. Fuel cost continues to be a significant component of generation operating costs and represents 61% of total operating expenses.

Total net operating revenues for nonutility operations, fuel sales being the major component, were \$31.8 million and \$31.1 million in 2014 and 2013, respectively. Total nonutility operating expenses increased by \$0.3 million, with \$29.7 million and \$29.4 million in 2014 and 2013, respectively.

No grants were received in fiscal year 2014. In fiscal year 2013, a total of \$3.3 million in grants were received. This includes \$0.28 million from AusAid for the purchase of prepaid meters, \$0.96 million from ADB for Peilstick engine parts, and \$2.1 million from RUS for the rehabilitation of Engine#7.

MEC received subsidies of \$0.7 million in 2014 compared to subsidies of \$0.8 million in 2013 as cost recovery for the operations of Wotje and Jaluit power plants. Subsidies for Jaluit and Wotje in 2014 amounted to \$347,200 and \$347,200, 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 reflects 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, 2014.

MARSHALLS ENERGY COMPANY, INC.
(A COMPONENT UNIT OF THE REPUBLIC OF THE MARSHALL ISLANDS)

Management's Discussion and Analysis
Years Ended September 30, 2014 and 2013

Summary Statements of Net Position for MEC is presented below:

	<u>2014</u>		<u>2013</u>		<u>2012</u>
Current and other assets	\$ 13,150,855	\$	12,151,605	\$	10,006,679
Capital assets	9,779,736		8,906,676		7,294,148
Total assets	22,930,591		21,058,281		17,300,827
Current and other liabilities	13,394,729		10,727,069		13,939,873
Long-term debt	13,475,357		14,558,635		15,055,701
Total liabilities	26,870,086		25,285,704		28,995,574
Net position:					
Net investment in capital assets	4,646,317		3,361,388		1,936,445
Restricted	-		404,006		-
Unrestricted	(8,585,812)		(7,992,817)		(13,631,192)
Total net position	\$ (3,939,495)	\$	(4,227,423)	\$	(11,694,747)

Total assets increased by \$1.9 million (or 9%) from 2013 to 2014 and increased by \$3.7 million from 2012 to 2013. The increase in total assets by \$3.7 million in 2013 is mainly attributable to the construction work in progress for engine#3 (under the ADB grant) and engine#7 (under the RUS grant). Repair works done on engine#3 and #7 continued in 2014 with Construction work in progress amounting to \$4.5 million and \$2.9 million in 2014 and 2013, respectively.

Construction work in progress as of September 30, 2014 consisted of engine repair works for engine#3 (under ADB grant) of \$1.4 million and engine#7 (under RUS grant) for \$2.2 million, tank refurbishment works for \$0.4 million and Warehouse construction for \$0.4 million.

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

Total liabilities increased from \$25.3 million in 2013 to \$26.9 million in 2014 in the amount of \$1.6 million. The overall increase of \$1.6 million (or 6%) is mainly attributable to the net impact of the increase in short term debt of \$2.5 million, increase in unearned income of \$0.6 million and decrease in long-term debt of \$1.5 million.

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

MARSHALLS ENERGY COMPANY, INC.
(A COMPONENT UNIT OF THE REPUBLIC OF THE MARSHALL ISLANDS)

Management's Discussion and Analysis
Years Ended September 30, 2014 and 2013

Summary of MEC's Statements of Revenues, Expenses and Changes in Net Position is presented below:

	<u>2014</u>	<u>2013</u>	<u>2012</u>
Revenue:			
Utility revenue	\$ 19,435,950	\$ 22,109,307	\$ 18,674,599
Non-utility revenue	31,788,150	31,058,754	31,383,640
Total Revenue	<u>51,224,100</u>	<u>53,168,061</u>	<u>50,058,239</u>
Expenses:			
Utility expenses	21,469,083	21,576,592	20,919,743
Non-utility expenses	29,665,616	29,393,776	29,590,490
Total expenses	<u>51,134,699</u>	<u>50,970,368</u>	<u>50,510,233</u>
Operating earnings / (loss)	<u>89,401</u>	<u>2,197,693</u>	<u>(451,994)</u>
RMI subsidy	694,400	800,000	874,944
Other grants	-	284,062	689,697
Payments to RepMar	-	-	(165,182)
Other income	-	1,630,394	210,428
Interest expense	(495,873)	(468,121)	(870,297)
Capital contributions	-	3,023,296	418,072
	<u>198,527</u>	<u>5,269,631</u>	<u>1,157,662</u>
Change in net position	<u>\$ 287,928</u>	<u>\$ 7,467,324</u>	<u>\$ 705,668</u>

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 decreased in 2014 by \$2.0 million (or 4%) to a total of \$51.2 million compared to \$53.2 million in 2013.

Utility revenue decreased by \$2.7 million (or 12%) from \$22.1 million in 2013 to \$19.4 million in 2014. The decrease relates to a decrease in electricity sales revenue of \$0.5 million and additional provision for bad debts of \$0.7 million. In 2013, there was a net recovery of allowance for doubtful accounts of \$1.5 million.

Nonutility revenue is mainly fuel sales. Nonutility revenue increased by \$0.7 million (or 2%) in 2014 to \$31.8 million compared to \$31.1 million in 2013. The increase relates to slight increase in fuel sales volume.

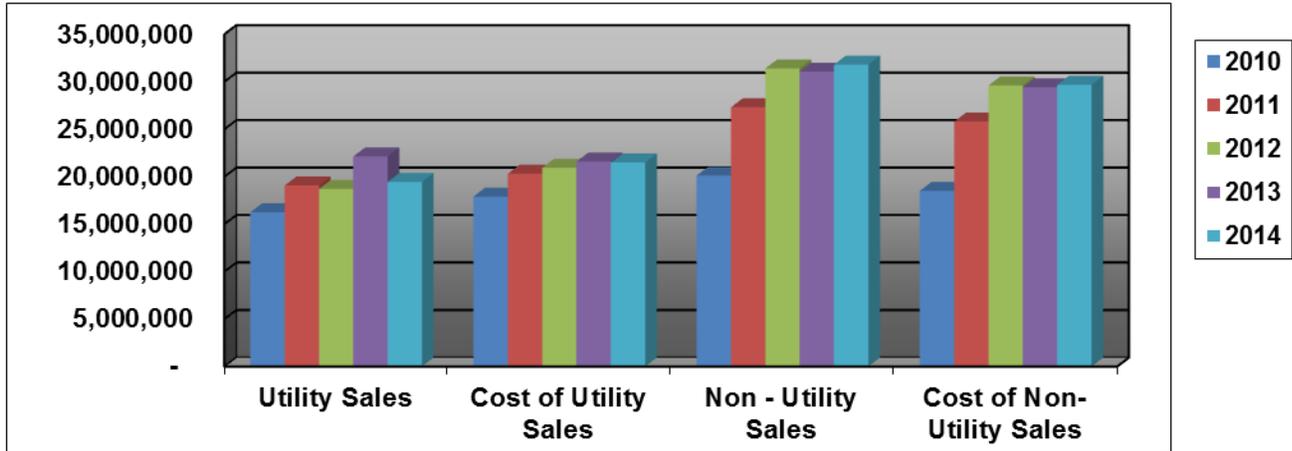
The operating income in 2014 was approximately \$89,000 compared to an operating income of \$2.2 million and operating loss of \$0.5 million in 2013 and 2012, respectively.

Total expenses increased by \$0.2 million from \$50.9 million in 2013 to \$51.1 million in 2014. Non-utility expenses increased by \$0.3 million while utility expenses slightly decreased by \$0.1 million.

MARSHALLS ENERGY COMPANY, INC.
(A COMPONENT UNIT OF THE REPUBLIC OF THE MARSHALL ISLANDS)

Management's Discussion and Analysis
Years Ended September 30, 2014 and 2013

The graphic below shows the major components of revenue from 2010 through to 2014:



MEC FOCUS IN THE COMING FISCAL YEAR

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

- Monitor MEC's CRP. - 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.
- Enforcement of disconnection policy. - As long as MEC allows outstanding accounts receivable balances to age, the greater MEC's risk and exposure is to bad debts and continued cash flow constraints.
- Complete construction work in progress for engine#3 and #7 works and MEC warehouse.
- 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, 2013 is set forth in the report on the audit of MEC's financial statements dated May 26, 2014. That Discussion and Analysis explains the major factors impacting the 2013 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 of September 30, 2014. 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.
(A COMPONENT UNIT OF THE REPUBLIC OF THE MARSHALL ISLANDS)

Statements of Net Position
September 30, 2014 and 2013

<u>ASSETS</u>	<u>2014</u>	<u>2013</u>
Utility plant:		
Electric plant in service	\$ 23,676,066	\$ 23,129,496
Less accumulated depreciation and amortization	(18,418,791)	(17,092,357)
	<u>5,257,275</u>	<u>6,037,139</u>
Construction work in progress	4,516,063	2,856,785
Net utility plant	<u>9,773,338</u>	<u>8,893,924</u>
Nonutility property	181,862	181,862
Less accumulated depreciation	(175,464)	(169,110)
Nonutility property, net	<u>6,398</u>	<u>12,752</u>
Total capital assets	<u>9,779,736</u>	<u>8,906,676</u>
Due from employees, net of current portion	83,107	106,379
Deposit for capital asset acquisitions	-	1,152,091
Other non-current assets	-	100,000
Total non-current assets	<u>9,862,843</u>	<u>10,265,146</u>
Current assets:		
Cash	530,983	928,818
Time certificates of deposit	1,017,926	500,000
Accounts receivable:		
Electricity	6,547,899	6,870,263
RepMar and other affiliates	6,242,251	3,544,222
Due from employees, current portion	28,744	28,744
Other	1,979,893	2,195,573
Total accounts receivable	14,798,787	12,638,802
Less allowance for uncollectible accounts	(5,963,723)	(5,147,506)
Net accounts receivable	<u>8,835,064</u>	<u>7,491,296</u>
Fuel and supplies	2,569,491	1,827,991
Prepayments	114,284	45,030
Total current assets	<u>13,067,748</u>	<u>10,793,135</u>
Total assets	<u>\$ 22,930,591</u>	<u>\$ 21,058,281</u>

See accompanying notes to financial statements.

MARSHALLS ENERGY COMPANY, INC.
(A COMPONENT UNIT OF THE REPUBLIC OF THE MARSHALL ISLANDS)

Statements of Net Position, Continued
September 30, 2014 and 2013

<u>NET POSITION AND LIABILITIES</u>	<u>2014</u>	<u>2013</u>
Net position:		
Net investment in capital assets	\$ 4,646,317	\$ 3,361,388
Restricted - expendable for capital acquisitions	-	404,006
Unrestricted	<u>(8,585,812)</u>	<u>(7,992,817)</u>
Total net position	<u>(3,939,495)</u>	<u>(4,227,423)</u>
Commitment and contingencies		
Noncurrent liabilities:		
Long-term debt	<u>12,006,371</u>	<u>13,495,449</u>
Current liabilities:		
Short-term debt	2,571,141	161,588
Current portion of long-term debt	1,468,986	1,063,186
Accounts payable - fuel	5,603,257	6,152,640
Accounts payable - other	608,494	1,319,741
Payable to affiliates	1,240,710	689,536
Accrued building and engine repairs	300,000	300,000
Accrued taxes	672,986	344,162
Other accrued liabilities	344,076	329,430
Unearned income	<u>2,054,065</u>	<u>1,429,972</u>
Total current liabilities	<u>14,863,715</u>	<u>11,790,255</u>
Total liabilities	<u>26,870,086</u>	<u>25,285,704</u>
Total net position and liabilities	<u>\$ 22,930,591</u>	<u>\$ 21,058,281</u>

See accompanying notes to financial statements.

MARSHALLS ENERGY COMPANY, INC.
(A COMPONENT UNIT OF THE REPUBLIC OF THE MARSHALL ISLANDS)

Statements of Revenues, Expenses and Changes in Net Position
Years Ended September 30, 2014 and 2013

	2014	2013
Utility operations:		
Operating revenues:		
Electricity sales	\$ 20,080,765	\$ 20,557,502
Other	62,298	84,403
	20,143,063	20,641,905
(Provision for) recovery of doubtful accounts	(707,113)	1,467,402
Total net operating revenues	19,435,950	22,109,307
Operating expenses:		
Cost of fuel	13,142,873	13,050,322
Cost of power	3,920,103	4,149,384
Administrative and general	1,716,188	1,381,917
Distribution operations	1,357,131	1,696,132
Depreciation and amortization	1,332,788	1,298,837
Total operating expenses	21,469,083	21,576,592
Operating (loss) earnings from utility operations	(2,033,133)	532,715
Nonutility operations:		
Operating revenues:		
Fuel sales	30,519,603	30,154,384
Propane sales	666,469	730,538
Lubricants sales	61,213	66,947
Other	540,865	106,885
Total net operating revenues	31,788,150	31,058,754
Operating expenses:		
Cost of fuel	28,192,596	27,852,348
Cost of propane and lubricants	451,465	500,317
Other	1,021,555	1,041,111
Total operating expenses	29,665,616	29,393,776
Operating income from nonutility operations	2,122,534	1,664,978
Operating earnings	89,401	2,197,693
Nonoperating income (expense):		
RepMar subsidy	694,400	800,000
Other income	-	1,630,394
Other grants	-	284,062
Interest expense	(495,873)	(468,121)
Total nonoperating income, net	198,527	2,246,335
Capital contributions:		
Rural Utilities Service	-	2,062,310
Asian Development Bank	-	960,986
	-	3,023,296
Change in net position	287,928	7,467,324
Net position at beginning of year	(4,227,423)	(11,694,747)
Net position at end of year	\$ (3,939,495)	\$ (4,227,423)

See accompanying notes to financial statements.

MARSHALLS ENERGY COMPANY, INC.
(A COMPONENT UNIT OF THE REPUBLIC OF THE MARSHALL ISLANDS)

Statements of Cash Flows
Years Ended September 30, 2014 and 2013

	2014	2013
Cash flows from operating activities:		
Cash received from customers	\$ 49,900,025	\$ 52,078,876
Cash payments to suppliers for goods and services	(47,149,604)	(47,623,770)
Cash payments to employees for services	(2,855,128)	(2,886,027)
Net cash (used for) provided by operating activities	(104,707)	1,569,079
Cash flows from noncapital financing activities:		
Subsidy from RepMar	694,400	800,000
Payments to RepMar	-	-
Grants received	-	284,062
Proceeds from advances from related party	-	-
Net proceeds from (payments of) short-term debt	2,409,553	161,588
Interest paid on short-term debt	(12,541)	-
Principal paid on long-term debt	(671,410)	(684,650)
Interest paid on long-term debt	(113,542)	(247,797)
Net cash provided by noncapital financing activities	2,306,460	313,203
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets	(1,441,765)	(2,911,365)
Deposits for capital assets acquisition	-	(1,152,091)
Capital contributions received	-	3,023,296
Principal paid on long-term debt	(411,867)	-
Interest paid on long-term debt	(228,030)	(100,000)
Net cash used for capital and related financing activities	(2,081,662)	(1,140,160)
Cash flows from investing activities:		
Net investment in time certificates of deposit	(517,926)	(500,000)
Net change in cash	(397,835)	242,122
Cash at beginning of year	928,818	686,696
Cash at end of year	\$ 530,983	\$ 928,818
Reconciliation of operating earnings to net cash (used for) provided by operating activities:		
Operating earnings	\$ 89,401	\$ 2,197,693
Adjustments to reconcile operating earnings to net cash (used for) provided by operating activities:		
Depreciation and amortization	1,332,788	1,298,837
Provision for (recovery of) doubtful accounts	707,113	(1,467,402)
Reversal of construction in progress	388,006	-
(Increase) decrease in assets:		
Accounts receivable:		
Electricity	(272,931)	(262,520)
RepMar and other affiliates	(2,698,029)	441,042
Due from employees	23,272	(127,798)
Other	215,680	(1,083,457)
Fuel and supplies	(741,500)	(87,726)
Prepayments	(69,254)	337,148
Other non-current assets	100,000	-
Increase (decrease) in liabilities:		
Accounts payable - fuel	(654,681)	(1,206,917)
Accounts payable - other	(711,247)	237,059
Payable to affiliates	1,255,573	112,257
Accrued taxes	439,300	-
Other accrued liabilities	(132,291)	(102,289)
Unearned income	624,093	1,283,152
Net cash (used for) provided by operating activities	\$ (104,707)	\$ 1,569,079

See accompanying notes to financial statements.

MARSHALLS ENERGY COMPANY, INC.
(A COMPONENT UNIT OF THE REPUBLIC OF THE MARSHALL ISLANDS)

Statements of Cash Flows, Continued
Years Ended September 30, 2014 and 2013

	2014	2013
Summary disclosure of noncash activities:		
Tax dues offset from RepMar:		
Payable to affiliates	\$ 704,399	\$ -
Electricity receivables	(704,399)	-
	\$ -	\$ -
Reversal of prior year accrual for building and engine repairs:		
Accrued building and engine repairs	\$ -	\$ (1,630,394)
Other income	-	1,630,394
	\$ -	\$ -
Deferred loan payments under RUS debt settlement agreement:		
Long-term debt	\$ -	\$ 187,584
Interest expense	-	(187,584)
	\$ -	\$ -
Off-set of advances from RepMar:		
Electricity receivables	\$ -	\$ 2,000,000
Advances from RepMar	-	(2,000,000)
	\$ -	\$ -

See accompanying notes to financial statements.

MARSHALLS ENERGY COMPANY, INC.
(A COMPONENT UNIT OF THE REPUBLIC OF THE MARSHALL ISLANDS)

Notes to Financial Statements
September 30, 2014 and 2013

(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 financial statements and notes and modifies certain other financial statement disclosure requirements.

MARSHALLS ENERGY COMPANY, INC.
(A COMPONENT UNIT OF THE REPUBLIC OF THE MARSHALL ISLANDS)

Notes to Financial Statements
September 30, 2014 and 2013

(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.

MARSHALLS ENERGY COMPANY, INC.
(A COMPONENT UNIT OF THE REPUBLIC OF THE MARSHALL ISLANDS)

Notes to Financial Statements
September 30, 2014 and 2013

(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, 2014 and 2013, the carrying amount of cash and time certificates of deposit was \$1,548,909 and \$1,428,818, respectively, and the corresponding bank balances were \$2,124,784 and \$2,072,213, respectively. Of the bank balance amounts, \$835,692 and \$716,099, respectively, were maintained in a financial institution subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2014 and 2013, bank deposits in the amount of \$273,166 and \$250,000, respectively, were FDIC insured. The remaining bank deposits of \$1,275,743 and \$1,356,114, 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.

MARSHALLS ENERGY COMPANY, INC.
(A COMPONENT UNIT OF THE REPUBLIC OF THE MARSHALL ISLANDS)

Notes to Financial Statements
September 30, 2014 and 2013

(2) Summary of Significant Accounting Policies, Continued

Deferred Outflows of Resources

In addition to assets, the statements 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 statements 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.

New Accounting Standards

During the year ended September 30, 2014, MEC implemented the following pronouncements:

- GASB 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 implementation of this statement did not have a material effect on the accompanying financial statements.
- GASB Statement No. 67, *Financial Reporting for Pension Plans*, which revises existing guidance for the financial reports of most pension plans. The implementation of this statement did not have a material effect on the accompanying financial statements.
- GASB 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 implementation of this statement did not have a material effect on the accompanying financial statements.

In June 2012, GASB issued 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 68 are effective for fiscal years beginning after June 15, 2014. Management has not yet determined the effect of implementation of this statement on the financial statements of MEC.

MARSHALLS ENERGY COMPANY, INC.
(A COMPONENT UNIT OF THE REPUBLIC OF THE MARSHALL ISLANDS)

Notes to Financial Statements
September 30, 2014 and 2013

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

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 this statement on the financial statements of MEC.

In November 2013, GASB issued Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date - an amendment of GASB Statement No. 68*, which addresses an issue regarding application of the transition provisions of Statement No. 68, *Accounting and Financial Reporting for Pensions*. The issue relates to amounts associated with contributions, if any, made by a state or local government employer or nonemployer contributing entity to a defined benefit pension plan after the measurement date of the government's beginning net pension liability. The provisions in Statement 71 are effective for fiscal years beginning after June 15, 2014. Management has not yet determined the effect of implementation of this statement on the financial statements of MEC.

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, 2014 and 2013, consist of the following:

	<u>2014</u>	<u>2013</u>
Distribution and power plant supplies	\$ 1,474,121	\$ 1,460,988
Fuel	993,230	304,187
Lubricants	<u>102,140</u>	<u>62,816</u>
	<u>\$ 2,569,491</u>	<u>\$ 1,827,991</u>

MARSHALLS ENERGY COMPANY, INC.
(A COMPONENT UNIT OF THE REPUBLIC OF THE MARSHALL ISLANDS)

Notes to Financial Statements
September 30, 2014 and 2013

(4) Capital Assets

Capital asset activity for the years ended September 30, 2014 and 2013 is as follows:

	2014			September 30, 2014
	October 1, 2013	Additions	Reclassifications	
Utility Plant:				
Power plant engines	\$ 15,995,292	\$ -	\$ -	\$ 15,995,292
Plant and machinery	2,174,520	23,252	438,390	2,636,162
Solar power systems	1,110,417	-	-	1,110,417
Vehicles	1,243,149	23,000	-	1,266,149
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	<u>702,331</u>	<u>61,928</u>	<u>-</u>	<u>764,259</u>
	23,129,496	108,180	438,390	23,676,066
Less accumulated depreciation and amortization	<u>(17,092,357)</u>	<u>(1,326,434)</u>	<u>-</u>	<u>(18,418,791)</u>
	6,037,139	(1,218,254)	438,390	5,257,275
Construction work-in-progress	<u>2,856,785</u>	<u>1,333,585</u>	<u>325,693</u>	<u>4,516,063</u>
	<u>8,893,924</u>	<u>115,331</u>	<u>764,083</u>	<u>9,773,338</u>
Nonutility Plant:				
LPG terminal	181,862	-	-	181,862
Less accumulated depreciation and amortization	<u>(169,110)</u>	<u>(6,354)</u>	<u>-</u>	<u>(175,464)</u>
	<u>12,752</u>	<u>(6,354)</u>	<u>-</u>	<u>6,398</u>
	<u>\$ 8,906,676</u>	<u>\$ 108,977</u>	<u>\$ 764,083</u>	<u>\$ 9,779,736</u>

MARSHALLS ENERGY COMPANY, INC.
(A COMPONENT UNIT OF THE REPUBLIC OF THE MARSHALL ISLANDS)

Notes to Financial Statements
September 30, 2014 and 2013

(4) Capital Assets, Continued

	2013			
	October 1, 2012	Additions	Reclassifications	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	<u>566,146</u>	<u>137,628</u>	<u>(1,443)</u>	<u>702,331</u>
	22,634,906	496,408	(1,818)	23,129,496
Less accumulated depreciation and amortization	<u>(15,801,693)</u>	<u>(1,292,482)</u>	<u>1,818</u>	<u>(17,092,357)</u>
	6,833,213	(796,074)	-	6,037,139
Construction work-in-progress	<u>441,828</u>	<u>2,414,957</u>	<u>-</u>	<u>2,856,785</u>
	<u>7,275,041</u>	<u>1,618,883</u>	<u>-</u>	<u>8,893,924</u>
Nonutility Plant:				
LPG terminal	181,862	-	-	181,862
Less accumulated depreciation and amortization	<u>(162,755)</u>	<u>(6,355)</u>	<u>-</u>	<u>(169,110)</u>
	<u>19,107</u>	<u>(6,355)</u>	<u>-</u>	<u>12,752</u>
	<u>\$ 7,294,148</u>	<u>\$ 1,612,528</u>	<u>\$ -</u>	<u>\$ 8,906,676</u>

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, 2014 and 2013, the R&M Fund has a balance of \$48,438 and \$98,474, respectively.

MARSHALLS ENERGY COMPANY, INC.
(A COMPONENT UNIT OF THE REPUBLIC OF THE MARSHALL ISLANDS)

Notes to Financial Statements
September 30, 2014 and 2013

(5) Long-Term Debt

Long-term debt at September 30, 2014 and 2013 is as follows:

	<u>2014</u>	<u>2013</u>
<p>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, 2014 and 2013.</p>	\$ 5,133,420	\$ 5,545,287
<p>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 that was originally procured for operating purposes. 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 \$37,960.</p>	8,102,202	8,474,656
<p>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.</p>	<u>239,735</u>	<u>538,692</u>
	13,475,357	14,558,635
Less current installments	<u>(1,468,986)</u>	<u>(1,063,186)</u>
Long-term debt	<u>\$ 12,006,371</u>	<u>\$ 13,495,449</u>

For the above RUS loan, during the years ended September 30, 2014 and 2013, deferred interest payments of \$0 and \$187,584, respectively, were recognized by MEC and were 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 years ended September 30, 2014 and 2013, grant funds in the cumulative amount of \$2,062,310 were drawn down and expended by MEC.

MARSHALLS ENERGY COMPANY, INC.
(A COMPONENT UNIT OF THE REPUBLIC OF THE MARSHALL ISLANDS)

Notes to Financial Statements
September 30, 2014 and 2013

(5) Long-Term Debt, Continued

Changes in long-term debt during the years ended September 30, 2014 and 2013 are as follows:

	2014				
	Balance	<u>Additions/</u>		Balance	Balance due
	October 1, <u>2013</u>	<u>Reclassification</u>	<u>Reductions</u>	September 30, <u>2014</u>	
RUS loan	\$ 5,545,287	\$ -	\$ (411,867)	\$ 5,133,420	\$ 881,900
Commercial bank loan	538,692	-	(298,957)	239,735	239,736
ADB Subsidiary loan	<u>8,474,656</u>	-	<u>(372,454)</u>	<u>8,102,202</u>	<u>347,350</u>
	<u>\$ 14,558,635</u>	<u>\$ -</u>	<u>\$ (1,083,278)</u>	<u>\$ 13,475,357</u>	<u>\$ 1,468,986</u>

	2013				
	Balance	<u>Additions/</u>		Balance	Balance due
	October 1, <u>2012</u>	<u>Reclassification</u>	<u>Reductions</u>	September 30, <u>2013</u>	
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	<u>8,881,388</u>	-	<u>(406,732)</u>	<u>8,474,656</u>	<u>343,873</u>
	<u>\$ 15,055,701</u>	<u>\$ 187,584</u>	<u>\$ (684,650)</u>	<u>\$ 14,558,635</u>	<u>\$ 1,063,186</u>

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

<u>Year ending</u> <u>September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2015	\$ 1,468,986	\$ 401,689	1,870,675
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	1,462,113	189,890	1,652,003
2020-2024	1,993,988	404,519	2,398,507
2025-2029	2,023,927	253,673	2,277,600
2030-2034	<u>2,340,835</u>	<u>95,168</u>	<u>2,436,003</u>
	<u>\$ 13,475,357</u>	<u>\$ 2,115,440</u>	<u>\$ 15,590,797</u>

(6) Short-Term Debt

On June 6, 2014, MEC obtained a \$1,000,000 short-term bank loan to finance fuel purchases, interest at 4.5% per annum, principal and interest payable in monthly installments of \$85,350, due on May 31, 2015. The short-term loan is collateralized by MEC's \$271,166 term certificate of deposit.

On July 7, 2014, MEC obtained a \$1,900,000 short term bank loan to finance the construction of a warehouse, interest at 7.5% per annum, due and payable on December 31, 2014. The loan is collateralized by receivables and RepMar bank accounts.

MARSHALLS ENERGY COMPANY, INC.
(A COMPONENT UNIT OF THE REPUBLIC OF THE MARSHALL ISLANDS)

Notes to Financial Statements
September 30, 2014 and 2013

(6) Short-Term Debt, Continued

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

Changes in short-term debt during the years ended September 30, 2014 and 2013, are as follows:

2014			
Balance October 1, 2013	Additions	Reductions	Balance September 30, 2014
\$ <u>161,588</u>	\$ <u>2,900,000</u>	\$ <u>(490,447)</u>	\$ <u>2,571,141</u>
2013			
Balance October 1, 2012	Additions	Reductions	Balance September 30, 2013
\$ <u>-</u>	\$ <u>1,000,000</u>	\$ <u>(838,412)</u>	\$ <u>161,588</u>

(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 \$76,592 and \$77,497 to Plan participant accounts during the years ended September 30, 2014 and 2013, respectively, and total plan assets were \$646,435 and \$443,299 as of September 30, 2014 and 2013, 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, 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, 2014 and 2013, MEC is liable for gross revenue tax to RepMar amounting to \$672,986 and \$233,686, respectively.

MARSHALLS ENERGY COMPANY, INC.
(A COMPONENT UNIT OF THE REPUBLIC OF THE MARSHALL ISLANDS)

Notes to Financial Statements
September 30, 2014 and 2013

(8) Related Party Transactions, Continued

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, 2014 and 2013, MEC is liable for import duties to RepMar amounting to \$0 and \$110,477, respectively, representing import duty owed prior to October 6, 2008.

Transactions for the years ended September 30, 2014 and 2013, and the related receivables from and payables to affiliates, are as follows:

	2014			
	<u>Revenues</u>	<u>Expenses</u>	<u>Receivables</u>	<u>Payables</u>
RepMar	\$ 3,386,241	\$ 991,695	\$ 1,262,918	\$ 1,050,145
Kwajalein Atoll Joint Utilities Resources, Inc.	4,321,630	-	2,754,626	-
Majuro Water and Sewer Company, Inc.	531,824	25,296	1,517,776	1,520
Marshall Islands Social Security Administration	53,453	235,952	12,674	122,593
Majuro Resort, Inc.	541,372	73,802	374,634	-
Other	<u>2,431,332</u>	<u>281,064</u>	<u>319,623</u>	<u>66,452</u>
	<u>\$ 11,265,852</u>	<u>\$ 1,607,809</u>	<u>\$ 6,242,251</u>	<u>\$ 1,240,710</u>
	2013			
	<u>Revenues</u>	<u>Expenses</u>	<u>Receivables</u>	<u>Payables</u>
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	<u>2,004,030</u>	<u>243,812</u>	<u>201,395</u>	<u>29,438</u>
	<u>\$ 11,803,460</u>	<u>\$ 1,639,639</u>	<u>\$ 3,544,222</u>	<u>\$ 689,536</u>

The allowance for uncollectable accounts pertaining to receivables from affiliates amounted to \$1,483,100 and \$1,083,163 as of September 30, 2014 and 2013, respectively.

During the years ended September 30, 2014 and 2013, MEC received operating subsidies from RepMar of \$694,400 and \$800,000, respectively.

MARSHALLS ENERGY COMPANY, INC.
(A COMPONENT UNIT OF THE REPUBLIC OF THE MARSHALL ISLANDS)

Notes to Financial Statements
September 30, 2014 and 2013

(8) Related Party Transactions, Continued

On August 6, 2010, the Asian Development Bank (ADB) approved a grant to RepMar in the amount of \$1,760,000 financed by the Japan Fund for Poverty Reduction. The purpose of the grant was to extend access to clean electricity to disconnected and unconnected poor households through the Improved Energy Supply For Poor Households Project. MEC was the Implementing Agency and administered grant funds drawn down against the grant. During the years ended September 30, 2014 and 2013, grant funds in the amount of \$0 and \$960,986, respectively, were drawn down and expended by MEC.

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 \$2,000,000 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. During the year ended September 30, 2014, unpaid withholding taxes and gross receipts taxes of MEC was offset against MEC's receivables from RepMar of \$704,399.

(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, 2014 and 2013 amounted to \$4,759,276 and \$4,746,622, respectively. 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.

MARSHALLS ENERGY COMPANY, INC.
(A COMPONENT UNIT OF THE REPUBLIC OF THE MARSHALL ISLANDS)

Notes to Financial Statements
September 30, 2014 and 2013

(9) Commitment and Contingencies, Continued

In view of these matters, realization of a major portion of the assets in the accompanying statements of net position at September 30, 2014, 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 financial exposure has 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 recorded net of estimated repair costs. Accrued remaining building and engine repairs amounted to \$300,000 at both September 30, 2014 and 2013.

(11) Other Nonoperating Income

In 2013, a prior bad debt for building and engine repairs of \$1,630,394 was written-off.

(12) Subsequent Events

On February 5, 2015 and June 5, 2015, MEC obtained bank loans of \$2,000,000 and \$1,500,000, respectively, with maturity dates of January 1, 2016 and December 31, 2015, respectively.

MARSHALLS ENERGY COMPANY, INC.
(A COMPONENT UNIT OF THE REPUBLIC OF THE MARSHALL ISLANDS)

Schedule of Revenues, Expenses and Changes in Net Position by Division
Year Ended September 30, 2014

	Generation	Distribution	Tank Farm	Jaluit	Wotje	Solar	MEC Gas	Admin.	TOTAL
Operating revenues:									
Fuel, propane and lube sales	\$ -	\$ -	\$ 30,574,452	\$ 648	\$ 5,716	\$ -	\$ 666,469	\$ -	\$ 31,247,285
Cost of sales	-	-	28,068,069	-	-	-	407,481	-	28,475,550
Gross profit on sales	-	-	2,506,383	648	5,716	-	258,988	-	2,771,735
Electric and service billings	19,536,627	-	-	265,654	149,361	129,123	-	-	20,080,765
Service and other income	-	67,417	55,062	17,506	315	(100)	5,274	457,689	603,163
Less provision for doubtful accounts	(582,609)	-	-	(79,696)	(44,808)	-	-	-	(707,113)
Total electricity sales and other income	18,954,018	67,417	55,062	203,464	104,868	129,023	5,274	457,689	19,976,815
Total net operating revenue	18,954,018	67,417	2,561,445	204,112	110,584	129,023	264,262	457,689	22,748,550
Operating expenses:									
Advertising	-	-	-	-	-	-	-	10,360	10,360
Auto POL and maintenance	24,364	68,650	10,583	602	2,745	3,512	2,847	53,528	166,831
Bank charges	-	-	-	-	-	-	-	48,624	48,624
Communications	28,267	29,697	1,452	1,870	1,870	-	650	38,998	102,804
Depreciation and amortization	1,051,872	80,149	13,149	7,333	7,928	-	36,241	136,116	1,332,788
Donations	-	640	-	-	-	200	-	12,863	13,703
Entertainment	4,900	4,678	1,055	524	129	137	44	33,639	45,106
Equipment rental	4,590	1,335	-	-	-	-	-	1,929	7,854
Freight and handling	119,939	20,169	156,628	35,823	68,213	1,964	-	7,982	410,718
Fuel and lubes	13,124,200	23,331	100	100,041	212,284	9	-	-	13,459,965
Gross revenue tax	-	2,027	918,669	537	180	-	20,152	13,727	955,292
Import tax	34,867	3,826	2,374	251	250	546	9,389	9,840	61,343
Insurance	143,562	21,560	73,313	8,129	7,539	-	2,479	13,621	270,203
Lease rental	5,475	11,030	-	2,125	4,230	-	-	16,449	39,309
Membership and other fees	800	315	126	-	85	330	-	74,600	76,256
Office	42,141	22,681	22,404	296	831	600	610	92,016	181,579
Professional and consulting fees	-	-	-	-	-	-	-	61,746	61,746
Repairs and maintenance	1,064,110	546,861	13,933	14,780	3,390	15,247	9,358	18,526	1,686,205
Safety and uniforms	19,357	14,954	131	-	-	-	-	965	35,407
Salaries, wages and benefits	1,180,664	531,174	131,374	159,991	139,637	116,252	44,215	931,113	3,234,420
Security services	17,735	-	41,335	-	-	-	8,552	2,157	69,779
Staff training	500	880	-	-	-	1,587	-	28,921	31,888
Travel	12,701	2,531	4,480	4,623	1,816	7,276	-	132,117	165,544
Utility	96,697	1,456	-	22,004	-	2,625	-	68,643	191,425
Total operating expenses	16,976,741	1,387,944	1,391,106	358,929	451,127	150,285	134,537	1,808,480	22,659,149
Operating income (loss)	1,977,277	(1,320,527)	1,170,339	(154,817)	(340,543)	(21,262)	129,725	(1,350,791)	89,401
Nonoperating income (expense):									
RepMar subsidy	-	-	-	347,200	347,200	-	-	-	694,400
Interest expense	-	-	-	-	-	-	-	(495,873)	(495,873)
	-	-	-	347,200	347,200	-	-	(495,873)	198,527
Change in net position	\$ 1,977,277	\$ (1,320,527)	\$ 1,170,339	\$ 192,383	\$ 6,657	\$ (21,262)	\$ 129,725	\$ (1,846,664)	\$ 287,928

See accompanying independent auditors' report.

**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 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, 2014, 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 September 22, 2015.

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 or significant deficiencies. However, material weaknesses or significant deficiencies may exist that have not been identified.

Compliance and Other Matters

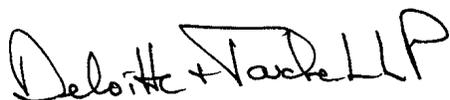
As part of obtaining reasonable assurance about whether MEC's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on 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 item 2014-001.

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.

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

September 22, 2015

MARSHALLS ENERGY COMPANY, INC.
(A COMPONENT UNIT OF THE REPUBLIC OF THE MARSHALL ISLANDS)

Schedule of Findings and Responses
Year Ended September 30, 2014

Finding No. 2014-001

RUS

Questioned Costs: \$129,173

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 policies should be adopted and established to facilitate compliance on Federal laws and regulations.

Condition:

1. Total grant funds expended as of September 30, 2014 amounted to \$2,220,426. As per agreement, this amount shall be matched with 21% share from MEC. Based on actual disbursements as of September 30, 2014, MEC should have matched \$466,289. Form SF 425, Federal Financial Report, for September 30, 2014, reflected MEC's share of \$337,116, which results in questioned costs of \$129,173.
2. Form SF 425, Federal Financial Reports, for June 2014 and September 2014 were submitted on February 12, 2015 (which lapsed on the required due date of 30 days after the end of each quarter) were available during our audit; however, no signature was found on the reports.
3. No procedure is in place to monitor receipt of delivered orders. Receiving reports are not filed.
4. MEC's fixed asset register does not provide sufficient information relative to monitoring and management of federally-funded fixed assets as required by 2 CFR Section 215.34. Furthermore, MEC does not have a formal accounting policy governing physical verification of fixed assets.

MARSHALLS ENERGY COMPANY, INC.
(A COMPONENT UNIT OF THE REPUBLIC OF THE MARSHALL ISLANDS)

Schedule of Findings and Responses, Continued
Year Ended September 30, 2014

Finding No. 2014-001, Continued

RUS, Continued

Questioned Costs: \$129,173, Continued

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

Effect: The effect of the above condition is noncompliance with grant award requirements 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 September 30, 2014 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 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 a hold on the rebuild of the #7 engine project and the earliest MEC can envisage the work commencing is now the fourth quarter of 2014. Once this work is underway, MEC will again commence making matching contributions until the required target is met.
2. MEC will ensure that all forms are completed and submitted in timely manner.
3. 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.
4. All items purchased under the grant are inventory parts needed for the engine rebuild and some spare parts for the Deutz engines. A listing containing all items and part numbers purchased is maintained and all these parts are kept in a secured location.

MARSHALLS ENERGY COMPANY, INC.
(A COMPONENT UNIT OF THE REPUBLIC OF THE MARSHALL ISLANDS)

Unresolved Prior Year Findings
Year Ended September 30, 2014

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