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, 2009 AND 2008

Deloitte.

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INDEPENDENT AUDITORS' REPORT

Board of Directors
Marshalls Energy Company, Inc.:

We have audited the accompanying statements of net assets of the Marshalls Energy Company, Inc. (MEC), a component unit of the Republic of the Marshall Islands, as of September 30, 2009 and 2008, and the related statements of revenues, expenses and changes in net deficiency and of cash flows for the years then ended. These financial statements are the responsibility of MEC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of MEC's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of MEC as of September 30, 2009 and 2008, and the changes in its net deficiency and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 3 through 12 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of MEC's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements of MEC taken as a whole. The accompanying Schedule of Revenues, Expenses and Changes in Net Deficiency by Source for the year ended September 30, 2009 (page 29) is presented for purposes of additional analysis and is not a required part of the basic financial statements of MEC. This schedule is the responsibility of MEC's management. Such information has been subjected to the auditing procedures applied in our audit of the basic financial statements for the year ended September 30, 2009 and, in our opinion, is fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 19, 2010, 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Deloitte & Touche LLP

October 19, 2010

Marshalls Energy Company, Inc. (MEC) herewith presents a discussion and analysis of the company's financial performance for the financial year ended 30th September, 2009. It is to be read in conjunction with the financial statements following this section.

FINANCIAL HIGHLIGHTS

MEC's net assets increased by $1.15 million in 2009 compared to a decrease in net assets of $4.10 million in 2008. This increase in net assets is attributed to the following factors:

- Decrease in world fuel prices
- Import Duties (MEC exemption) Act of 2008
- Increase subsidy from the Republic of the Marshall Islands (RepMar)
- Recipient of other grant funding sources

In 2009, total net utility operating revenues were $14.03 million, a decrease of $4.66 million in comparison to $18.69 million in net utility operating revenues in 2008. The decrease in utility revenue is a result of the drop in world fuel prices experienced during 2009. In compliance with the Cabinet approval of the Pricing Template, MEC was allowed to adjust (increase or decrease) the electricity tariffs in line with the movements of published fuel prices and without the need to seek Cabinet approval. The effect of the decrease meant a corresponding decrease in electricity revenue of approximately 25%.

Total utility operating expenses were $16.27 million and $21.69 million in 2009 and 2008, respectively. The decrease in the amount of $5.42 million or the same rate of 25% is attributed to the fuel cost component and is in line with expectations due to the drop in world fuel prices. The decrease in fuel costs to MEC meant a decrease in fuel and lubricant costs used for generation. The most significant component of generation operating costs continues to be fuel and lubricants, the cost of which for 2009 represented 77% of total generation costs compared to 83% in 2008.

Total operating revenues for non-utility operations, of which fuel sales is the major component, were $13.03 million and $13.02 million in 2009 and 2008, respectively. Total non-utility operating expenses decreased by $1.10 million or 8% with $11.86 million and $12.96 million in 2009 and 2008, respectively. The decrease is a result of the Import Duties (MEC exemption) Act of 2008, enacted on October 6, 2008, allowing MEC to be exempt from paying import duty on all types of fuel imported to the Marshall Islands. In addition, this is a positive sign that MEC is able to maintain pricing competitiveness and retain market share despite the availability of fuel sales on the high seas.

The major contributing factor to MEC's increase in net assets is a result of the subsidies and grants received by MEC throughout 2009. MEC received a subsidy of $1.15 million in 2009 compared to a $0.36 million in 2008, resulting in an increase of approximately $0.80 million. The $0.80 million increase in subsidy was used to purchase fuel in the amount of $0.58 million and for generator parts in the amount of $0.22 million, purchased directly by RepMar.

MEC also received $0.30 million in capital contributions from RepMar for the purchase of solar equipment and parts. In addition, MEC was a recipient of other grant funding in the amount of $1.91 million from the Japan Non-Project Grant Account (JNPGA). The grant funding was utilized by MEC for the purchase of fuel as well.

It is also important to mention that the audit performed for year ended September 30, 2009 was impacted by two main factors:

1.) On August 1, 2008, MEC began its initial migration to a new accounting and financial system implementation. The new accounting and financial system purchased is called Napier Computer Systems (NCS). Although the initiative to have a fully integrated accounting and financial accounting system is long overdue, following are several challenges experienced by MEC management.

   - MEC does not have exclusive rights to the software and is leasing the software on a month to month basis.
   - The initial migration that began on August 1, 2008 involved MEC's Accounts Receivable (electricity utility billing) module only whereas all other financial transactions and subsidiary ledgers remained with the legacy system. As such, MEC was required to support and parallel the legacy and NCS systems in FY 2009. Furthermore, the legacy system continued to be the system of record and reconciliations of the parallel systems were not completed as appropriate.
   - The legacy system continued to be the system of record for MEC throughout FY 2009. With MEC's financial structure supported by parallel systems, the necessary system reconciliations were not completed, thereby resulting in additional workload, process inefficiencies and higher risk of exposure for financial statement misstatement.
   - Re-assessment of MEC's training needs for NCS are necessary to ensure a smooth transition and final phase of the implementation, which is expected to be completed in FY 2010.

2.) MEC also experienced a change in management team with the retirement of MEC's long time general manager effective at the end of FY 2009.

FINANCIAL ANALYSIS OF MEC

The Statement of Net Assets and the Statement of Revenues, Expenses and Changes in Net Assets (Deficiency) provide an indication of MEC's financial condition. MEC's net assets (deficiency) reflect the difference between total assets and total liabilities. An increase in net assets over time normally indicates an improvement in financial condition. As illustrated in the figures below, MEC's net assets increased for the year ended 30th September, 2009.

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

	2009	2008	2007
Current and other assets	$ 11,262,802	$ 9,153,146	$ 10,689,710
Capital assets	8,840,097	9,479,186	9,925,415
Total assets	20,102,899	18,632,332	20,615,125
Current liabilities	15,488,339	13,221,965	9,302,997
Non-current liabilities	14,445,281	16,389,299	18,194,956
Total liabilities	29,933,620	29,611,264	27,497,953
Net assets:			
Invested in capital assets	1,844,155	1,855,195	1,631,202
Restricted	-	-	373,056
Deficiency	(11,674,876)	(12,834,127)	(8,887,086)
Total net assets	$ (9,830,721)	$ (10,978,932)	$ (6,882,828)

Total assets have decreased from $20.62 million in 2007 to $18.63 in 2008 but have increased to $20.10 million in 2009. As previously noted, the decrease in total assets by $1.98 million (or 10%) from 2007 to 2008 is primarily due to the decrease in cash balances of $2.95 million. Net cash used for operating activities and capital and related financing activities amounted to $6.26 million and $1.71 million, respectively. This was partially offset by net cash provided by noncapital financing activities of $5.02 million, resulting in an overall decrease in cash balances of $2.95 million. The increase in total assets by $1.47 million (or 8%) in 2009 is primarily due to an increase of $3.58 million in fuel and supplies for a fuel shipment received in September 2009, a decrease of $1.70 million in net accounts receivable, and $0.64 million decrease in net capital assets due to accumulated depreciation and amortization.

Net capital assets decreased from $9.93 million in 2007 to $9.48 million and decreased further to $8.84 million in 2009. In 2009, net capital assets decreased by $0.64 million mainly as a result of the annual depreciation charge of $1.08 million offset by capital asset purchases, including miscellaneous plant and equipment in the amount of $0.25 million and the purchase of vehicles costing $0.12 million as an ongoing initiative to replace the scrapped, fully depreciated vehicles written off in 2007.

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

Total liabilities increased significantly from $27.50 million in 2007 to $29.61 million in 2008 and increased slightly to $29.93 million in 2009. The $2.11 million (or 8%) increase experienced in 2008 is represented by the increase in amounts owing for advances from RepMar of $4.42 million, the increase in accounts payable of $0.35 million offset by the decrease in long term debt owed to RUS and the Bank of Guam of $1.60 million, and the decrease in accrued repair costs for station one of $0.99 million.

In 2009, there was a slight increase in the amount of $0.32 million due primarily to the net effect of a $1.87 million decrease in the long-term debt owed to RUS and the Bank of Guam, a $1.81 million increase in accounts payable consisting mainly of a fuel shipment received in September 2009, a $1.68 million decrease in the balance owing for advances from RepMar due to offsetting of RepMar electricity usage consumption throughout 2009, and a $1.92 million increase in deferred revenue to recognize the prepaid fuel purchase made by Marshall Islands Fishing Venture (MIFV) and Kwajalein Atoll Joint Utilities Resources (KAJUR) for the fuel shipment received in September 2009.

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

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

	2009	2008	2007
Revenue:			
Utility revenue	$ 14,030,622	$ 18,690,921	$ 13,734,688
Non-utility revenue	13,028,994	13,018,799	8,363,152
Total revenue	27,059,616	31,709,720	22,097,840
Expenses:			
Utility expenses	16,274,630	21,690,677	17,465,012
Non-utility expenses	11,861,696	12,962,924	7,528,366
Total expenses	28,136,326	34,653,601	24,993,378
Operating loss	(1,076,710)	(2,943,881)	(2,895,538)
RMI subsidy	1,153,927	355,618	874,250
Other grants	1,911,000	-	-
Interest expense	(1,144,912)	(1,507,841)	(1,611,293)
Capital contributions	304,906	-	-
	2,224,921	(1,152,223)	(737,043)
Change in net assets	$ 1,148,211	$ (4,096,104)	$ (3,632,581)

The Statements of Revenue, Expenses and Changes in Net Deficiency identify the various revenue and expense items that contributed to the change in net deficiency. MEC's total revenue increased significantly in 2008 by $9.61 million (or 43%) to a total of $31.71 million compared to $22.10 million in 2007. In 2009, MEC's total revenue decreased by $4.65 million (or 15%) to a total of $27.06 million. The increase in revenue experienced during 2008 is due to the significant increase in world fuel prices, which were necessarily passed on to both electricity and fuel customers in the form of higher prices. In 2009, world fuel prices dropped and cost savings were passed on to both electricity and fuel customers.

Electricity billings increased by $4.96 million (or 36%) from $13.73 million in 2007 to $18.69 million in 2008 and decreased by $4.66 million (or 25%) in 2009 to $14.03 million, of which $0.36 million pertains to doubtful accounts. Non-Utility revenue, which is mainly fuel sales, increased by $4.65 million (or 56%) to $13.02 million compared to $8.36 million in 2007. There was no significant change in 2009 with non-utility revenue in the amount of $13.03 million.

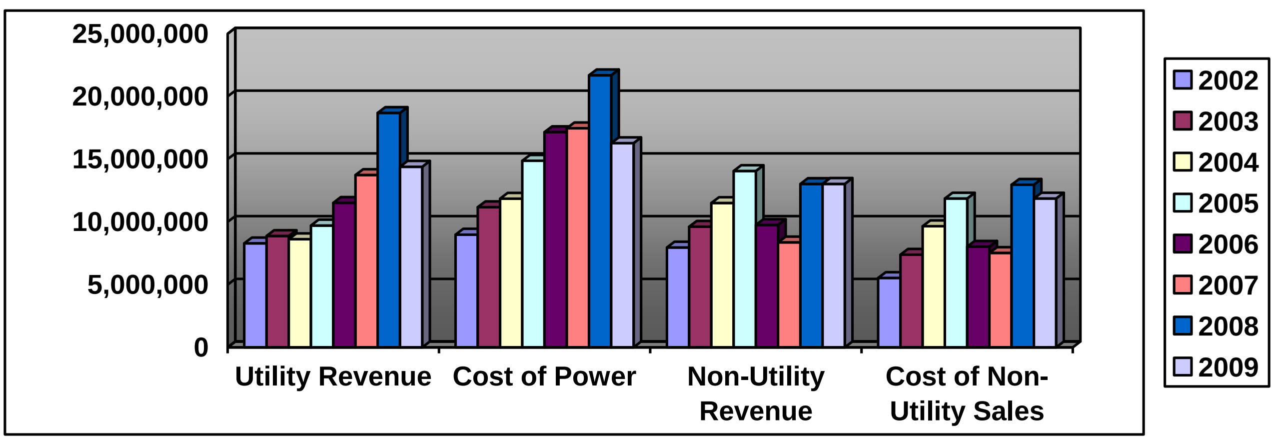
The operating loss for 2009 of $1.08 million compared to $2.94 million and $2.90 million in 2008 and 2007, respectively. The decrease in operating loss by $1.87 million in 2009 is primarily due to the decrease in world fuel prices and MEC import tax exemption on fuel. Although there was little to no change in fuel revenue, non-utility expenses were dramatically decreased by $1.10 million in 2009 in the amount of $11.86 million compared to $12.96 million in 2008.

Capital contributions from RepMar were received by MEC in the amount of $0.30 million in 2009 and used for the refurbishment of engine parts. No capital funding was received in 2008 or 2007.

Operating subsidies of $1.15 million were received in 2009 compared to $0.36 million in 2008 and $0.87 million in 2007. During 2009, $0.22 million of the operating subsidy was for generator parts purchased by RepMar. The remaining and majority of the operating subsidy received in 2009, on the other hand, was used for fuel purchases.

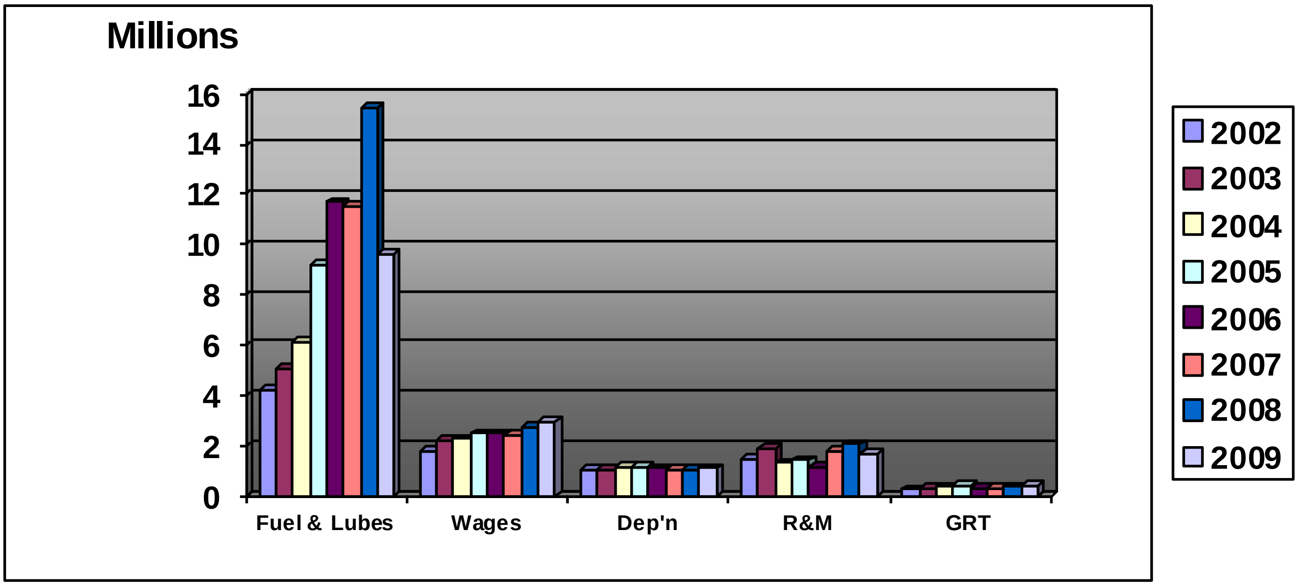
MEC was also the recipient of a $1.91 million grant from Japan. Additionally, the subsidy received was used for the purchase of fuel. As part of the JNPGA requirements, MEC is responsible for replenishing and depositing fifty percent (50%) of the JNPGA amount into an established savings account with the Bank of Guam no later than January 2012. Default in the deposit terms may have adverse impacts on future RepMar funding as it pertains to Non-Project Grant funding types. It is in the best interest of MEC to meet the 50% deposit terms as a potential recipient of the monies saved and allow RepMar to be able to secure similar type of funding assistance for other RepMar programs and initiatives.

The graphic below shows the major components of revenue from 2002 through to 2009:



Total expenses increased from $24.99 million in 2007 to $34.65 million in 2008 and decreased to $28.14 million in 2009 due almost entirely to changes in fuel costs. The cost of fuel as a percentage of total generation operating costs increased from 78% in 2007 to 83% in 2008 and declined from 83% in 2008 to 77% in 2009. Total fuel costs for generation did not increase proportionately to the price increases due to the reduction in fuel consumption for generation because customers used less electricity due to the higher tariffs. The cost of fuel and lubricants used for generation decreased to $9.65 million in 2009 compared to $15.46 million in 2008 and $11.55 million in 2007.

The following graphic shows the major components of operating expenses, excluding the cost of fuel sold, from 2002 through to 2009:



CASH FLOW

Net cash provided by operating activities for 2009 was $1.02 million compared to net cash used for operating activities of $6.26 million in 2008 and $3.50 million in 2007. As illustrated in the above graph, most of the cash was used to pay for fuel purchases in 2008. In 2008, the source of cash used for fuel purchases was supplemented by cash advances from June 2008 onwards, totaling $6.7 million, received from RepMar. Of this amount, $0.76 million was for advance payment of two months of government electricity bills. As of 30th September, 2009, $3.6 million (inclusive of the September 30, 2009 month end billing) has been repaid to RepMar by way of offsets against government electricity bills. In 2009, the source of cash used for fuel purchases was supplemented by RepMar subsidy and other grant sources (JPNGA) in the amount of $0.70 million and $1.91 million, respectively.

FUTURE OUTLOOK ON SUSTAINABILITY

In spite of MEC's net deficiency position, the future outlook on sustainability for MEC is promising, as a wholly owned government 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 to initiate in fiscal year 2010, plays a significant and positive role towards MEC's road to recovery and efforts to secure a viable and sustainable future for MEC. The MEC CRP goals are:

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

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

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

- Renegotiate the terms of the Rural Utilities Services (RUS) loan with the aim of deferring loan servicing payments for at least 3 to 5 fiscal years. On an annual basis, MEC pays approximately $1.10 million towards MEC's debt to RUS. A deferment of the loan will allow for a much needed cash flow injection to rehabilitate the MEC power plant and other operations. As of September 30, 2009, the RUS loan balance is approximately $7.00 million.

- Restructure commercial debt with the Bank of Guam with the aim of securing concessional financing from a development finance institution (preferably the Asian Development Bank) to liquidate the Bank of Guam debt. On an annual basis, MEC pays approximately $1.92 million towards MEC's commercial debt with Bank of Guam. Similar to the RUS deferment program, the concessional financing will increase MEC's cash flow that is needed to rehabilitate the MEC power plant and other operations. In addition, MEC will have the opportunity to recognize cost savings resulting from the lower interest rates of the concessional financing versus the higher interest rates of a commercial loan.

- Initiate Majuro atoll-wide conversion to a pre-pay meter system to improve cash flow and reduce receivables accumulation. As a recipient of grant funding from the US Department of the Interior, MEC will be converting all residential customers to a pre-pay meter starting in late fiscal year 2010. The conversion is expected to be completed within a two-three (2-3) year timeframe. The installation of the pre-pay meters will improve cash flow and reduce MEC's exposure to bad debt. As of September 30, 2009, MEC's Accounts Receivable Balance is $6.04 million, of which residential customers make up $1.25 million in the greater than ninety days (90) aging category and $1.17 million is made up of the customers that have been disconnected from the power grid.

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

- Aggressively explore options to reduce generation cost factors, including exploration of alternative fuel sources and grid-connected alternative generation technologies. For FY 2009, 77% of MEC's operating cost was attributed to fossil fuel to run the generators compared to 83% in FY 2008. Although world fuel prices are now on a decreasing trend in FY 2009 compared to FY 2008, there is a great need for MEC to identify alternative measures to reduce its complete dependency on fossil fuel to generate electricity. As such, the aim under the CRP is to explore options to reduce power generation cost by venturing into Clean Development Mechanism (CDM) technologies that should reduce the consumption of fossil fuel and increase efficiencies. Other viable options include the implementation of a solar to grid concept and a hybrid system (Solar, Wind, Diesel Generator combined).

- Rehabilitate power plants, prioritizing full rehabilitation of the two Deutz generators. This is one of the most urgent undertakings of the CRP and needs to be highly prioritized. The total megawatt (MW) output from these two generators is 12MW at maximum efficiency. Currently, one of the Deutz engines is out of service and the other engine is yielding only 4.7MW at best. The estimated total cost to fully overhaul both generators will be around $4.5M. It is extremely critical that these two identified generators are overhauled to prolong the life of the asset and power plant to produce electricity. The successful execution and approval of the RUS deferment program and securing a concessional financing instrument to liquate the Bank of Guam commercial debt are critical to the rehabilitation efforts of the power plant. Any deviation or delays will have adverse impacts and will continue to place strains on MEC's operations and financial position.

- Develop and adopt new financial management and reporting policies. Financial reporting is a key resource that is needed to assist MEC management and the MEC Board of Directors to make appropriate and timely decisions in the best interest of MEC. It is extremely critical that the financial data is accurate, valid, relevant and timely for financial statement reporting and management reporting. MEC must develop and foster a more internally controlled financial environment, identify process gaps/opportunities, and implement process improvement to mitigate the risks. Furthermore, there is a great need for a fully integrated financial and accounting system and required capacity training that will need to be addressed within fiscal year 2010.

  A key accounting policy and procedure that will be a priority for fiscal year 2011 is the general ledger account reconciliations. Initially, a list of the account reconciliations will be compiled and will include the appropriate due dates and frequency. In addition, all reconciliations completed will require a more thorough review and approval process to be performed by MEC management or designee that would require strict adherence and compliance in order for the internal control of reconciliations to be working properly as intended.

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

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

During fiscal year 2009, there were two tariff decreases. These took effect in November 2008 and January 2009, which is in line with the declining world fuel price trend. Despite the wildly fluctuating world fuel prices, studies indicate that MEC has been able to maintain electricity tariffs at levels which are one of the lowest in the Pacific.

With the decrease in world fuel prices and the rapid decline in world fuel prices experienced from October 2008, the projections that the declining net asset value will slow and possibly begin to increase is indicated as it is projected that the recent history of declining net asset value will slow and possibly begin to increase.

MEC FOCUS IN THE COMING FISCAL YEAR

The decrease in world fuel prices, Import Duties (MEC Exemption) Act of 2008, and increased subsidy from RepMar and other grant funding sources (JPNGA) were key factors in MEC's change in net asset position of $1.15 million for the year ended September 30, 2009. To maintain the positive momentum towards the company's future sustainability and viability, MEC expects the upcoming fiscal year 2010 to be the start of a challenging and exciting journey to recovery.

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

- Implement MEC's CRP initially in fiscal year 2010. 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. In fiscal year 2010, the objectives will be in various stages of progress and completion.

- Improve/increase cash flow to support the CRP goals and objectives through the RUS deferment program and securing a concessional loan (through ADB). MEC management and MEC Board of Directors must actively lead and pursue the opportunities identified for a favorable outcome and without any further delays. In the case of the commercial loan with Bank of Guam, timing is of the essence. The loan is amortized over a period of ten years and matures in three (3) years. On June 1, 2010, the remaining principal and interest balances are due. If the concessional loan is not secured with ADB as the preferred financial institution, MEC must seek other alternatives to refinance the commercial debt with Bank of Guam.

  As of June 1, 2010, MEC has successfully refinanced the commercial debt with Bank of Guam. Similar to the original terms, the loan will continue to amortize over a period of ten years and mature in three (3) years. On June 1, 2013, the remaining principal and interest balances are due. With the refinancing and extension of the commercial loan, MEC has a cash flow saving of $60,000 per month or $720,000 annually. To further add, conditions of the commercial loan agreement allows for early pay off of the commercial loan without any associated penalties. As MEC works diligently towards securing the RUS deferment program and concessional financing, steps to aggressively pursue Accounts Receivable collections is a necessity to sustain MEC's operations in the interim period. Disconnection policy needs to be enforced without delay or prejudice. As long as MEC allows outstanding accounts receivable balances to age, the greater MEC's risk and exposure is to bad debt and continued cash flow constraints.

- Perform timely and accurate reconciliations of the RepMar advance payment in the amount of $6.70 million received in June 2008. Based on consumption rate for the electric accounts eligible to receive the offsetting credit, records indicate that the advance payment from RepMar is expected to be paid in full within the first quarter of fiscal year 2011. This will be a great milestone reached for MEC to fulfill its obligation to repay the $6.70 million. Most importantly, MEC's cash flow position will improve immensely. As such, it is important that reconciliation of the RepMar advance payment is completed timely and accurately to resume normal billing and collection efforts.

- 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, 2008 is set forth in the report on the audit of MEC's financial statements dated May 21, 2009. That Discussion and Analysis explains the major factors impacting the 2008 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 30th September, 2009. 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 Assets

September 30, 2009 and 2008

ASSETS	2009	2008
Utility plant:		
Electric plant in service	$ 20,717,527	$ 20,618,184
Construction work in progress	354,060	61,273
Total utility plant	21,071,587	20,679,457
Less accumulated depreciation and amortization	(12,270,320)	(11,241,416)
Net utility plant	8,801,267	9,438,041
Other non-current assets:		
Nonutility property	181,862	181,862
Less accumulated depreciation	(143,032)	(140,717)
Nonutility property, net	38,830	41,145
Current assets:		
Cash	1,457,813	1,235,531
Accounts receivable:		
Electricity	4,313,022	5,742,273
Affiliates	1,314,231	1,084,201
Other	409,066	545,800
Total accounts receivable	6,036,319	7,372,274
Less allowance for uncollectible accounts	(2,762,012)	(2,397,909)
Net accounts receivable	3,274,307	4,974,365
Fuel and supplies	6,485,043	2,901,472
Prepayments	45,639	41,778
Total current assets	11,262,802	9,153,146
Total assets	$ 20,102,899	$ 18,632,332

See accompanying notes to financial statements.

MARSHALLS ENERGY COMPANY, INC.

Statements of Net Assets, Continued

September 30, 2009 and 2008

NET DEFICIENCY AND LIABILITIES	2009	2008
Net assets (deficiency):		
Invested in capital assets, net of related debt	$ 1,844,155	$ 1,855,195
Deficiency	(11,674,876)	(12,834,127)
Total net deficiency	(9,830,721)	(10,978,932)
Commitment and contingencies		
Long-term debt	14,445,281	16,389,299
Current liabilities:		
Current portion of long-term debt	2,022,622	1,953,031
Accounts payable - fuel	4,319,596	2,512,547
Accounts payable - other	463,967	471,315
Advances from RepMar	3,303,020	4,981,548
Payable to affiliates	433,985	394,310
Accrued building and engine repairs	2,140,822	2,415,882
Accrued taxes	324,491	304,323
Other accrued liabilities	482,959	109,343
Deferred revenue	1,996,877	79,666
Total current liabilities	15,488,339	13,221,965
Total liabilities	29,933,620	29,611,264
Total net deficiency and liabilities	$ 20,102,899	$ 18,632,332

See accompanying notes to financial statements.

MARSHALLS ENERGY COMPANY, INC.

Statements of Revenues, Expenses and Changes in Net Deficiency
Years Ended September 30, 2009 and 2008

	2009	2008
Utility operations:		
Operating revenues	$ 14,394,725	$ 18,690,921
Less provision for doubtful accounts	(364,103)	-
Total net operating revenues	14,030,622	18,690,921
Operating expenses:		
Cost of power	12,502,109	17,999,936
Administrative and general	1,171,073	1,023,681
Distribution operations	1,168,126	1,269,762
Depreciation and amortization	1,044,604	1,027,392
Taxes	273,408	264,509
Distribution maintenance	115,310	105,397
Total operating expenses	16,274,630	21,690,677
Operating loss from utility operations	(2,244,008)	(2,999,756)
Nonutility operations:		
Operating revenues:		
Fuel and gas sales	12,795,178	12,663,515
Other	233,816	355,284
Total operating revenues	13,028,994	13,018,799
Operating expenses:		
Cost of sales	11,015,891	12,111,200
Other	845,805	851,724
Total operating expenses	11,861,696	12,962,924
Operating income from nonutility operations	1,167,298	55,875
Operating loss	(1,076,710)	(2,943,881)
Nonoperating income (expense):		
RepMar subsidy	1,153,927	355,618
Other grants	1,911,000	-
Interest expense	(1,144,912)	(1,507,841)
Total nonoperating income (expense), net	1,920,015	(1,152,223)
Capital contribution	304,906	-
Change in net deficiency	1,148,211	(4,096,104)
Net deficiency at beginning of year	(10,978,932)	(6,882,828)
Net deficiency at end of year	$ (9,830,721)	$ (10,978,932)

See accompanying notes to financial statements.

MARSHALLS ENERGY COMPANY, INC.

Statements of Cash Flows

Years Ended September 30, 2009 and 2008

	2009	2008
Cash flows from operating activities:		
Cash received from customers	$ 27,998,357	$ 26,931,088
Cash payments to suppliers for goods and services	(24,484,807)	(30,913,980)
Cash payments to employees for services	(2,497,715)	(2,279,469)
Net cash provided by (used for) operating activities	1,015,835	(6,262,361)
Cash flows from noncapital financing activities:		
Subsidy from RepMar	937,730	355,618
Net cash advances received from RepMar	1,423,355	6,758,590
Principal paid on long-term debt	(1,246,378)	(1,005,851)
Interest paid on long-term debt	(675,135)	(1,085,115)
Net cash provided by noncapital financing activities	439,572	5,023,242
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets	(440,205)	(623,140)
Capital contribution received	304,906	-
Principal paid on long-term debt	(628,049)	(590,616)
Interest paid on long-term debt	(469,777)	(497,638)
Net cash used for capital and related financing activities	(1,233,125)	(1,711,394)
Net change in cash	222,282	(2,950,513)
Cash at beginning of year	1,235,531	4,186,044
Cash at end of year	$ 1,457,813	$ 1,235,531
Reconciliation of operating loss to net cash provided by (used for) operating activities:		
Operating loss	$ (1,076,710)	$ (2,943,881)
Adjustments to reconcile operating loss to net cash provided by (used for) operating activities:		
Depreciation and amortization	1,079,294	1,069,369
Provision for doubtful accounts	364,103	-
(Increase) decrease in assets:		
Accounts receivable:		
Electricity	213,973	(3,848,766)
Affiliates	(1,693,280)	(590,343)
Other	136,734	(247,595)
Fuel and supplies	(1,456,374)	966,461
Prepayments	(3,861)	(34,417)
Increase (decrease) in liabilities:		
Accounts payable - fuel	1,807,049	(355,194)
Accounts payable - other	(7,348)	371,585
Payable to affiliates	39,675	201,841
Accrued building and engine repairs	(275,060)	(990,549)
Accrued taxes	20,168	148,105
Other accrued liabilities	(49,739)	82,951
Deferred revenue	1,917,211	(91,928)
Net cash provided by (used for) operating activities	$ 1,015,835	$ (6,262,361)

See accompanying notes to financial statements.

MARSHALLS ENERGY COMPANY, INC.

Statements of Cash Flows, Continued

Years Ended September 30, 2009 and 2008

	2009	2008
Summary disclosure of noncash activities:		
Off-set of advances from RepMar:		
Electricity receivables	$ 1,215,278	$ 1,181,348
Receivables from affiliates	1,463,250	1,159,363
Advances from RepMar	(2,678,528)	(2,340,711)
	$ -	$ -
Contributed fuel and supplies:		
Fuel and supplies	$ 2,127,197	$ -
Other grants	(1,911,000)	-
RepMar subsidy	(216,197)	-
	$ -	$ -

See accompanying notes to financial statements.

(1) Organization

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

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

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

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

MEC's financial statements are incorporated into the financial statements of RepMar as a component unit.

(2) Summary of Significant Accounting Policies

The accounting policies of MEC conform to accounting principles generally accepted in the United States of America as applicable to governmental entities, specifically proprietary funds. Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, requires that proprietary activities apply all applicable GASB pronouncements as well as Statements and Interpretations issued by the Financial Accounting Standards Board (FASB), Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989. MEC has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

MEC considers utility and nonutility revenues and costs that are directly related to utility and nonutility operations to be operating revenues and expenses. Revenues and expenses related to financing and other activities are reflected as nonoperating.

(2) Summary of Significant Accounting Policies, Continued

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.

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

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

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

- Unrestricted; net assets that are not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action of management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

Basis of Accounting

Proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operation of the fund are included in the statements of net assets. Proprietary fund operating statements present increases and decreases in net total assets. The accrual basis of accounting is utilized by proprietary funds. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

Cash

Custodial credit risk is the risk that in the event of a bank failure, MEC's deposits may not be returned to it. Such deposits are not covered by depository insurance and are either uncollateralized or collateralized with securities held by the pledging financial institution or held by the pledging financial institution but not in the depositor-government's name. MEC does not have a deposit policy for custodial credit risk.

For purposes of the statements of net assets and cash flows, cash is defined as cash on hand and cash held in demand accounts. As of September 30, 2009 and 2008, cash was $1,457,813 and $1,235,531, respectively, and the corresponding bank balances were $1,519,166 and $1,166,385, respectively, of which $1,516,806 and $739,648, respectively, were maintained in a financial institution subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2009 and 2008, bank deposits in the amount of $250,000 and $100,000, respectively, were FDIC insured. MEC does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC coverage are uncollateralized. Accordingly, these deposits were exposed to custodial credit risk.

(2) Summary of Significant Accounting Policies, Continued

Receivables

All receivables are due from government agencies, businesses and individuals located within the Republic of the Marshall Islands and are interest free and uncollateralized. The allowance for uncollectible accounts is stated at an amount which management believes will be adequate to absorb possible losses on accounts receivable that may become uncollectible based on evaluations of the collectibility of these accounts and prior collection experience. Management determines the adequacy of the allowance for uncollectible accounts based upon review of the aged accounts receivable. The allowance is established through a provision for bad debts charged to expense.

Fuel and Supplies

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

Plant and Nonutility Property

Plant and nonutility property with a cost that equals or exceeds $500 is capitalized. Such assets are stated at cost. Depreciation of plant and nonutility property and amortization of leasehold land and residences are calculated on the straight-line method based on the estimated useful lives of the respective assets. The estimated useful lives of these assets are as follows:

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

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

New Accounting Standards

During fiscal year 2009, MEC implemented the following pronouncements:

- GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, which establishes standards for the measurement, recognition, and display of other postemployment benefits expense/expenditures and related liabilities, note disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employers.

- GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, which provides guidance and consistency under which a governmental entity would be required to report a liability related to pollution remediation.

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

- GASB Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*, which improves the quality of financial reporting by requiring endowments to report their land and other real estate investments at fair value, creating consistency in reporting among similar entities that exist to invest resources for the purpose of generating income.

- GASB Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, which improves financial reporting by contributing to the GASB's efforts to codify all GAAP for state and local governments so that they derive from a single source.

- GASB Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*, which incorporates accounting and financial reporting guidance previously only contained in the American Institute of Certified Public Accountants (AICPA) auditing literature into the GASB's accounting and financial reporting literature for state and local governments, and addresses three issues from the AICPA's literature - related party transactions, going concern considerations, and subsequent events.

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

In June 2007, GASB issued statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, which addresses whether and when intangible assets should be considered capital assets for financial reporting purposes. The provisions of this statement are effective for periods beginning after June 15, 2009. Management does not believe that the implementation of this statement will have a material effect on the financial statements of MEC.

In June 2008, GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, which is intended to improve how state and local governments report information about derivative instruments - financial arrangements used by governments to manage specific risks or make investments - in their financial statements. The provisions of this statement are effective for periods beginning after June 15, 2009. Management does not believe that the implementation of this statement will have a material effect on the financial statements of MEC.

In December 2008, GASB issued Technical Bulletin No. 2008-1, *Determining the Annual Required Contribution Adjustment for Postemployment Benefits*, which clarifies the requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers,* and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions,* for calculating the annual required contribution (ARC) adjustment. The provisions of this statement are effective for periods beginning after December 15, 2008. Management does not believe that the implementation of this statement will have a material effect on the financial statements of MEC.

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In March 2009, GASB issued Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, which enhances the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. The provisions of this statement are effective for periods beginning after June 15, 2010. Management does not believe that the implementation of this statement will have a material effect on the financial statements of MEC.

Reclassifications

Certain reclassifications have been made to the 2008 financial statements to conform to the 2009 presentation.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(3) Fuel and Supplies

Fuel and supplies at September 30, 2009 and 2008, consist of the following:

	2009	2008
Fuel	$ 5,064,166	$ 1,638,762
Distribution and power plant supplies	1,283,969	1,221,776
Lubricants	136,908	40,934
	$ 6,485,043	$ 2,901,472

(4) Capital Assets

Capital asset activity for the years ended September 30, 2009 and 2008 was as follows:

	2009			
	October 1, 2008	Additions	Deletions	September 30, 2009
Utility Plant:				
Power plant engines	$ 14,720,739	$ -	$ -	$ 14,720,739
Plant and machinery	1,848,218	19,495	-	1,867,713
Vehicles	810,987	122,064	(48,075)	884,976
Leasehold improvements	641,012	-	-	641,012
Residences	561,073	-	-	561,073
Fences and seawalls	371,702	-	-	371,702
Leasehold land	330,000	-	-	330,000
Solar power systems	1,110,417	-	-	1,110,417
Furniture and fixtures	224,036	5,859	-	229,895
Nonutility Plant:				
LPG terminal	181,862	-	-	181,862
	20,800,046	147,418	(48,075)	20,899,389
Less accumulated depreciation and amortization	(11,382,133)	(1,079,294)	48,075	(12,413,352)
	9,417,913	(931,876)	-	8,486,037
Construction work-in-progress	61,273	292,787	-	354,060
	$ 9,479,186	$ (639,089)	$ -	$ 8,840,097

	2008			
	October 1, 2007	Additions	Deletions	September 30, 2008
Utility Plant:				
Power plant engines	$ 14,720,739	$ -	$ -	$ 14,720,739
Plant and machinery	1,815,632	32,586	-	1,848,218
Vehicles	710,986	100,001	-	810,987
Leasehold improvements	641,012	-	-	641,012
Residences	548,284	12,789	-	561,073
Fences and seawalls	371,702	-	-	371,702
Leasehold land	330,000	-	-	330,000
Solar power systems	633,796	476,621	-	1,110,417
Furniture and fixtures	204,560	19,476	-	224,036
Nonutility Plant:				
LPG terminal	181,862	-	-	181,862
	20,158,573	641,473	-	20,800,046
Less accumulated depreciation and amortization	(10,312,764)	(1,069,369)	-	(11,382,133)
	9,845,809	(427,896)	-	9,417,913
Construction work-in-progress	79,606	458,288	(476,621)	61,273
	$ 9,925,415	$ 30,392	$ (476,621)	$ 9,479,186

(5) Long-Term Debt

Long-term debt at September 30, 2009 and 2008 is as follows:

	2009	2008
On November 18, 1997, MEC entered into a loan agreement with the Federal Financing Bank (FFB) in the amount of $12.5 million for the construction of a new power plant, with loan repayments guaranteed by the Rural Utilities Service (RUS). MEC is required to submit drawdown requests to RUS for approval of loan advances. Interest rates are calculated based on the FFB rates at the date of the loan advances and range from 5.49% to 7.25% per annum. Principal and interest are payable in quarterly installments of $273,770 through January 2, 2018. The mortgage notes have been unconditionally guaranteed by RepMar, under which RepMar will make debt service payments to RUS in the event of default by MEC, and have been collateralized by a leasehold mortgage and security agreement over the assets of MEC. These notes are subject to certain coverage ratio requirements. MEC is not in compliance with these ratio requirements as of September 30, 2009 and 2008.	$ 6,995,942	$ 7,623,991
On May 25, 2007, MEC obtained a bank loan of $12 million to refinance debts to a fuel supplier and a commercial bank and to finance working capital requirements. The loan is amortized over a period of 10 years and matures in 3 years. Interest is calculated at 1.75% over the bank's reference rate with a minimum rate of 6.5%. As of September 30, 2009 and 2008, interest rate was 6.5%. Principal and interest are payable in monthly equal payments of $160,000 to May 1, 2010. The remaining principal and interest balance are due on June 1, 2010. The loan is guaranteed, unconditionally and absolutely, by RepMar.	9,471,961	10,718,339
	16,467,903	18,342,330
Less current installments	(2,022,622)	(1,953,031)
Long-term debt	$ 14,445,281	$ 16,389,299

Changes in long-term debt during the years ended September 30, 2009 and 2008 are as follows:

	2009				
	Balance October 1, 2008	Additions	Reductions	Balance September 30, 2009	Balance due in One Year
RUS loan	$ 7,623,991	$ -	$ 628,049	$ 6,995,942	$ 668,314
Commercial bank loan	10,718,339	-	1,246,378	9,471,961	1,354,308
	$18,342,330	$ -	$ 1,874,427	$16,467,903	$2,022,622

(5) Long-Term Debt, Continued

	2008				
	Balance October 1, 2007	Additions	Reductions	Balance September 30, 2008	Balance due in One Year
RUS loan	$ 8,214,607	$ -	$ 590,616	$ 7,623,991	$ 628,047
Commercial bank loan	11,724,190	-	1,005,851	10,718,339	1,324,984
	$19,938,797	$ -	$1,596,467	$ 18,342,330	$1,953,031

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

Year ending September 30,	Principal	Interest	Total
2010	$ 2,022,622	$ 992,476	$ 3,015,098
2011	2,156,650	858,443	3,015,093
2012	2,103,031	638,291	2,741,322
2013	2,647,614	641,258	3,288,872
2014	2,615,141	399,952	3,015,093
2015-2018	4,922,845	411,793	5,334,638
	$ 16,467,903	$ 3,942,213	$ 20,410,116

The above reflects the amortization of the commercial bank loan over a ten year period, which is the current arrangement with the lender. The loan matures on June 1, 2010 and management believes that due to the RepMar guarantee, the loan will be extended at the end of the initial three year period (see note 9).

(6) 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, 2009 and 2008, MEC is liable for gross revenue tax to RepMar amounting to $214,015 and $87,393, 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, 2009 and 2008, MEC is liable for import duties to RepMar amounting to $110,476 and $216,930, respectively, representing import duty owed prior to October 6, 2008.

(6) Related Party Transactions, Continued

Transactions for the years ended September 30, 2009 and 2008, and the related receivables from and payables to affiliates, are as follows:

	2009			
	Revenues	Expenses	Receivables	Payables
RepMar	$ 2,753,616	$ 493,622	$ 537,564	$ 286,960
Majuro Water and Sewer Company, Inc.	371,121	2,787	40,552	-
Marshall Islands Social Security Administration	19,083	533,304	1,335	141,213
Majuro Resort, Inc.	362,966	5,272	464,885	-
Kwajalein Atoll Joint Utility Resources	2,767,954	-	10,529	-
Other	1,867,701	173,648	259,366	5,812
	$ 8,142,441	$ 1,208,633	$ 1,314,231	$ 433,985

	2008			
	Revenues	Expenses	Receivables	Payables
RepMar	$ 3,687,897	$ 1,048,088	$ 241,125	$ 241,721
Majuro Water and Sewer Company, Inc.	380,107	6,691	-	518
Marshall Islands Social Security Administration	59,182	264,509	10,087	131,484
Majuro Resort, Inc.	488,048	7,709	262,996	65
Kwajalein Atoll Joint Utility Resources	3,962,798	-	280,398	-
Other	2,008,333	183,525	289,595	20,522
	$ 10,586,365	$ 1,510,522	$ 1,084,201	$ 394,310

Changes in the advances from RepMar account during the years ended September 30, 2009 and 2008, are as follows:

	2009	2008
Balance at beginning of year	$ 4,981,548	$ 563,669
Advances received	1,000,000	7,058,590
Utility billings offset	(2,678,528)	(2,340,711)
Repayments	-	(300,000)
	$ 3,303,020	$ 4,981,548

During the years ended September 30, 2009 and 2008, MEC received operating subsidies from RepMar of $1,153,927 and $355,618, respectively. MEC also received advances of $423,355 passed through RepMar from international donors during fiscal year 2009.

As of September 30, 2009 and 2008, MEC maintained a demand deposit account with an affiliate financial institution of $2,360 and $426,292, respectively.

(7) Commitments and Contingencies

Commitments

On June 22, 2006, MEC entered into a five-year fuel supply contract with SK Networks Co., Ltd. commencing January 2007 through December 2011. Under the fuel supply contract, MEC's minimum purchase obligation shall be 13,000,000 U.S. gallons per year.

Contingencies

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplates the continuation of MEC as a going concern. MEC has sustained substantial operating losses during the years ended September 30, 2009 and 2008 of $1,076,710 and $2,943,881, respectively, and has used a substantial amount of working capital in its operations resulting in a working capital deficiency of $4,225,537 at September 30, 2009. Furthermore, at September 30, 2009, total liabilities exceed total assets by $9,830,721. 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, 2009, 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 will be implementing its Comprehensive Recovery Plan (CRP), effective 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. The objectives of the CRP include but are not limited to MEC's efforts to renegotiate the terms of the Rural Utilities Services (RUS) loan with the aim of deferring loan servicing payments for at least three (3) to five (5) fiscal years and to restructure MEC's commercial debt with the Bank of Guam with the aim of securing concessional financing from a development finance institution (preferably the Asian Development Bank) to liquidate the Bank of Guam debt (see note 9).

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.

(8) Risk Management

MEC is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. MEC has elected to purchase commercial insurance from independent third parties for the risks of loss to which it is exposed. Settled claims from these risks have not exceeded commercial insurance coverage for the past three years.

Insurance proceeds of $3,410,336 received in 2007 for fire damages to MEC’s power plant building and engines were netted against estimated repair costs to put the assets back into service. Accrued building and engine repairs expense as of September 30, 2009 and 2008 amounted to $2,140,822 and $2,415,882, respectively.

(9) Subsequent Event

On September 8, 2010, MEC entered into a subsidiary loan agreement with RepMar in the amount of $8,542,445. Loan proceeds were used to pay off MEC's $12 million bank loan on October 8, 2010.

MARSHALLS ENERGY COMPANY, INC.

Statement of Revenues, Expenses and Changes in Net Deficiency by Source
Year Ended September 30, 2009

	Generation	Distribution	Tank Farm	Jaluit	Wotje	Solar	MEC Gas	Admin.	TOTAL
Operating revenues:									
Fuel and gas sales	$ -	$ -	$12,252,032	$ -	$ -	$ -	$ 543,146	$ -	$ 12,795,178
Cost of sales	-	-	10,755,261	-	-	-	260,630	-	11,015,891
Gross profit on sales	-	-	1,496,771	-	-	-	282,516	-	1,779,287
Electric and service billings	13,940,972	-	-	179,308	112,837	161,608	-	-	14,394,725
Service and Other income	3,438	59,320	25,223	9,561	300	19,017	2,333	114,624	233,816
Less provision for doubtful accounts	(364,103)	-	-	-	-	-	-	-	(364,103)
Total electricity sales and other income	13,580,307	59,320	25,223	188,869	113,137	180,625	2,333	114,624	14,264,438
Total net operating revenue	13,580,307	59,320	1,521,994	188,869	113,137	180,625	284,849	114,624	16,043,725
Operating expenses:									
Fuel and lubes	9,230,950	-	-	221,560	201,278	-	-	-	9,653,788
Salaries, wages and benefits	1,025,567	542,461	165,587	203,930	149,264	100,575	41,139	693,737	2,922,260
Repairs and maintenance	1,056,519	469,656	55,512	31,415	1,838	12,176	13,013	9,685	1,649,814
Depreciation and amortization	803,135	55,735	26,048	(21)	-	73,654	8,642	112,101	1,079,294
Gross revenue tax	91	125	410,257	214	-	-	12,110	752	423,549
Auto POL and maintenance	53,867	116,394	17,526	5,076	-	25	-	35,839	228,727
Office	-	2,055	4,198	16,789	-	-	-	183,053	206,095
Insurance	90,202	17,469	64,939	4,408	8,140	874	1,782	11,747	199,561
Freight and handling	72,736	70,357	-	16,277	37,632	220	-	1,318	198,540
Import tax	94,038	40,217	-	-	-	-	-	-	134,255
Travel	36,100	5,605	11,816	614	1,572	366	-	62,148	118,221
Communications	12,462	6,729	7,473	425	180	-	986	47,950	76,205
Professional fees	-	-	12,381	-	-	-	-	34,399	46,780
Staff training	-	-	-	-	-	-	-	38,360	38,360
Safety and uniforms	21,921	2,921	-	259	1,960	-	-	90	27,151
Lease rental	4,020	-	3,000	5,084	3,833	-	-	8,985	24,922
Membership and other fees	-	-	-	-	-	-	-	22,835	22,835
Equipment rental	1,290	7,981	685	-	-	-	5,180	-	15,136
Bank charges	5,720	-	-	-	-	-	-	5,880	11,600
Advertising	-	-	-	-	-	-	-	5,716	5,716
Entertainment	-	-	-	39	-	-	-	4,445	4,484
Contributions	-	-	-	-	-	-	-	4,138	4,138
Miscellaneous	21,348	1,923	1,346	-	-	-	1,021	3,366	29,004
Total operating expenses	12,529,966	1,339,628	780,768	506,069	405,697	187,890	83,873	1,286,544	17,120,435
Operating income (loss)	1,050,341	(1,280,308)	741,226	(317,200)	(292,560)	(7,265)	200,976	(1,171,920)	(1,076,710)
Nonoperating income (expense):									
RepMar subsidy	915,847	-	-	93,000	145,080	-	-	-	1,153,927
Other grants	1,911,000	-	-	-	-	-	-	-	1,911,000
Interest expense	(1,143,398)	-	-	-	-	-	-	(1,514)	(1,144,912)
	1,683,449	-	-	93,000	145,080	-	-	(1,514)	1,920,015
Capital contribution	-	-	-	-	-	304,906	-	-	304,906
Change in net deficiency	$2,733,790	$ (1,280,308)	$ 741,226	$ (224,200)	$ (147,480)	$ 297,641	$ 200,976	$ (1,173,434)	$ 1,148,211

See accompanying independent auditors' report.