

**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, 2019 AND 2018**

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

Years Ended September 30, 2019 and 2018  
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	8
Statements of Revenues, Expenses and Changes in Net Position	9
Statements of Cash Flows	10
Notes to Financial Statements	11
IV. OTHER SUPPLEMENTARY INFORMATION:	
Schedule of Revenues, Expenses and Changes in Net Position by Division	24
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>	25
Independent Auditors' Report on Compliance for the Sole Major Federal Program; Report on Internal Control Over Compliance; and Report on Schedule of Expenditures of Federal Awards Required by the Uniform Guidance	27
Schedule of Expenditures of Federal Awards	29
Notes to Schedule of Expenditures of Federal Awards	30
Schedule of Findings and Questioned Costs	31
Summary Schedule of Prior Audit Findings	34
Corrective Action Plan	35

## **INDEPENDENT AUDITORS' REPORT**

Board of Directors  
Marshalls Energy Company, Inc.:

### **Report on the Financial Statements**

We have audited the accompanying financial statements of 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, 2019 and 2018, 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 Marshalls Energy Company, Inc. as of September 30, 2019 and 2018, 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.

## ***Emphasis of Matter***

### *COVID-19*

As discussed in Note 12 to the financial statements, MEC has determined that the COVID-19 pandemic may negatively impact its business, results of operations and net position. MEC is unable to reasonably estimate its ultimate financial impact. Our opinion is not modified with respect to this matter.

## ***Other Matters***

### *Required Supplementary Information*

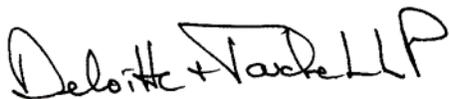
Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 3 to 7 be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting 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 Supplementary 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 June 19, 2020, 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 solely 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 effectiveness of MEC's 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.



June 19, 2020

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

Management's Discussion and Analysis  
Years Ended September 30, 2019 and 2018

Marshalls Energy Company, Inc. (MEC) herewith presents a discussion and analysis of the company's financial performance for the fiscal year ended 30<sup>th</sup> September, 2019. It is to be read in conjunction with the financial statements following this section.

**FINANCIAL HIGHLIGHTS**

MEC's net position increased by \$0.5 million in fiscal year 2019 compared to an increase of \$0.8 million in fiscal year 2018. In 2019, total net utility operating revenues were \$18.5 million, a slight increase of \$0.2 million from \$18.3 million in net utility operating revenues in 2018. Total utility operating expenses were \$19.3 million and \$18.4 million in 2019 and 2018, respectively. The increase of \$0.9 million or the same rate of 5% is mainly due to the net impact of increases in the cost of fuel of \$0.7 million or 7%, administrative and general expenses of \$0.4 million or 25%, distribution expenses of \$0.2 million or 11% offset by a decrease in cost of power of \$0.3 million or 7% in 2019. The increase in cost of fuel relates to increased global fuel prices experienced during the year compared to fiscal year 2018. Cost of fuel continues to be a significant component of generation operating costs and represents 53% and 51% of total operating costs in fiscal years 2019 and 2018, respectively.

Total net operating revenues from nonutility operations, with fuel sales being the major component, were \$16.3 million and \$16 million in 2019 and 2018, respectively, a slight increase of \$0.3 million year on year. The provision for doubtful accounts expense for fiscal years 2018 and 2019 is for fuel sales and was charged against operating revenues in the amount of \$2.5 million and \$2.2 million for fiscal years 2019 and 2018, respectively. This charge relates to one customer where numerous attempts to recover have proven unsuccessful. Total operating expenses from nonutility operations increased by \$0.8 million, from \$16.1 million in 2018 to \$16.9 million in 2019 and is line with the increase in global fuel prices in 2019 compared to 2018.

MEC received operating subsidies from REPMAR in the amount of \$2 million in 2019 compared to \$1.2 million in 2018. In 2019, MEC received \$0.5 million as a cost recovery for the operations of the Wotje and Jaluit power plants. However, no subsidy was received in 2019 as cost recovery for the operations of the solar division to support the funding gap in solar tariff for maintenance services toward solar units in the outer islands. In 2019, MEC was the sub recipient of grant funding in the amount of \$1.5 million from the 11th European Development Fund (EDF11) under the ACP-EU Partnership Agreement. This grant was received as budget support to MEC and was used to support reform initiatives set out in the report published under the ADB Technical Assistance (TA) for Capacity Building and Sector Reform for Renewable Investments in the Pacific.

**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 30<sup>th</sup> September, 2019.

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

Management's Discussion and Analysis  
Years Ended September 30, 2019 and 2018

Statements of Net Position

The Summary Statements of Net Position for MEC as of September 30, 2019 compared with September 30, 2018 and 2017 is presented below:

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Assets:			
Current and other assets	\$ 19,449,883	\$ 21,532,051	\$ 16,188,122
Capital assets	6,338,653	7,199,765	8,230,984
Total assets	<u>25,788,536</u>	<u>28,731,816</u>	<u>24,419,106</u>
Liabilities:			
Current and other liabilities	11,738,213	13,583,990	8,648,328
Long-term debt	6,428,742	8,006,332	9,398,560
Total liabilities	<u>18,166,955</u>	<u>21,590,322</u>	<u>18,046,888</u>
Net position:			
Net investment in capital assets	6,125,040	5,843,850	5,794,593
Restricted	-	-	238,794
Unrestricted	1,496,541	1,297,644	338,831
Total net position	<u>\$ 7,621,581</u>	<u>\$ 7,141,494</u>	<u>\$ 6,372,218</u>

Total assets decreased by \$2.9 million (or 10%) from \$28.7 million in 2018 to \$25.8 million in 2019 and increased by \$4.3 million or (18%) from \$24.4 million in 2017 to \$28.7 million in 2018. The decrease in total assets in 2019 mainly relates to the net impact of decreases in non-current assets of \$0.5 million and current assets of \$2.4 million. The decrease in current assets was the result of a decrease in cash (\$2.5 million), net accounts receivable (\$0.8 million) and prepayments (\$0.5 million) offset by an increase in TCDs (\$0.5 million) and fuel and supplies (\$0.9 million).

Capital assets includes construction work in progress as of September 30, 2019 of \$0.9 million, which consists of tank refurbishment and LPG farm refurbishment works. Refer to note 5 to the accompanying financial statements for additional information relating to capital assets.

Total liabilities decreased by \$3.4 million (or 16%) from \$21.6 million in 2018 to \$18.2 million in 2019 and increased by \$3.5 million (or 20%) from \$18 million in 2017 to \$21.6 million in 2018. The decrease in total liabilities relates to the decrease in non-current and current liabilities of \$0.7 million and \$2.7 million, respectively. The decrease in current liabilities (excluding the current portion of long-term debt) of \$1.8 million was the result of a decrease in accounts payable (\$2.6 million) offset by an increase in unearned revenues (\$0.8 million). Long-term debt decreased by \$1.6 million (or 20%), which was due to scheduled 2019 debt service. Refer to note 6 to the accompanying financial statements for additional information relating to 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, 2019 and 2018

Statements of Revenues, Expenses and Changes in Net Position

The Summary Statements of Revenues, Expenses and Changes in Net Position for MEC for the year ended September 30, 2019 as compared to September 30, 2018 and 2017 is presented below:

	<u>2019</u>		<u>2018</u>		<u>2017</u>
Operating revenues:					
Utility revenue	\$ 18,454,203	\$	18,317,571	\$	17,895,474
Non-utility revenue	16,313,432		16,023,676		13,181,277
Total operating revenues	<u>34,767,635</u>		<u>34,341,247</u>		<u>31,076,751</u>
Operating expenses:					
Utility expenses	19,324,068		18,440,541		17,132,725
Non-utility expenses	16,915,826		16,076,545		11,954,964
Total operating expenses	<u>36,239,894</u>		<u>34,517,086</u>		<u>29,087,689</u>
Operating profit (loss)	<u>(1,472,259)</u>		<u>(175,839)</u>		<u>1,989,062</u>
Nonoperating revenues (expenses):					
RMI subsidy	2,016,514		1,169,925		1,140,800
Impairment loss	-		-		(1,396,717)
Other	90,435		-		854,301
Interest expense	(154,603)		(224,810)		(302,057)
	<u>1,952,346</u>		<u>945,115</u>		<u>296,327</u>
	480,087		769,276		2,285,389
Capital contributions	<u>-</u>		<u>-</u>		<u>672,576</u>
Change in net position	480,087		769,276		2,957,965
Net position - beginning	<u>7,141,494</u>		<u>6,372,218</u>		<u>3,414,253</u>
Net position - ending	<u>\$ 7,621,581</u>	\$	<u>7,141,494</u>	\$	<u>6,372,218</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 operating revenues increased in 2019 by \$0.5 million (or 1%) to a total of \$34.8 million compared to \$34.3 million in 2018 while MEC's total operating expenses increased in 2019 by \$1.7 million (or 5%) to a total of \$36.2 million compared to \$34.5 million in 2018.

Total utility revenues increased by \$0.1 million (or 1%) from \$18.3 million in 2018 to \$18.5 million in 2019. The slight increase relates to an increase in cash power sales in 2019 compared to 2018.

Total non-utility revenues are composed mainly of fuel sales. Non-utility revenues increased by \$0.3 million (or 2%) in 2019 to \$16.3 million compared to \$16 million in 2018. The increase mainly relates to increase in global fuel prices in 2019 compared to 2018.

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

Management's Discussion and Analysis  
 Years Ended September 30, 2019 and 2018

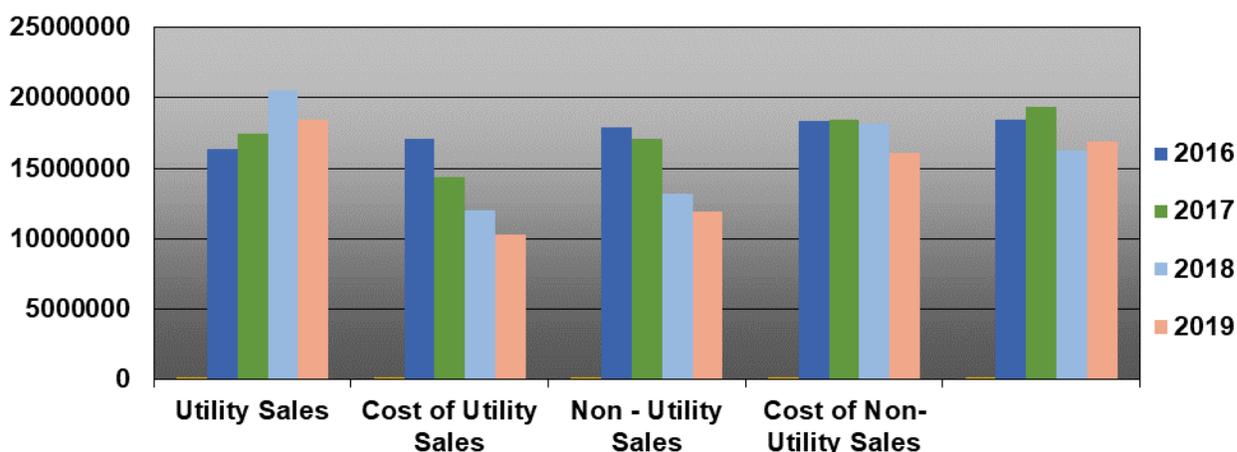
Total utility expenses increased by \$0.9 million (or 5%) from \$18.4 million in 2018 to \$19.3 million in 2019. The increase mainly relates to increase in global fuel prices in 2019 compared to 2018.

Total non-utility expenses are composed mainly of fuel purchases. Non-utility expenses increased by \$0.8 million (or 5%) in 2019 to \$16.9 million compared to \$16.1 million in 2018. The increase mainly relates to increase in global fuel prices in 2019 compared to 2018.

Total operating loss in 2019 was \$1.5 million, which was comprised of an operating loss of \$0.9 million from utility operations and an operating loss of \$0.6 million from nonutility operations. Total operating loss for 2019 increased by \$1.3 million compared with the total operating loss of \$0.2 million in 2018.

Management's Discussion and Analysis for the year ended September 30, 2018 is set forth in the report on the audit of MEC's financial statements dated June 7, 2019. That Discussion and Analysis explains the major factors impacting the 2018 financial statements and can be obtained from the contact information below.

The graphic below shows the major components of MEC's revenues and expenditures trend for the past four years:



**MEC FOCUS IN THE COMING FISCAL YEAR**

MEC finalized its 3-year Business Plan (BP) in June 2019, the BP is a legal requirement under the SOE Act, 2015. The plan outlines the key objectives and strategic actions for fiscal years 2020 to 2023. An important component in the key objectives is the implementation of recommendations set out in the report issued to MEC under the TA for Capacity Building and Energy Sector Reform for Renewable Investments in the Pacific.

The BP will drive the operational and management strategies and is MEC's key focus over the next 3 years to achieve the MEC vision and enhance the quality of life for the people of the RMI.

The BP contains a total of 49 strategic actions, spread over 18 key objectives and covers 7 key areas.

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

Management's Discussion and Analysis  
Years Ended September 30, 2019 and 2018

The global emergence of coronavirus disease 2019 (COVID-19) in FY2020 is having an extraordinary impact on Pacific Islands economies and across the globe. The RMI has been spared any confirmed cases of COVID-19 and have taken strong proactive measures to protect the health of the nation. The structure of the RMI economy is heavily dependent upon the public sector as well as fisheries activities. With the advent of COVID-19, global oil prices have substantially dropped due to exceeding supply over demand. While the drop in global oil prices is considered to be temporary, MEC is expected to benefit from this through lower operating costs. MEC's fuel sales related to fisheries activities may see a decline; however, with the drop in global oil prices, we believe that MEC will be able to weather the current situation.

MEC operations have been slightly impacted by COVID-19. The impact has been mostly in the area of delayed shipments or receipt of orders and the other area is fuel whereby MEC has experienced both a decrease in fuel price and fuel sales demand. The drop in fuel demand started in the month of February 2020 where there were zero incoming foreign vessels. We can all agree that COVID-19 and the RMI National Disaster Committee (NDC) 30 day quarantine versus 14 days has to do with the low (averaging 15K per month) incoming foreign vessels to this date. MEC had a 75K-100K gallon fuel demand from foreign vessels before the month of February. Hopefully, with the discontinuance of the RMI Health Travel Advisory and restrictions by the NDC and opening of the RMI borders, we will see our business gain track to normalcy.

**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 30<sup>th</sup> September, 2019. 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. Chief Executive Officer 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, 2019 and 2018

	2019	2018
<u>ASSETS</u>		
Utility plant:		
Electric plant in service	\$ 29,514,333	\$ 29,579,112
Less accumulated depreciation and amortization	(24,041,530)	(23,035,228)
	5,472,803	6,543,884
Construction work in progress	865,850	655,881
Net utility plant	6,338,653	7,199,765
Nonutility property	181,862	181,862
Less accumulated depreciation	(181,862)	(181,862)
Nonutility property, net	-	-
Total capital assets	6,338,653	7,199,765
Due from employees, net of current portion	-	20,584
Long-term replacement parts	967,885	889,088
Deposit on acquisition of capital assets	300,187	-
Total non-current assets	7,606,725	8,109,437
Current assets:		
Cash	2,852,351	5,381,918
Time certificates of deposit	2,944,977	2,396,919
Accounts receivables, net	5,329,696	6,138,273
Due from employees	15,823	34,459
Fuel and supplies	6,826,160	5,966,157
Prepayments	112,804	604,653
Security deposit	100,000	100,000
Total current assets	18,181,811	20,622,379
Total assets	\$ 25,788,536	\$ 28,731,816
<u>NET POSITION AND LIABILITIES</u>		
Net position:		
Net investment in capital assets	\$ 6,125,040	\$ 5,843,850
Unrestricted	1,496,541	1,297,644
Total net position	7,621,581	7,141,494
Commitment and contingencies		
Noncurrent liabilities:		
Long-term debt	5,878,156	6,544,096
Unearned fuel purchase incentive, net of current portion	1,470,497	1,653,885
Accrued leave, net of current portion	173,424	-
Total noncurrent liabilities	7,522,077	8,197,981
Current liabilities:		
Current portion of long-term debt	550,586	1,462,236
Accounts payable - fuel	3,580,240	6,074,445
Accounts payable - other	467,038	375,006
Payable to affiliates	493,885	681,009
Accrued leave	202,720	-
Accrued taxes	1,976,190	2,115,975
Other accrued liabilities	236,090	348,838
Unearned fuel purchase incentive, current portion	183,812	183,765
Unearned revenue - cash power	2,369,708	1,378,772
Unearned revenue - fuel	584,609	772,295
Total current liabilities	10,644,878	13,392,341
Total liabilities	18,166,955	21,590,322
Total net position and liabilities	\$ 25,788,536	\$ 28,731,816

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, 2019 and 2018

	2019	2018
Utility operations:		
Operating revenues:		
Electricity sales	\$ 18,456,541	\$ 18,746,602
Other	87,250	43,699
	18,543,791	18,790,301
Provision for doubtful accounts	(89,588)	(472,730)
Total net operating revenues	18,454,203	18,317,571
Operating expenses:		
Cost of fuel	10,177,626	9,487,166
Cost of power	4,220,789	4,524,191
Administrative and general	2,119,112	1,698,124
Distribution operations	1,468,998	1,325,170
Depreciation and amortization	1,337,543	1,405,890
Total operating expenses	19,324,068	18,440,541
Operating loss from utility operations	(869,865)	(122,970)
Nonutility operations:		
Operating revenues:		
Fuel sales	17,948,882	17,426,085
Propane sales	447,998	614,322
Lubricants sales	60,693	27,939
Other	369,539	119,721
	18,827,112	18,188,067
Provision for doubtful accounts	(2,513,680)	(2,164,391)
Total net operating revenues	16,313,432	16,023,676
Operating expenses:		
Cost of fuel	15,933,405	15,007,283
Cost of propane and lubricants	310,177	370,888
Other	672,244	698,374
Total operating expenses	16,915,826	16,076,545
Operating loss from nonutility operations	(602,394)	(52,869)
Operating loss	(1,472,259)	(175,839)
Nonoperating income (expense):		
RepMar subsidies	2,016,514	1,169,925
Other grants	90,435	-
Interest expense	(154,603)	(224,810)
Total nonoperating income (expense), net	1,952,346	945,115
Change in net position	480,087	769,276
Net position at beginning of year	7,141,494	6,372,218
Net position at end of year	\$ 7,621,581	\$ 7,141,494

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, 2019 and 2018

	2019	2018
Cash flows from operating activities:		
Cash received from customers	\$ 36,379,462	\$ 36,144,004
Cash received from fuel supplier	-	2,000,000
Cash payments to suppliers for goods and services	(34,464,883)	(31,197,081)
Cash payments to employees for services	(3,498,496)	(3,536,486)
Net cash (used for) provided by operating activities	(1,583,917)	3,410,437
Cash flows from noncapital financing activities:		
Operating RepMar subsidies received	2,016,514	1,169,925
Other grants received	90,435	-
Principal paid on long-term debt	(435,287)	(311,752)
Interest paid on long-term debt	(96,153)	(67,848)
Net cash provided by noncapital financing activities	1,575,509	790,325
Cash flows from capital and related financing activities:		
Deposit on acquisition of capital assets	(300,187)	-
Acquisition and construction of capital assets	(476,431)	(374,671)
Principal paid on long-term debt	(1,142,303)	(1,080,476)
Interest paid on long-term debt	(54,180)	(116,008)
Net cash used for capital and related financing activities	(1,973,101)	(1,571,155)
Cash flows from investing activities:		
Net increase in time certificates of deposit	(548,058)	(46,304)
Net change in cash	(2,529,567)	2,583,303
Cash at beginning of year	5,381,918	2,798,615
Cash at end of year	\$ 2,852,351	\$ 5,381,918
Reconciliation of operating earnings to net cash (used for) provided by operating activities:		
Operating loss	\$ (1,472,259)	\$ (175,839)
Adjustments to reconcile operating earnings to net cash (used for) provided by operating activities:		
Depreciation and amortization	1,337,543	1,405,890
Provision for doubtful accounts	2,603,268	2,637,121
Decrease (increase) in assets:		
Accounts receivable	(1,794,691)	(1,640,685)
Due from employees	39,220	30,455
Fuel and supplies	(860,003)	(3,171,389)
Prepayments	491,849	1,136
Long-term replacement parts	(78,797)	(570,960)
Increase (decrease) in liabilities:		
Accounts payable - fuel	(2,498,475)	3,215,459
Accounts payable - other	92,032	(381,573)
Payable to affiliates	(187,124)	42,156
Accrued leave	376,144	-
Accrued building and engine repairs	-	(501,934)
Accrued taxes	(139,785)	(191,637)
Other accrued liabilities	(112,748)	68,266
Unearned fuel purchase incentive	(183,341)	1,837,650
Unearned income	803,250	806,321
Net cash (used for) provided by operating activities	\$ (1,583,917)	\$ 3,410,437

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, 2019 and 2018

(1) Organization

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 as well as the public utility company on the island of Ebeye.

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 is governed by a seven-member RMI Combined Utilities Board of Directors appointed by the Cabinet of RepMar. The RMI Combined Utilities Board of Directors also have governance over Kwajalein Atoll Joint Utilities Resources, Inc. (KAJUR) and Majuro Water and Sewer Company, Inc. (MWSC), which are component units of RepMar.

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*, as amended by GASB Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus*, GASB Statement No. 38, *Certain Financial Statement Note Disclosures*, and GASB Statement No. 61, *The Financial Reporting Entity: Omnibus - an amendment of GASB Statements No. 14 and 34*, 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.

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

Notes to Financial Statements  
September 30, 2019 and 2018

(2) Summary of Significant Accounting Policies, Continued

To conform to these requirements, 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: Nonexpendable net position subject to externally imposed stipulations that require MEC to maintain such permanently. As of September 30, 2019 and 2018, MEC does not have nonexpendable restricted net position.
- Restricted: Expendable net position whose use by MEC is subject to externally imposed stipulations that can be fulfilled by actions of MEC pursuant to those stipulations or that expire with the passage of time. As of September 30, 2019 and 2018, MEC does not have expendable restricted net position.
- 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 deferred outflows of resources, and liabilities and deferred inflows of resources 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 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 are 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, 2019 and 2018

(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, 2019 and 2018, the carrying amount of cash and time certificates of deposit was \$5,797,328 and \$7,778,837, respectively, and the corresponding bank balances were \$5,384,979 and \$6,758,674, respectively. Of the bank balance amounts, \$1,871,787 and \$3,575,308, respectively, were maintained in a financial institution subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2019 and 2018, bank deposits in the amount of \$250,000 were FDIC insured. The remaining bank deposits of \$3,513,192 and \$3,183,366, respectively, were maintained in a financial institution 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 (moving average) or market (net realizable value).

Long-term Replacement Parts

Long-term replacement parts are slow-moving inventory not reasonably expected to be realized in cash during MEC's normal operating cycle and are valued at the lower of cost (moving average) 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. 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, 2019 and 2018

(2) Summary of Significant Accounting Policies, Continued

Plant and Nonutility Property, Continued

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
Land and building	20 years
Computer software	3 - 5 years

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 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 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.

Compensated Absences

MEC recognizes the cost of accrued annual and sick leave at the time such leave is earned. As of September 30, 2019 MEC recorded \$376,144 of accrued annual and sick leave, which is included within the statements of net position as accrued leave. Sick leave will not be advanced or paid to employees upon termination of their employment. Unused sick leave may be accumulated and carried over in subsequent payroll years. Although sick leave accumulates indefinitely during the term of the employee's employment, employees can only use a maximum of ten (10) days or eighty (80) hours of paid sick leave per payroll year. Unused annual or vacation leave hours in excess of the 208 hours annual limit will not be carried over into a succeeding payroll year. Annual or vacation time can be taken up to a maximum of twenty (20) days in a payroll year.

Taxes

Corporate profits are not subject to income tax in the Republic of the Marshall Islands. The Government of the Republic of the Marshall Islands imposes a gross revenue tax of 3% on revenues. Pursuant to the Income Tax Act of 1989, as amended, sales of electricity by public utility companies are exempt from gross revenue tax. Accordingly, MEC is exempt from gross revenue tax on the sale of electric services. MEC is required to pay gross revenue tax on all other revenues. Pursuant to the Import Duties (MEC Exemption) Act of 2008, MEC is exempt from paying import duty on all types of fuel imported in the Republic of the Marshall Islands, including fuel imported for power generation and for commercial resale.

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

Notes to Financial Statements  
September 30, 2019 and 2018

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards

During the year ended September 30, 2019, MEC implemented the following pronouncements:

- GASB Statement No. 83, *Certain Asset Retirement Obligations*, which addresses accounting and financial reporting for certain asset retirement obligations (AROs) associated with the retirement of a tangible capital asset.
- GASB Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*, which improves the information that is disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements.

The implementation of these statements did not have a material effect on the accompanying financial statements. However, the implementation of GASB Statement No. 88 did result in additional required disclosures surrounding debt. See Note 6.

In January 2017, GASB issued Statement No. 84, *Fiduciary Activities*, which establishes criteria for identifying fiduciary activities of all state and local governments. The provisions in Statement No. 84 are effective for fiscal years beginning after December 15, 2018. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In June 2017, GASB issued Statement No. 87, *Leases*, which establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. The provisions in Statement No. 87 are effective for fiscal years beginning after December 15, 2019. Management has yet to determine whether the implementation of this statement will have a material effect on the financial statements.

In June 2018, GASB issued Statement No. 89, *Accounting for Interest Cost Incurred before the End of a Construction Period*, which requires that interest cost incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred for financial statements prepared using the economic resources measurement focus. The provisions in Statement No. 89 are effective for fiscal years beginning after December 15, 2019. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In August 2018, GASB issued Statement No. 90, *Majority Equity Interests - an Amendment of GASB Statements No. 14 and No. 61*, which improves the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and the relevance of financial statement information for certain component units. The provisions in Statement No. 90 are effective for fiscal years beginning after December 15, 2018. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In May 2019, GASB issued Statement No. 91, *Conduit Debt Obligations*, which clarifies the existing definition of a conduit debt obligation; establishing that a conduit debt obligation is not a liability of the issuer; establishing standards for accounting and financial reporting of additional commitments and voluntary commitments extended by issuers and arrangements associated with conduit debt obligations; and improving required note disclosures. The provisions in Statement No. 91 are effective for fiscal years beginning after December 15, 2020. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

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

Notes to Financial Statements  
September 30, 2019 and 2018

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In May 2020, GASB issued Statement No. 95, *Postponement of the Effective Dates of Certain Authoritative Guidance*, which postpones the effective dates of GASB Statement No. 84, 89, 90 and 91 by one year and GASB Statement No. 87 by 18 months; however, earlier application of the provisions addressed in GASB Statement No. 95 is encouraged and is permitted to the extent specified in each pronouncement as originally issued. Management has yet to ascertain whether implementation of these statements will be postponed as provided in GASB Statement No. 95.

Reclassifications

Certain balance in the 2018 presentation has been reclassified to conform to the 2019 presentation.

Estimates

The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and deferred outflows of resources, liabilities and deferred inflows of resources, 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) Accounts Receivable

Accounts receivable at September 30, 2019 and 2018, consist of the following:

	<u>2019</u>	<u>2018</u>
RepMar and other affiliates	\$ 10,569,599	\$ 8,940,419
Other:		
Electricity	3,734,270	3,813,679
Solar	1,318,905	1,169,055
Fuel	528,366	505,390
Other	<u>962,160</u>	<u>882,619</u>
	17,113,300	15,311,162
Less allowance for uncollectible accounts	<u>(11,783,604)</u>	<u>(9,172,889)</u>
	<u>\$ 5,329,696</u>	<u>\$ 6,138,273</u>

(4) Fuel and Supplies

Fuel and supplies at September 30, 2019 and 2018, consist of the following:

	<u>2019</u>	<u>2018</u>
Fuel	\$ 4,906,862	\$ 4,023,483
Distribution and power plant supplies	1,641,378	1,721,420
Lubricants	227,800	180,388
Propane gas	<u>50,120</u>	<u>40,866</u>
	<u>\$ 6,826,160</u>	<u>\$ 5,966,157</u>



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

Notes to Financial Statements  
September 30, 2019 and 2018

(5) Capital Assets, Continued

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, 2019 and 2018, the R&M Fund has a balance of \$142,399 and \$3,117, respectively.

(6) Long-Term Debt

Note and Loan Payable

Long-term debt at September 30, 2019 and 2018 is as follows:

	<u>Interest Rate</u>	<u>Maturity Dates</u>	<u>2019</u>	<u>2018</u>
Rural Utilities Service	5.49% - 7.25%	2020	\$ 213,612	\$ 1,355,915
Asian Development Bank	1%	2034	<u>6,215,130</u>	<u>6,650,417</u>
			<u>\$ 6,428,742</u>	<u>\$ 8,006,332</u>

The Rural Utilities Service (RUS) 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.

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

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2020	\$ 550,586	\$ 89,004	\$ 639,590
2021	369,884	85,636	455,520
2022	375,470	80,050	455,520
2023	381,141	74,379	455,520
2024	386,898	68,622	455,520
2025-2029	2,023,927	253,673	2,277,600
2030-2034	<u>2,340,836</u>	<u>95,168</u>	<u>2,436,004</u>
	<u>\$ 6,428,742</u>	<u>\$ 746,532</u>	<u>\$ 7,175,274</u>

Change in Long-term Debt

A summary of changes in long-term debt for the years ended September 30, 2019 and 2018 is as follows:

	Balance October 1, 2018	<u>Additions</u>	<u>Reductions</u>	Balance September 30, 2019	<u>Due Within One Year</u>
Notes payable:					
RUS loan	\$ 1,355,915	\$ -	\$ (1,142,303)	\$ 213,612	\$ 213,612
Loan payable:					
ADB	<u>6,650,417</u>	<u>-</u>	<u>(435,287)</u>	<u>6,215,130</u>	<u>336,974</u>
	<u>\$ 8,006,332</u>	<u>\$ -</u>	<u>\$ (1,577,590)</u>	<u>\$ 6,428,742</u>	<u>\$ 550,586</u>

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

Notes to Financial Statements  
September 30, 2019 and 2018

(6) Long-Term Debt, Continued

Change in Long-term Debt, Continued

	Balance October 1, 2017	<u>Additions</u>	<u>Reductions</u>	Balance September 30, 2018	Due Within One Year
Notes payable:					
RUS loan	\$ 2,436,391	\$ -	\$ (1,080,476)	\$ 1,355,915	\$ 1,130,275
Loan payable:					
ADB	<u>6,962,169</u>	<u>-</u>	<u>(311,752)</u>	<u>6,650,417</u>	<u>331,961</u>
	<u>\$ 9,398,560</u>	<u>\$ -</u>	<u>\$ (1,392,228)</u>	<u>\$ 8,006,332</u>	<u>\$ 1,462,236</u>

Debt Covenants

Asian Development Bank:

MEC obtained a subsidiary loan from the Asian Development Bank (ADB), through RepMar. The ADB Subsidiary Loan Agreement, dated September 8, 2010, is utilized to pay off a bank loan that was originally procured for operating purposes. The Loan Agreement specifies that in case of default, RepMar, at its option, may by notice to MEC declare the principal of the subsidiary loan then outstanding to be due and payable immediately together with the interest and other charges.

Rural Utilities Service:

The RUS Loan Agreement, dated May 1, 1997, sets forth covenants to ensure proper operation and maintenance of the electric utility system and payment of debt service. The primary requirements of the loan agreement is summarized below:

Rate Covenant - MEC has covenanted to at all times fix, prescribe and collect rates, fees and charges in connection with the services furnished by the electric utility system that will be sufficient to yield the sum of net income during each fiscal year equal to at least 125% of the annual debt service. TIER is defined as net income (after tax) plus interest divided by interest expense. The Loan Agreement prohibits MEC, without the prior written consent of RUS, to incur additional indebtedness while MEC maintains a TIER below 1.0; or if the additional indebtedness will cause MEC's TIER to fall below 1.0; or an Event of Default has occurred and is continuing.

Events of default with finance related consequences - the Loan Agreement specifies a number of Events of Default and related Remedies. MEC shall furnish to RUS promptly, after becoming aware, notice of the occurrence of any default under the Loan Documents or the receipt of any notice with respect to the occurrence of any event with which the giving of notice or the passage of time, or both, could become an Event of Default.

Acceleration - Upon the occurrence of an Event of Default and is continuing, RUS may, by notice in writing to MEC, declare all unpaid principal of and all interest accrued on the Notes to be immediately due and payable and, upon such declaration, all such principal and interest shall become immediately due and payable.

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

Notes to Financial Statements  
September 30, 2019 and 2018

(7) Change in Long-Term Liabilities

Changes in other long-term liabilities during the years ended September 30, 2019 and 2018 were as follows:

	Balance October 1, 2018	Additions	Reductions	Balance September 30, 2019	Due Within One Year
Accrued leave	\$ -	\$ 376,144	\$ -	\$ 376,144	\$ 202,720
Unearned fuel purchase incentive (see Note 10)	1,837,650	-	(183,341)	1,654,309	183,812
	<u>\$ 1,837,650</u>	<u>\$ 376,144</u>	<u>\$ (183,341)</u>	<u>\$ 2,030,453</u>	<u>\$ 386,532</u>
	Balance October 1, 2017	Additions	Reductions	Balance September 30, 2018	Due Within One Year
Unearned fuel purchase incentive (see Note 10)	\$ -	\$ 2,000,000	\$ (162,350)	\$ 1,837,650	\$ 183,765

(8) Employee Retirement Plan

MEC, together with KAJUR and MWSC, have implemented a defined contribution retirement savings plan (the Plan) for their respective 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 their respective employers up to 10% 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 \$85,638 and \$88,922 to Plan participant accounts during the years ended September 30, 2019 and 2018, respectively, and total combined plan assets were \$1,616,246 and \$1,490,260 as of September 30, 2019 and 2018, respectively.

(9) Related Party Transactions

MEC is wholly-owned by RepMar and is therefore affiliated with all RepMar-owned and affiliated entities, including KAJUR and MWSC. 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.

A summary of related party transactions for the years ended September 30, 2019 and 2018, and the related receivable and payable balances as of September 30, 2019 and 2018, are as follows:

	2019			
	<u>Revenues</u>	<u>Expenses</u>	<u>Receivables</u>	<u>Payables</u>
RepMar	\$ 2,905,367	\$ 1,177,785	\$ 1,270,054	\$ 451,651
Kwajalein Atoll Joint Utilities Resources, Inc.	4,143,584	-	5,477,036	-
Majuro Water and Sewer Company, Inc.	415,638	31,784	2,957,694	-
Marshall Islands Social Security Administration	26,565	484,425	4,138	-
Majuro Resort, Inc.	451,233	15,949	472,494	2,162
Marshall Islands National Telecommunications Authority	553,280	92,554	97,292	23,862
College of Marshall Islands	372,987	-	130,997	-
Other	1,004,306	152,988	159,894	16,210
	<u>\$ 9,872,960</u>	<u>\$ 1,955,485</u>	<u>\$ 10,569,599</u>	<u>\$ 493,885</u>

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

Notes to Financial Statements  
September 30, 2019 and 2018

(9) Related Party Transactions, Continued

	2018			
	<u>Revenues</u>	<u>Expenses</u>	<u>Receivables</u>	<u>Payables</u>
RepMar	\$ 2,705,111	\$ 637,616	\$ 356,597	\$ 512,832
Kwajalein Atoll Joint Utilities Resources, Inc.	4,143,584	-	4,791,589	-
Majuro Water and Sewer Company, Inc.	623,078	14,182	2,961,322	-
Marshall Islands Social Security Administration	24,913	315,883	5,820	150,877
Majuro Resort, Inc.	401,573	14,211	559,456	-
Marshall Islands National Telecommunications Authority	585,003	83,855	73,271	17,300
College of Marshall Islands	396,907	-	70,412	-
Other	<u>1,096,935</u>	<u>126,056</u>	<u>121,952</u>	<u>-</u>
	<u>\$ 9,977,104</u>	<u>\$ 1,191,803</u>	<u>\$ 8,940,419</u>	<u>\$ 681,009</u>

The allowance for uncollectable accounts pertaining to receivables from affiliates amounted to \$7,694,877 and \$5,564,732 as of September 30, 2019 and 2018, respectively.

During the years ended September 30, 2019 and 2018, MEC received subsidies and contributions from RepMar as follows:

	<u>2019</u>	<u>2018</u>
RMI operations	\$ 1,500,254	\$ -
Jaluit and Wotje operations	516,260	549,965
Outer islands solar	<u>-</u>	<u>619,960</u>
	<u>\$ 2,016,514</u>	<u>\$ 1,169,925</u>

MEC is the subrecipient of RMI grant funding in the amount of \$1,500,000 from the 11th European Development Fund (EDF11) under the ACP-EU Partnership Agreement to support reform of the energy sector in RMI.

The outer islands solar subsidy is restricted for the purpose of funding the gap in the solar tariff in order for MEC to maintain solar units in the outer islands. During the year ended September 30, 2018, MEC incurred maintenance expenses associated with the outer islands solar units of \$216,316. As of September 30, 2018, the outer islands solar subsidy is expended and no amount is restricted within net position.

As of September 30, 2019 and 2018, MEC is liable for current and delinquent gross revenue taxes to RepMar, totaling \$1,803,718 and \$2,067,016, respectively. In addition, MEC is liable for current and delinquent withholding payroll taxes to RepMar, totaling \$25,288 and \$48,959, respectively. Accrued taxes payable exclude related penalties and interest.

In 2015, the Government of Japan and RepMar concluded a grant agreement for Non-Project Grant Aid in the amount of JPY100,000,000 with MEC as the ultimate grantee. The purpose of the Grant is to assist in the supply of petroleum fuel to MEC and mitigating the social and economic difficulties caused by volatile and sustained high oil prices. The Grant was paid directly by the Government of Japan through an independent procurement agent to MEC's fuel supplier. During the year ended September 30, 2017, MEC received the equivalent gallons of fuel from the supplier in the amount of \$726,263. As part of the agreement, MEC was required to establish a counterpart fund with RepMar in the amount of \$275,952 no later than July 5, 2018. As of September 30, 2019 and 2018, MEC has fully satisfied the requirement to make counterpart fund payments to RepMar.

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

Notes to Financial Statements  
September 30, 2019 and 2018

(9) Related Party Transactions, Continued

In 2015, RepMar entered into a sub-grant agreement with the International Union for Conservation of Nature and Natural Resources, in which the Ministry of Natural Resources and Commerce will manage all the necessary works needed to facilitate the implementation of the MEC and KAJUR Power Plants Fuel and Waste Oil Management System Upgrade Phase 1. During the year ended September 30, 2016, MEC received \$50,000 under this grant agreement and MEC fully expended the grant during the year ended September 30, 2018 whereby MEC incurred expenditures of \$50,000 associated with this grant.

(10) Commitments and Contingencies

Commitments

In 2017, MEC entered into a diesel fuel supply agreement (“the supply agreement”) with ExxonMobil Asia Pacific Pte. Ltd. (ExxonMobil) for an initial period of three years with automatic renewal for an additional period of seven years. In accordance with the supply agreement, MEC is obligated to purchase a minimum quota of 310,000 bbls per annum. Concurrently, MEC entered into a marketing assistance program agreement (“the marketing agreement”) with ExxonMobil whereby ExxonMobil provided \$2,000,000 to MEC as a fuel purchase incentive for the purpose of assisting MEC in the marketing of ExxonMobil products. In the event that MEC is unable to purchase the minimum quota, MEC will be subject to certain damages as outlined in the marketing agreement. Accordingly, MEC will recognize the fuel purchase incentive over the term of the supply agreement. As of September 30, 2019 and 2018, MEC has recorded a liability of \$1,654,309 and \$1,837,650, respectively, associated with the marketing agreement as unearned fuel purchase incentive in the accompanying financial statements.

Contingencies

The accompanying financial statements have been prepared in accordance 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 subsidies 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 subsidies 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.

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 not be material to the accompanying financial statements.

MEC is in the process of developing and implementing plans and systems to ensure effective waste oil management and environmental protection. MEC's management believes that no provision for any liability, if any, which may arise from this matter is required to be reflected in the accompanying financial statements.

MEC has a material amount of unpaid gross revenue and withholding payroll taxes payable to RepMar as of September 30, 2019. The nonpayment of taxes is an effort to address increasing accounts receivable balances due from related parties via an offsetting exercise to reduce each party's liabilities. MEC's management believes that no provision for any additional liability, if any, which may arise from this matter is required to be reflected in the accompanying financial statements.

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

Notes to Financial Statements  
September 30, 2019 and 2018

(10) Commitments and Contingencies, Continued

MEC has a material amount of nonmoving construction work-in-progress as of September 30, 2019. The non-movement of construction work-in-progress is due to (a) MEC is in the process of working on various covenants imposed by the grantor prior to grant finalization; and (b) existing land disputes between landowners. MEC's management believes that no impairment, if any, that may arise from this matter is required to be reflected in the accompanying financial statements

(11) 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 \$0 at September 30, 2019 and 2018. MEC, subsequent to year end received \$320,000 against this claim with the balance being fully provided for during the year ended September 30, 2019.

(12) Subsequent Event

On January 3, 2020, C.M. 006 (2020) was approved to transfer various assets of RepMar to MEC.

On March 11, 2020, the World Health Organization declared the novel strain of coronavirus (COVID-19) a global pandemic and recommended containment and mitigation measures worldwide. As of June 19, 2020, there have been no confirmed cases of COVID-19 in the Marshall Islands. MEC has determined that should the pandemic reach the Marshall Islands, it may negatively impact MEC's business, results of operations, and financial position and MEC may become dependent upon the financial support of RepMar. However, the effect of the pandemic on RepMar is also uncertain and future available funding to RepMar component units may be limited. Therefore, while MEC expects this matter to potentially have a negative impact on its business, results of operations, and financial position, the related financial impact cannot be reasonably estimated at this time.

**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, 2019

	Generation	Distribution	Tank Farm	Jaluit	Wotje	Solar	MEC Gas	Admin.	TOTAL
<b>Operating revenues:</b>									
Fuel, propane and lube sales	\$ -	\$ -	\$ 17,996,864	\$ 11,882	\$ 829	\$ -	\$ 447,998	\$ -	\$ 18,457,733
Cost of sales	-	-	15,969,871	-	-	-	280,025	-	16,249,896
Gross profit on sales	-	-	2,026,993	11,882	829	-	167,973	-	2,207,677
Electric and service billings	17,897,069	-	-	217,340	150,977	191,155	-	-	18,456,541
Service and other income	-	99,079	267,884	18,562	230	1,100	1,590	68,344	456,789
Less provision for doubtful accounts	(89,321)	-	(2,364,097)	-	-	(149,850)	-	-	(2,603,268)
Total electricity sales and other income	17,807,748	99,079	(2,096,213)	235,902	151,207	42,405	1,590	68,344	16,310,062
Total net operating revenue	17,807,748	99,079	(69,220)	247,784	152,036	42,405	169,563	68,344	18,517,739
<b>Operating expenses:</b>									
Fuel and Lubes	10,201,747	9,706	(6,314)	176,132	138,238	-	-	-	10,519,509
Salaries, Wages and Benefits	1,164,209	640,297	89,668	145,765	166,284	298,158	34,536	1,374,943	3,913,860
Repairs and Maintenance	688,873	394,275	95,618	22,496	9,689	152,377	42,227	9,527	1,415,082
Depreciation and Amortization	1,059,436	67,517	10,348	2,738	767	74,028	1,815	120,894	1,337,543
Gross Revenue Tax	-	2,972	524,234	894	68	-	13,096	590	541,854
Office	52,568	4,420	81,003	14,999	8,813	1,922	7,737	59,908	231,370
Insurance	208,510	10,974	109,743	10,974	10,974	-	3,658	26,403	381,236
Freight and Handling	99,414	46,406	9,364	46,484	34,938	9,683	-	2,532	248,821
Auto POL and Maintenance	14,419	88,736	6,515	417	2,646	2,919	4,310	40,777	160,739
Utility	64,896	7,645	4,114	7,475	-	4,500	156	70,127	158,913
Travel	9,469	5,889	8,455	16,161	4,684	9,081	-	134,954	188,693
Communications	29,961	4,723	2,322	2,363	2,400	750	1,267	35,920	79,706
Professional and Consulting Fees	18,909	129,895	88,000	-	-	-	2,037	97,046	335,887
Import Tax	54,519	44,297	6,668	500	627	2,090	1,892	4,437	115,030
Security Services	16,985	-	27,083	-	-	-	28,506	2,157	74,731
Membership and Other Fees	5,305	1,180	1,695	-	-	-	45	45,878	54,103
Bank Charges	-	-	-	-	-	-	-	62,159	62,159
Entertainment	437	415	840	569	551	-	-	25,256	28,068
Staff Training	-	1,765	-	-	-	-	181	25,010	26,956
Safety and Uniforms	12,106	3,009	3,117	30	30	120	60	4,410	22,882
Equipment Rental	2,355	2,068	40	21,000	2,625	-	-	2,842	30,930
Lease Rental	-	-	-	7,548	5,111	-	-	11,981	24,640
Donations	3,266	3,067	-	1,067	-	-	3,600	13,580	24,580
Advertising	249	211	2,071	-	-	-	160	10,015	12,706
Total operating expenses	13,707,633	1,469,467	1,064,584	477,612	388,445	555,628	145,283	2,181,346	19,989,998
Operating income (loss)	4,100,115	(1,370,388)	(1,133,804)	(229,828)	(236,409)	(513,223)	24,280	(2,113,002)	(1,472,259)
<b>Nonoperating income (expense):</b>									
RepMar subsidies	-	1,500,254	-	291,494	224,766	-	-	-	2,016,514
Other grants	-	90,435	-	-	-	-	-	-	90,435
Interest expense	-	-	-	-	-	-	-	(154,603)	(154,603)
	-	1,590,689	-	291,494	224,766	-	-	(154,603)	1,952,346
Change in net position	\$ 4,100,115	\$ 220,301	\$ (1,133,804)	\$ 61,666	\$ (11,643)	\$ (513,223)	\$ 24,280	\$ (2,267,605)	\$ 480,087

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, 2019, 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 June 19, 2020.

### **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.

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

### **Compliance and Other Matters**

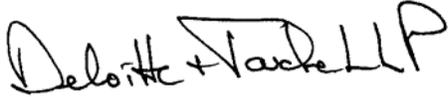
As part of obtaining reasonable assurance about whether MEC's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Findings and Questioned Costs as items 2019-001 and 2019-002.

## MEC's Response to Findings

MEC's responses to the findings identified in our audit are described in the accompanying Corrective Action Plan. 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 + Tatchell LLP". The signature is written in a cursive, slightly stylized font.

June 19, 2020

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE FOR THE SOLE MAJOR  
FEDERAL PROGRAM; REPORT ON INTERNAL CONTROL OVER COMPLIANCE;  
AND REPORT ON SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
REQUIRED BY THE UNIFORM GUIDANCE**

Board of Directors  
Marshalls Energy Company, Inc.:

### **Report on Compliance for the Sole Major Federal Program**

We have audited Marshalls Energy Company, Inc.'s (MEC's) compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on MEC's sole major federal program for the year ended September 30, 2019. MEC's sole major federal program is identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs.

#### ***Management's Responsibility***

Management is responsible for compliance with federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

#### ***Auditors' Responsibility***

Our responsibility is to express an opinion on compliance for MEC's sole major federal program based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about MEC's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for the sole major federal program. However, our audit does not provide a legal determination of MEC's compliance.

#### ***Opinion on the Sole Major Federal Program***

In our opinion, MEC complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on the sole major federal program for the year ended September 30, 2019.

## Report on Internal Control Over Compliance

Management of MEC is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered MEC's internal control over compliance with the types of requirements that could have a direct and material effect on the major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for the major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of MEC's internal control over compliance.

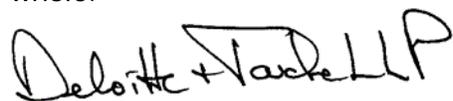
*A deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

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

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

## Report on Schedule of Expenditures of Federal Awards Required by the Uniform Guidance

We have audited the financial statements of MEC as of and for the year ended September 30, 2019. We have issued our report thereon dated June 19, 2020, which contained an unmodified opinion on those financial statements. Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by the Uniform Guidance and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The 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 Schedule of Expenditures of Federal Awards is fairly stated in all material respects in relation to the financial statements as a whole.



June 19, 2020

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

Schedule of Expenditures of Federal Awards  
Year Ended September 30, 2019

Federal Grantor/Program Title	Federal CFDA Number	Federal Expenditures
<u>U.S. Department of Agriculture:</u>		
Rural Utilities Services:		
Rural Electrification Loans and Loan Guarantees (1)	10.850	<u>\$ 1,355,915</u>

(1) Includes direct loans funded by FFB but guaranteed by RUS.

See notes to the Schedule of Expenditures of Federal Awards.

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

Notes to Schedule of Expenditures of Federal Awards  
Year Ended September 30, 2019

(1) Organization

The Marshalls Energy Company, Inc.'s (MEC's) principal lines of business are predominantly the generation and transmission of electricity and the buying and selling of petroleum products. 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 as well as the public utility company on the island of Ebeye.

(2) Basis of Presentation

The accompanying Schedule of Expenditures of Federal Awards (the Schedule) includes the federal award activity of the Marshalls Energy Company, Inc. (MEC) under programs of the federal government for the year ended September 30, 2019. The information in this Schedule is presented in accordance with the requirements of Title 2 *U.S. Code of Federal Regulations Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Because the Schedule presents only a selected portion of the operations of MEC, it is not intended to and does not present the financial position, changes in net position, or cash flows of MEC.

(3) Summary of Significant Accounting Policies

Expenditures reported on the Schedule are reported on the accrual basis of accounting. Such expenditures are recognized following the cost principles contained in the Uniform Guidance, wherein MEC received a loan from the Federal Financing Bank guaranteed by the Rural Utilities Service (RUS) of the U.S. Department of Agriculture to purchase and construct facilities necessary to provide the services described above on Majuro atoll. The loan is considered expended when disbursed from MEC's RUS construction fund. Disbursements are made only on items specifically approved by RUS. MEC has not elected to use the 10-percent de minimis indirect cost rate allowed under the Uniform Guidance.

(4) RUS Loan

Balances and transactions relating to the RUS loan are included in MEC's financial statements. Loan proceeds received during fiscal year 2019, including the September 30, 2018 loan balance from previous years for which RUS imposes continuing compliance requirements, are included in the federal expenditures presented in the Schedule. The loan balance outstanding at September 30, 2019 for CFDA program 10.850 Rural Electrification Loans and Loan Guarantees is \$213,613.

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

Schedule of Findings and Questioned Costs  
Year Ended September 30, 2019

**SECTION I - SUMMARY OF AUDITORS' RESULTS**

*Financial Statements*

Type of report the auditor issued on whether the financial statements audited were prepared in accordance with GAAP: Unmodified

Internal control over financial reporting:

- Material weakness(es) identified? No
- Significant deficiency(ies) identified? None reported

Noncompliance material to financial statements noted? Yes

*Federal Awards*

Internal control over major federal programs:

- Material weakness(es) identified? No
- Significant deficiency(ies) identified? None reported

Type of auditors' report issued on compliance for major federal programs: Unmodified

Any audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516(a)? No

Identification of major federal programs:

<u>CFDA Number</u>	<u>Name of Federal Program</u>
10.850	Rural Electrification Loans and Loan Guarantees

Dollar threshold used to distinguish between Type A and Type B programs: \$750,000

Auditee qualified as low-risk auditee? No

**SECTION II - FINANCIAL STATEMENT FINDINGS**

<u>Reference Number</u>	<u>Findings</u>
2019-001	Local Noncompliance
2019-002	Local Noncompliance

**SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

No matters were reported.

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

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2019

Finding No. 2019-001

Local Noncompliance

Criteria: RepMar's Procurement Code states the following:

- (a) Section 124 – unless otherwise authorized by law, all Government contracts shall be awarded by competitive sealed bidding.
- (b) Section 127 – procurement of goods and services not exceeding \$25,000 may be made in accordance with small purchase procedures promulgated by RepMar's Policy Office. Small purchase procedures are those relatively simple and informal methods for securing services, supplies, or other property that do not cost more than \$25,000. RepMar's Ministry of Finance has previously declared that if small purchase procedures are used, price or rate quotations shall be obtained from an adequate number of qualified sources.
- (c) Section 128 – a contract may be awarded for supply, service, or construction item without completion when it is determined in writing that there is only one source for the required supply, service, or construction item.

Condition: MEC does not have a formal procurement policy requiring documentation indicating the history of procurement to be maintained on file.

Cause: The cause of the above condition is the lack of established policies and procedures requiring documentation of procurement procedures to ensure compliance with RepMar's Procurement Code.

Effect: The effect of the above condition noncompliance with RepMar's Procurement Code.

Recommendation: We recommend management establish policies and procedures in compliance with RepMar's Procurement Code.

Auditee Response and Corrective Action Plan:

MEC describes corrective action in the Corrective Action Plan.

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

Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2019

Finding No. 2019-002

Local Noncompliance

Criteria: 48 MIRC Chapter 1, Income Tax Act of 1989, Section 110, states that every business shall on or before the last day of the following the close of each quarter, pay the amount of tax imposed on gross revenues under Section 109 of the Chapter.

Condition: MEC filed and paid gross revenue taxes for the year ended September 30, 2019 in a manner inconsistent with the criteria. In addition, gross revenue taxes from previous years in the amount of \$1,680,918 have not been paid.

Cause: The cause of the above condition is the lack of policies and procedures to monitor timely payment of gross revenue taxes.

Effect: The effect of the above condition is noncompliance with RepMar Income Tax Act of 1989, as amended.

Recommendation: We recommend management establish policies and procedures to comply with the RepMar Income Tax Act of 1989, as amended.

Auditee Response and Corrective Action Plan:

MEC describes corrective action in the Corrective Action Plan.

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

Summary Schedule of Prior Audit Findings  
Year Ended September 30, 2019

<u>Finding Number</u>	<u>CFDA Number</u>	<u>Questioned Costs</u>	<u>Status</u>
2013-001	10.859	\$309,714	Refer Note 1.
2014-001	10.859	\$129,173	Refer Note 1.
2015-001	10.857	\$ -	Refer Note 1.

Note 1: Management is awaiting follow-up and issuance of a management decision from the Federal agency.

**MARSHALLS ENERGY COMPANY, INC.**

**CORRECTIVE ACTION PLAN  
2 CFR § 200.511(c)  
Year Ended September 30, 2019**

<b>Finding Number</b>	<b>Planned Corrective Action</b>	<b>Anticipated Completion Date</b>	<b>Responsible Contact Person</b>
2019-001	<p>Following a legal opinion issued from the AG's office on July 7, 2016, indicating the applicability of the RMI Procurement Code to MEC under the SOE Act, MEC has since adopted the Procurement Code as it's guide to purchasing.</p> <p>MEC recognizes the need to formally establish its own procurement policy tailored to the specialized needs of the industry. As of the date of this report, MEC's internal procurement policy is being developed by management and to be finalized and approved by the Board within the next fiscal year.</p>	September 30, 2020	CFO, Leihani S. Anjain
2019-002	<p>MEC understands this noncompliance. The reason for the nonpayment of taxes is an effort to address MWSC's increasing accounts receivable balance, which amounted to \$2.1 million as of September 30, 2016, via an offsetting exercise to reduce each party's liabilities. An exercise of this nature is not unprecedented. It previously resulted in an offset of \$2.3 million for outstanding obligations and accounts receivable between the GRMI, MEC, and MIR.</p> <p>MEC is greatly concerned with the financial burden MWSC continues to impose as a result of its inability to meet its annual electric bill obligation and is trying all possible avenues to have the outstanding balance addressed.</p>	September 30, 2020	CFO, Leihani S. Anjain

**MARSHALLS ENERGY COMPANY, INC.**

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

---

**INDEPENDENT AUDITORS' REPORT ON  
COMPLIANCE WITH ASPECTS OF CONTRACTUAL  
AGREEMENTS AND REGULATORY REQUIREMENTS**

---

**YEAR ENDED SEPTEMBER 30, 2019**

## **INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH ASPECTS OF CONTRACTUAL AGREEMENTS AND REGULATORY REQUIREMENTS**

Board of Directors  
Marshalls Energy Company, Inc.:

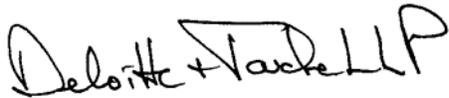
We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Marshalls Energy Company, Inc. (MEC), which comprise the statement of net position as of September 30, 2019, and the related statements of revenue and 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 June 19, 2020. In accordance with *Government Auditing Standards*, we have also issued our report dated June 19, 2020, 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. No reports other than the reports referred to above and our schedule of findings and response related to our audit have been furnished to management.

In connection with our audit, nothing came to our attention that caused us to believe that MEC failed to comply with the terms, covenants, provisions, or conditions of their loan, grant, and security instruments as set forth in 7 CFR Part 1773, *Policy on Audits of Rural Utilities Service Borrowers*, §1773.33 and clarified in the Rural Utilities Service (RUS) policy memorandum dated February 7, 2014, insofar as they relate to accounting matters as enumerated below. However, our audit was not directed primarily toward obtaining knowledge of such noncompliance. Accordingly, had we performed additional procedures, other matters may have come to our attention regarding MEC's noncompliance with the above-referenced terms, covenants, provisions, or conditions of the contractual agreements and regulatory requirements, insofar as they relate to accounting matters. In connection with our audit, we noted no matters regarding MEC's accounting and records to indicate that MEC did not:

- Maintain adequate and effective accounting procedures
- Utilize adequate and fair methods for accumulating and recording labor, material, and overhead costs, and the distribution of these costs to construction, retirement, and maintenance or other expense accounts
- Reconcile continuing property records to the controlling general ledger plant accounts
- Clear construction accounts and accrue depreciation on completed construction
- Record and properly price the retirement of plant
- Seek approval of the sale, lease, or transfer of capital assets and disposition of proceeds for the sale or lease of plant, material, or scrap

- Maintain adequate control over materials and supplies
- Prepare accurate and timely Financial and Operating Reports
- Obtain written RUS approval to enter into any contract for the management, operation, or maintenance of the borrower's system if the contract covers all or substantially all of the electric system
- Disclose material related party transactions in the financial statements, in accordance with requirements for related parties in generally accepted accounting principles
- Record depreciation in accordance with RUS requirements (See RUS Bulletin 183-1, Depreciation Rates and Procedures)
- Comply with the requirements for the detailed schedule of deferred debits and deferred credits
- Comply with the requirements for the detailed schedule of investments.

The purpose of this report is solely to describe the scope of our testing of compliance, and the result of that testing, and not to provide an opinion on the compliance. Accordingly, this communication is not suitable for any other purpose.

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

June 19, 2020