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, 2016 AND 2015

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

Years Ended September 30, 2016 and 2015
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Deloitte & Touche LLP
361 South Marine Corps Drive
Tamuning, GU 96913
USA

Tel: +1 (671) 646-3884
Fax: +1 (671) 649-4265

www.deloitte.com

INDEPENDENT AUDITORS' REPORT

Board of Directors
Marshalls Energy Company, Inc.:

Report on the Financial Statements

We have audited the accompanying financial statements of the Marshalls Energy Company, Inc. (MEC), a component unit of the Republic of the Marshall Islands, which comprise the statements of net position as of September 30, 2016 and 2015, 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 the Marshalls Energy Company, Inc. as of September 30, 2016 and 2015, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 3 to 7 be presented to supplement the 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 April 19, 2017, on our consideration of MEC's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering MEC's internal control over financial reporting and compliance.

Deloitte & Touche LLP

April 19, 2017

Marshalls Energy Company, Inc. (MEC) herewith presents a discussion and analysis of the company's financial performance for the fiscal year ended 30th September, 2016. It is to be read in conjunction with the financial statements following this section.

FINANCIAL HIGHLIGHTS

MEC's net position increased by $6.5 million in fiscal year 2016 compared to an increase of $1.3 million in fiscal year 2015. The increase in net postion mainly relates to increase in operating income from utility operations and increase in non-operating income.

In 2016, total net utility operating revenues were $17.1 million, an increase of $0.72 million from $16.4 million in net utility operating revenues in 2015.

Total utility operating expenses were $14.4 million and $17.5 million in 2016 and 2015, respectively. The decrease of $3.1 million or the same rate of 17% is mainly attributed to the fuel cost component and is in line with the drop in global fuel prices experienced in 2016. Fuel cost continues to be a significant component of generation operating costs and represents 45% of total operating costs in 2016 compared to 51% in 2015.

Total net operating revenues for non-utility operations, fuel sales being the major component, were $12.0 million and $20.5 million in 2016 and 2015, respectively. Total non-utility operating expenses decreased by $8.1 million, from $18.4 million in 2015 to $10.3 million in 2016. The decrease relates to both the decrease in global fuel prices and decrease in sales volume for 2016.

In 2015, MEC was awarded the State Bulk Fuel Revolving Fund Grant from the Rural Utilities Service (RUS) in the amount of $1.0 million for the establishment of a bulk fuel revolving loan fund to assist in reducing the cost of securing adequate fuel supplies for its operations. The amount recorded as grant income in 2016 is approximately $0.9 million.

MEC also received $50,000 in grant from the International Union for Conservation of Nature and Natural Resources (IUCN), through RepMar, for the Fuel and Waste Oil Management System Upgrade and $726,262 under the Japan Government Non-Project Grant Aid for fuel support.

MEC received subsidies from RepMar of $0.9 million in 2016 compared to subsidies of $0.5 million in 2015; $0.6 million as cost recovery for the operations of Wotje and Jaluit power plants and $0.3 million for assistance and support to fund the gap in solar tariff for maintenance services towards solar unit in the outer islands.

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 (deficiency) reflect the difference between total assets and total liabilities. An increase in net position over time normally indicates an improvement in financial condition. As illustrated in the figures below, MEC's net position increased for the year ended 30th September, 2016.

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

	2016	2015	2014
Current and other assets	$ 11,353,071	$ 9,743,985	$ 13,067,748
Capital and other noncurrent assets	11,116,477	11,917,469	9,862,843
Total assets	22,469,548	21,661,454	22,930,591
Current liabilities	9,752,028	13,929,341	14,863,715
Non-current liabilities	8,896,267	10,417,977	12,006,371
Total liabilities	18,648,295	24,347,318	26,870,086
Net position:			
Invested in capital assets	7,651,945	7,203,824	4,646,317
Restricted	312,308	-	-
Deficiency	(4,143,000)	(9,889,688)	(8,585,812)
Total net position (deficiency)	$ 3,821,253	$ (2,685,864)	$ (3,939,495)

Total assets increased by $0.8 million (or 4%) from 2015 to 2016 and decreased by $1.3 million (or -6%) from 2014 to 2015. The increase in total assets in 2016 mainly relates to the net impact of decrease in non-current assets of $0.8 million, decrease in net accounts receivable of $0.4 million, increase in fuel and supplies of $0.7 million and increase in cash and TCD of $1.2 million. The decrease in total assets by $1.3 million (or -6%) from 2014 to 2015 mainly relates the net impact of increase in non-current assets of $2.1 million, decrease in net accounts receivable of $2.5 million and decrease in fuel and supplies of $1.1 million.

Construction work in progress as of September 30, 2016 consisted of engine repair works for engine#3 (under ADB grant) of $1.4 million and tank refurbishment works for $0.5 million.

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

Total liabilities decreased in the amount of $5.7 million from $24.3 million in 2015 to $18.6 million in 2016. The overall decrease of $5.7 million (or -23%) is mainly attributable to the net impact of the decrease in accounts payable - other of $0.9 million, decrease in short-term debt of $2.4 million, decrease in unearned income of $1.0 million, and decrease in long-term debt of $1.5 million compared to 2015.

Refer to notes #5 and #6 to the accompanying financial statements for additional information relating to long-term and short-term debt, respectively.

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

	2016	2015	2014
Revenue:			
Utility revenue	$ 17,087,488	$ 16,362,849	$ 19,435,950
Non-utility revenue	12,003,501	20,534,640	31,788,150
Total Revenue	29,090,989	36,897,489	51,224,100
Expenses:			
Utility expenses	14,411,062	17,459,394	21,469,083
Non-utility expenses	10,318,720	18,439,898	29,665,616
Total expenses	24,729,782	35,899,292	51,134,699
Operating profit	4,361,207	998,197	89,401
RMI subsidy	942,400	475,168	694,400
Other grants	1,695,383	80,880	-
Contributions to RepMar	(183,968)	-	-
Interest expense	(307,905)	(555,692)	(495,873)
Capital contributions	-	255,078	-
	2,145,910	255,434	198,527
Change in net position	$ 6,507,117	$ 1,253,631	$ 287,928

The Statements of Revenue, Expenses and Changes in Net Position identify the various revenue and expense items that contributed to the change in net position. MEC's total revenue decreased in 2016 by $7.8 million (or-21%) to a total of $29.1 million compared to $36.9 million in 2015.

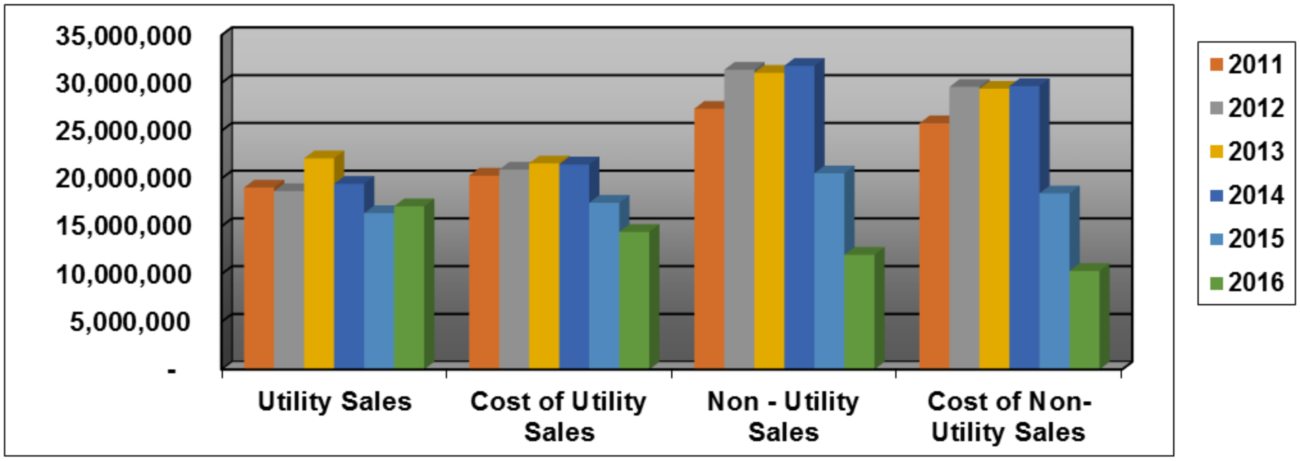
Utility revenue increased by $0.7 million (or 4%) from $16.4 million in 2015 to $17.1 million in 2016. The slight increase relates to increase in cash power sales compared to 2015.

Non-utility revenue is mainly fuel sales. Non-utility revenue decreased by $8.5 million (or -42%) in 2016 to $12.0 million compared to $20.5 million in 2015. The decrease relates to decrease in global fuel prices and decrease in sales volume for 2016.

The operating income in 2016 was approximately $4.4 million compared to an operating income of $998,197 and $89,401 in 2015 and 2014, respectively.

Total expenses decreased by $11.2 million from $35.9 million in 2015 to $24.7 million in 2016. Non-utility expenses decreased by $8.1 million while utility expenses decreased by $3.0 million.

The graphic below shows the major components of revenue from 2011 through to 2016:



MEC FOCUS IN THE COMING FISCAL YEAR

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

- Revision and update of MEC's CRP and Strategic Plan. The CRP was an aggressive roadmap in MEC's efforts to revive the company's core operations and financials within a three year timeframe from 2010.
- While most of the objectives were completed by the end of 2016, there are several goals and objectives which are at various stages of progress and completion and these will be rolled over to the newly updated CRP which will be revised during 2017.
- Enforcement of disconnection policy. As long as MEC allows outstanding accounts receivable balances to age, the greater MEC's risk and exposure is to bad debt and continued cash flow constraints.
- Continue with repair works for Engine#3
- Promote energy efficiency and conservation among consumers. In support of RepMar's National Energy Plan to provide affordable, reliable, clean energy and to sustain quality of life, MEC must start to play an active role in creating awareness and providing consumers with the resources to conserve energy. Although energy conservation will result in decreased annual revenue, the more significant and lasting impact will be the power generation cost savings and social responsibility to educate consumers to be more energy efficient.

Management's Discussion and Analysis for the year ended September 30, 2015 is set forth in the report on the audit of MEC's financial statements dated June 29, 2016. That Discussion and Analysis explains the major factors impacting the 2015 financial statements.

ADDITIONAL FINANCIAL INFORMATION

This discussion and analysis is designed to provide MEC's customers and other stake holders with an overview of the company's operations and financial condition as at 30th September, 2016. 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, 2016 and 2015

ASSETS	2016	2015
Utility plant:		
Electric plant in service	$ 29,251,388	$ 25,883,284
Less accumulated depreciation and amortization	(20,471,350)	(19,717,090)
	8,780,038	6,166,194
Construction work in progress	1,914,739	5,152,249
Net utility plant	10,694,777	11,318,443
Nonutility property	181,862	181,862
Less accumulated depreciation	(181,862)	(178,902)
Nonutility property, net	-	2,960
Total capital assets	10,694,777	11,321,403
Due from employees, net of current portion	68,845	98,171
Long-term replacement parts	352,855	497,895
Total non-current assets	11,116,477	11,917,469
Current assets:		
Cash	811,413	546,983
Time certificates of deposit	2,099,316	1,124,752
Accounts receivable:		
Electricity	4,767,312	5,204,353
RepMar and other affiliates	6,054,559	5,223,346
Due from employees, current portion	51,407	38,746
Other	1,628,421	2,034,585
Total accounts receivable	12,501,699	12,501,030
Less allowance for uncollectible accounts	(6,537,734)	(6,173,573)
Net accounts receivable	5,963,965	6,327,457
Fuel and supplies	2,214,047	1,472,285
Prepayments	164,330	172,508
Security deposit	100,000	100,000
Total current assets	11,353,071	9,743,985
Total assets	$ 22,469,548	$ 21,661,454

See accompanying notes to financial statements.

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

Statements of Net Position, Continued

September 30, 2016 and 2015

NET POSITION AND LIABILITIES	2016	2015
Net position:		
Net investment in capital assets	$ 7,651,945	$ 7,203,824
Restricted	312,308	-
Unrestricted	(4,143,000)	(9,889,688)
Total net position	3,821,253	(2,685,864)
Commitment and contingencies		
Noncurrent liabilities:		
Long-term debt	8,896,267	10,417,977
Current liabilities:		
Short-term debt	-	2,351,607
Current portion of long-term debt	1,492,550	1,425,585
Accounts payable - fuel	2,685,211	2,787,718
Accounts payable - other	998,921	1,931,418
Payable to affiliates	643,165	594,331
Accrued building and engine repairs	300,000	300,000
Accrued taxes	2,293,021	1,633,901
Other accrued liabilities	290,767	862,238
Unearned income	1,048,393	2,042,543
Total current liabilities	9,752,028	13,929,341
Total liabilities	18,648,295	24,347,318
Total net position and liabilities	$ 22,469,548	$ 21,661,454

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, 2016 and 2015

	2016	2015
Utility operations:		
Operating revenues:		
Electricity sales	$ 17,414,247	$ 16,516,116
Other	34,943	42,434
	17,449,190	16,558,550
Provision for doubtful accounts	(361,702)	(195,701)
Total net operating revenues	17,087,488	16,362,849
Operating expenses:		
Cost of fuel	6,529,849	8,881,201
Cost of power	3,767,246	3,911,319
Administrative and general	1,711,038	1,803,348
Distribution operations	1,159,694	1,537,237
Depreciation and amortization	1,243,235	1,326,289
Total operating expenses	14,411,062	17,459,394
Operating income (loss) from utility operations	2,676,426	(1,096,545)
Nonutility operations:		
Operating revenues:		
Fuel sales	11,027,010	19,628,292
Propane sales	711,779	683,457
Lubricants sales	7,645	65,865
Other	257,067	157,026
Total net operating revenues	12,003,501	20,534,640
Operating expenses:		
Cost of fuel	9,475,749	17,283,138
Cost of propane and lubricants	426,694	414,370
Other	416,277	742,390
Total operating expenses	10,318,720	18,439,898
Operating income from nonutility operations	1,684,781	2,094,742
Operating earnings	4,361,207	998,197
Nonoperating income (expense):		
RepMar subsidy	942,400	475,168
Other grants	1,695,383	80,880
Interest expense	(307,905)	(555,692)
Contributions to RepMar	(183,968)	-
Total nonoperating income, net	2,145,910	356
Capital contributions:		
Rural Utilities Service	-	255,078
Change in net position	6,507,117	1,253,631
Net position at beginning of year	(2,685,864)	(3,939,495)
Net position at end of year	$ 3,821,253	$ (2,685,864)

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, 2016 and 2015

	2016	2015
Cash flows from operating activities:		
Cash received from customers	$ 29,629,312	$ 39,303,576
Cash payments to suppliers for goods and services	(21,217,752)	(32,132,135)
Cash payments to employees for services	(2,987,152)	(2,718,716)
Net cash provided by operating activities	5,424,408	4,452,725
Cash flows from noncapital financing activities:		
Subsidy from RepMar	444,800	475,168
Grants received	50,000	80,880
Payment to RepMar	(183,968)	-
Net repayment of short-term debt	(2,351,607)	(219,534)
Interest paid on short-term debt	(106,418)	(151,598)
Principal paid on long-term debt	(379,998)	(615,954)
Interest paid on long-term debt	(75,521)	(87,065)
Net cash used for noncapital financing activities	(2,602,712)	(518,103)
Cash flows from capital and related financing activities:		
Subsidy from RepMar	260,400	-
Acquisition and construction of capital assets	(646,539)	(2,870,343)
Capital contributions received	-	255,078
Principal paid on long-term debt	(1,074,747)	(1,015,841)
Interest paid on long-term debt	(121,816)	(180,690)
Net cash used for capital and related financing activities	(1,582,702)	(3,811,796)
Cash flows from investing activities:		
Net investment in time certificates of deposit	(974,564)	(106,826)
Net change in cash	264,430	16,000
Cash at beginning of year	546,983	530,983
Cash at end of year	$ 811,413	$ 546,983
Reconciliation of operating earnings to net cash provided by operating activities:		
Operating earnings	$ 4,361,207	$ 998,197
Adjustments to reconcile operating earnings to net cash provided by operating activities:		
Depreciation and amortization	1,259,530	1,326,289
Provision for doubtful accounts	361,702	195,701
Loss on disposal of asset	13,635	-
Decrease (increase) in assets:		
Accounts receivable:		
Electricity	439,500	1,357,695
RepMar and other affiliates	(594,013)	1,018,905
Due from employees	16,665	(25,066)
Other	406,164	(154,692)
Fuel and supplies	(741,762)	599,311
Prepayments	8,178	(58,224)
Long-term replacement parts	145,040	-
Increase (decrease) in liabilities:		
Accounts payable - fuel	623,756	(2,947,728)
Accounts payable - other	(932,497)	1,322,924
Payable to affiliates	48,834	(646,379)
Accrued taxes	659,120	616,662
Other accrued liabilities	(575,621)	860,652
Unearned income	(75,030)	(11,522)
Net cash provided by operating activities	$ 5,424,408	$ 4,452,725

See accompanying notes to financial statements.

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

Statements of Cash Flows, Continued

Years Ended September 30, 2016 and 2015

		2016		2015
Summary disclosure of noncash activities:				
Grantor's direct payment to vendor				
Accounts payable - fuel	$	726,263	$	-
Other grants		(726,263)		-
	$	-	$	-
Amortization of unearned income				
Unearned income	$	919,120	$	-
Other grants		(919,120)		-
	$	-	$	-

See accompanying notes to financial statements.

(1) Organization

The Marshalls Energy Company, Inc. (MEC) was granted a corporate charter by the Cabinet of the Republic of the Marshall Islands (RepMar) on February 2, 1984. MEC's principal lines of business are predominantly the generation and transmission of electricity and the buying and selling of petroleum products. Other lines of business include the rental of equipment and accommodation facilities. The principal markets for the generation and transmission of electricity are government agencies, businesses and residential customers located on the atolls of Majuro, Jaluit and Wotje. Petroleum products are sold primarily to foreign and domestic fishing vessels 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 the Kwajalein Atoll Joint Utilities Resources, Inc. and the Majuro Water and Sewer Company, Inc., 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*, which was subsequently amended by Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus,* and modified by Statement No. 38, *Certain Financial Statement Note Disclosures*, establish financial reporting standards for governmental entities, which require that management's discussion and analysis of the financial activities be included with the financial statements and notes and modifies certain other financial statement disclosure requirements.

(2) Summary of Significant Accounting Policies, Continued

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

- Net investment in capital assets - capital assets, net of accumulated depreciation and related debt, plus construction or improvement of those assets.
- Restricted – net position that is constrained for specific purposes which are externally imposed by providers, such as creditors, grantors, contributors, and the like, or imposed by law.
- Unrestricted - net position that is not subject to externally imposed stipulations. Unrestricted net position may be designated for specific purposes by action of management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

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

Basis of Accounting

Proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and 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.

(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, 2016 and 2015, the carrying amount of cash and time certificates of deposit was $2,910,729 and $1,671,735, respectively, and the corresponding bank balances were $2,554,853 and $1,635,078, respectively. Of the bank balance amounts, $425,448 and $440,275, respectively, were maintained in a financial institution subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2016 and 2015, bank deposits in the amount of $250,000 were FDIC insured. The remaining bank deposits of $2,129,405 and $1,194,803, as of September 30, 2016 and 2015, respectively, were maintained in financial institutions not subject to depository insurance. MEC does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC coverage are uncollateralized. Accordingly, these deposits were exposed to custodial credit risk.

Receivables

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

Fuel and Supplies

Fuel and supplies are valued at the lower of cost (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. 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

(2) Summary of Significant Accounting Policies, Continued

Plant and Nonutility Property, Continued

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.

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.

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.

Reclassifications

Certain balances in the 2015 presentation has been reclassified to conform to the 2016 presentation.

New Accounting Standards

During the year ended September 30, 2016, MEC implemented the following pronouncements:

- GASB Statement No. 72, *Fair Value Measurement and Application*, which addresses accounting and financial reporting issues related to fair value measurements and requires entities to expand their fair value disclosures by determining major categories of debt and equity securities within the fair value hierarchy on the basis of the nature and risk of the investment. The implementation of this statement did not have a material effect on the accompanying financial statements.

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

- GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, which eliminates two of the four categories of authoritative GAAP that exist under the existing hierarchy prescribed by Statement No. 55. The two categories that will remain under the new standard are (1) GASB Statements and (2) GASB technical bulletins and implementation guides in addition to AICPA guidance that the GASB clears. The implementation of this statement did not have a material effect on the accompanying financial statements.

- GASB Statement No. 79, *Certain External Investment Pools and Pool Participants*, addresses for certain external investment pools and their participants the accounting and financial reporting implications that result from changes in the regulatory provisions referenced by previous accounting and financial reporting standards. Those provisions were based on the Investment Company Act of 1940, Rule 2a7. Rule 2a7 contains the Securities and Exchange Commission's regulations that apply to money market funds and were significantly amended in 2014. The implementation of this statement did not have a material effect on the accompanying financial statements.

In June 2015, GASB issued Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not Within the Scope of GASB Statement No. 68, and Amendments to Certain Provisions of GASB Statements No. 67 and No. 68*, which aligns the reporting requirements for pensions and pension plans not covered in GASB Statements No. 67 and No. 68 with the reporting requirements in Statement No. 68. The provisions in Statement No. 73 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In June 2015, GASB issued Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which replaces Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans, as amended*, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and addresses financial reporting requirements for governments whose employees are provided with postemployment benefits other than pensions (other postemployment benefits or OPEB). The provisions in Statement No. 74 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In June 2015, GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, which replaces the requirements of Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions, as amended*, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, and provides guidance on reporting by governments that provide OPEB to their employees and for governments that finance OPEB for employees of other governments. The provisions in Statement No. 75 are effective for fiscal years beginning after June 15, 2017. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In August 2015, GASB issued Statement No. 77, *Tax Abatement Disclosures*, which requires governments that enter into tax abatement agreements to disclose certain information about the agreements. The provisions in Statement No. 77 are effective for fiscal years beginning after December 15, 2015. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In December 2015, GASB issued Statement No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*, which addresses a practice issue regarding the scope and applicability of Statement No. 68, *Accounting and Financial Reporting for Pensions*. The provisions in Statement No. 78 are effective for fiscal years beginning after December 15, 2015. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In January 2016, GASB issued Statement No. 80, *Blending Requirements for Certain Component Units - an amendment of GASB Statement No. 14*, which improves financial reporting by clarifying the financial statement presentation requirements for certain component units. The provisions in Statement No. 80 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In March 2016, GASB issued Statement No. 81, *Irrevocable Split-Interest Agreements*, which improves accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement. The provisions in Statement No. 81 are effective for fiscal years beginning after December 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

In March 2016, GASB issued Statement No. 82, *Pension Issues - an amendment of GASB Statements No. 67, No. 68, and No. 73*, which addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements. The provisions in Statement No. 82 are effective for fiscal years beginning after June 15, 2016. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and 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) Fuel and Supplies

Fuel and supplies at September 30, 2016 and 2015, consist of the following:

	2016	2015
Distribution and power plant supplies	$ 1,578,571	$ 935,921
Fuel	477,669	310,374
Lubricants	157,807	225,990
	$ 2,214,047	$ 1,472,285

(4) Capital Assets

Capital asset activities for the years ended September 30, 2016 and 2015 were as follows:

	2016			
	October 1, 2015	Additions	Reclassifications	September 30, 2016
Utility Plant:				
Power plant engines	$ 16,485,170	$ -	$ 3,562,131	$ 20,047,301
Plant and machinery	2,197,772	17,748	(11,079)	2,204,441
Land and building	1,846,877	-	-	1,846,877
Solar power systems	1,110,417	-	-	1,110,417
Vehicles	1,527,495	258,926	(504,866)	1,281,555
Leasehold improvements	641,012	-	-	641,012
Residences	561,073	-	-	561,073
Fences and seawalls	371,702	-	-	371,702
Leasehold land	330,000	-	-	330,000
Furniture and fixtures	811,766	45,244	-	857,010
	25,883,284	321,918	3,046,186	29,251,388
Less accumulated depreciation and amortization	(19,717,090)	(1,256,570)	502,310	(20,471,350)
	6,166,194	(934,652)	3,548,496	8,780,038
Construction work-in-progress	5,152,249	324,621	(3,562,131)	1,914,739
	11,318,443	(610,031)	(13,635)	10,694,777
Nonutility Plant:				
LPG terminal	181,862	-	-	181,862
Less accumulated depreciation and amortization	(178,902)	(2,960)	-	(181,862)
	2,960	(2,960)	-	-
	$ 11,321,403	$ (612,991)	$ (13,635)	$ 10,694,777

	2015			
	October 1, 2014	Additions	Reclassifications	September 30, 2015
Utility Plant:				
Power plant engines	$ 15,995,292	$ 51,488	$ 438,390	$ 16,485,170
Plant and machinery	2,636,162	-	(438,390)	2,197,772
Land and building	-	1,846,877	-	1,846,877
Solar power systems	1,110,417	-	-	1,110,417
Vehicles	1,266,149	288,285	(26,939)	1,527,495
Leasehold improvements	641,012	-	-	641,012
Residences	561,073	-	-	561,073
Fences and seawalls	371,702	-	-	371,702
Leasehold land	330,000	-	-	330,000
Furniture and fixtures	764,259	47,507	-	811,766
	23,676,066	2,234,157	(26,939)	25,883,284
Less accumulated depreciation and amortization	(18,418,791)	(1,325,238)	26,939	(19,717,090)
	5,257,275	908,919	-	6,166,194
Construction work-in-progress	4,516,063	1,107,104	(470,918)	5,152,249
	9,773,338	2,016,023	(470,918)	11,318,443
Nonutility Plant:				
LPG terminal	181,862	-	-	181,862
Less accumulated depreciation and amortization	(175,464)	(3,438)	-	(178,902)
	6,398	(3,438)	-	2,960
	$ 9,779,736	$ 2,012,585	$ (470,918)	$ 11,321,403

(4) 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, 2016 and 2015, the R&M Fund has a balance of $36,810 and $36,449, respectively.

(5) Long-Term Debt

Long-term debt at September 30, 2016 and 2015 is as follows:

	2016	2015
On November 18, 1997, MEC entered into a loan agreement with the Federal Financing Bank (FFB) in the amount of $12.5 million for the construction of a new power plant, with loan repayments guaranteed by the Rural Utilities Service (RUS). MEC is required to submit drawdown requests to RUS for approval of loan advances. Interest rates are calculated based on the FFB rates at the date of the loan advances and range from 5.49% to 7.25% per annum. Originally, principal and interest are payable in quarterly installments of $273,770 through January 2, 2018. On June 22, 2012, RUS granted a two-year $2 million loan deferment giving MEC a two-year break from having to make payments to RUS. Effective June 22, 2012 through March 31, 2014, interest payments of $25,000 were due quarterly. Thereafter, quarterly payments of $299,121 are due. The loan will mature on December 31, 2019. The mortgage notes have been unconditionally guaranteed by RepMar, under which RepMar will make debt service payments to RUS in the event of default by MEC, and have been collateralized by a leasehold mortgage and security agreement over the assets of MEC. These notes are subject to certain coverage ratio requirements. MEC is in compliance with these ratio requirements as of September 30, 2016 and 2015.	$ 3,042,832	$ 4,117,579
On September 8, 2010, MEC obtained a subsidiary loan from the Asian Development Bank, through RepMar, of $10 million to pay off a bank loan that was originally procured for operating purposes. This loan will mature on May 31, 2034. Interest is calculated at 1.0% per annum through September 30, 2018 and at 1.5% per annum thereafter. Principal and interest are payable in monthly equal payments of $37,960.	7,345,985	7,725,983
	10,388,817	11,843,562
Less current installments	(1,492,550)	(1,425,585)
Long-term debt	$ 8,896,267	$ 10,417,977

A separate $2,317,388 grant was awarded for the purpose of funding the purchase of parts for an engine overhaul. During the year ended September 30, 2015, a final draw down of grant funds and expended by MEC amounted to $255,078.

(5) Long-Term Debt, Continued

On June 18, 2015, MEC received a $1,000,000 grant from RUS for the purpose of establishing a bulk fuel revolving loan fund and assisting MEC in reducing the costs of securing adequate fuel supplies for power generation. During the years ended September 30, 2016 and 2015, MEC recognized grant revenues of $919,120 and $80,880, respectively, associated with this grant.

Changes in long-term debt during the years ended September 30, 2016 and 2015 were as follows:

	2016				
	Balance October 1, 2015	Additions/ Reclassification	Reductions	Balance September 30, 2016	Balance due in One Year
RUS loan	$ 4,117,579	$ -	$ (1,074,747)	$ 3,042,832	$1,138,184
ADB Subsidiary loan	7,725,983	-	(379,998)	7,345,985	354,366
	$11,843,562	$ -	$ (1,454,745)	$10,388,817	$1,492,550

	2015				
	Balance October 1, 2014	Additions/ Reclassification	Reductions	Balance September 30, 2015	Balance due in One Year
RUS loan	$ 5,133,420	$ -	$ (1,015,841)	$ 4,117,579	$1,074,744
Commercial bank loan	239,735	-	(239,735)	-	-
ADB Subsidiary loan	8,102,202	-	(376,219)	7,725,983	350,841
	$13,475,357	$ -	$ (1,631,795)	$11,843,562	$1,425,585

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

Year ending September 30,	Principal	Interest	Total
2017	$ 1,492,550	$ 130,373	$ 1,622,923
2018	1,612,074	39,987	1,652,061
2019	1,041,658	126,269	1,167,927
2020	364,380	91,140	455,520
2021	369,884	85,636	455,520
2022-2026	1,934,924	342,676	2,277,600
2027-2031	2,085,526	192,074	2,277,600
2032-2034	1,487,821	37,141	1,524,962
	$ 10,388,817	$ 1,045,296	$ 11,434,113

(6) Short-Term Debt

On June 5, 2015, MEC obtained a $1,500,000 short-term bank loan to finance fuel purchases, interest at 7.5% per annum, principal and interest payable in lump sum on December 31, 2015. The short-term loan is collateralized by MEC's receivables and fuel inventory. The outstanding loan balance amounted to $0 and $1,500,000 as of September 30, 2016 and 2015, respectively.

(6) Short-Term Debt, Continued

On February 5, 2015, MEC obtained a $2,000,000 short-term bank loan to finance fuel purchases, interest at 7.5% per annum, principal and interest payable in eleven monthly installments of $175,000, with a final installment of $167,607 due on February 29, 2016. The short-term loan is collateralized by MEC's $1,031,222 time certificate of deposit, receivables and fuel inventory. The outstanding loan balance amounted to $0 and $851,607 as of September 30, 2016 and 2015, respectively.

Changes in short-term debt during the years ended September 30, 2016 and 2015, were as follows:

2016			
Balance October 1, 2015	Additions	Reductions	Balance September 30, 2016
$ 2,351,607	$ -	$ (2,351,607)	$ -

2015			
Balance October 1, 2014	Additions	Reductions	Balance September 30, 2015
$ 2,571,141	$ 3,500,000	$ (3,719,534)	$ 2,351,607

(7) Employee Retirement Plan

MEC has implemented a defined contribution retirement savings plan (the Plan) for its employees, whereby employees eighteen years and older are eligible to participate upon one year of employment. Plan participants may contribute any amount of their salaries to be matched 100% by MEC up to 5% of base salaries. Withdrawal from the Plan occurs upon termination of employment, death, or financial hardship. Plan assets are held in a trust fund administered by a trustee in accordance with the trust agreement. Management has the authority to establish or amend Plan provisions and contribution requirements. MEC contributed $78,157 and $77,326 to Plan participant accounts during the years ended September 30, 2016 and 2015, respectively, and total plan assets were $848,141 and $732,448 as of September 30, 2016 and 2015, respectively.

(8) Related Party Transactions

MEC is wholly-owned by RepMar and is therefore affiliated with all RepMar-owned and affiliated entities, including the Kwajalein Atoll Joint Utilities Resources, Inc. and the Majuro Water and Sewer Company, Inc. 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.

As of September 30, 2016 and 2015, MEC is liable for current and delinquent gross revenue taxes to RepMar, totaling $1,648,585 and $1,289,648, respectively. In addition, MEC is liable for current and delinquent withholding payroll taxes to RepMar, totaling $644,436 and $344,253, respectively. Accrued taxes payable for 2016 and 2015 exclude related penalties and interest.

(8) Related Party Transactions, Continued

A summary of related party transactions for the years ended September 30, 2016 and 2015, and the related receivable and payable balances as of September 30, 2016 and 2015, are as follows:

	2016			
	Revenues	Expenses	Receivables	Payables
RepMar	$ 2,446,969	$ 775,112	$ 705,480	$ 451,651
Kwajalein Atoll Joint Utilities Resources, Inc.	2,695,738	-	2,337,201	50,000
Majuro Water and Sewer Company, Inc.	406,417	14,182	2,150,472	10,858
Marshall Islands Social Security Administration	29,919	251,898	4,436	113,831
Majuro Resort, Inc.	389,004	46,203	487,589	413
Other	2,013,580	258,323	369,381	16,412
	$ 7,981,627	$ 1,345,718	$ 6,054,559	$ 643,165

	2015			
	Revenues	Expenses	Receivables	Payables
RepMar	$ 2,669,161	$ 903,608	$ 409,545	$ 451,651
Kwajalein Atoll Joint Utilities Resources, Inc.	3,220,336	-	2,294,338	-
Majuro Water and Sewer Company, Inc.	391,656	580	1,832,052	2,475
Marshall Islands Social Security Administration	36,204	244,182	12,674	114,108
Majuro Resort, Inc.	435,766	44,054	370,947	1,945
Other	1,853,054	227,750	303,790	24,152
	$ 8,606,177	$ 1,420,174	$ 5,223,346	$ 594,331

The allowance for uncollectable accounts pertaining to receivables from affiliates amounted to $2,595,559 and $2,157,216 as of September 30, 2016 and 2015, respectively.

During the years ended September 30, 2016 and 2015, MEC received operating subsidies from RepMar as follows:

	2016	2015
Outer islands solar	$ 347,200	$ -
Jaluit operations	297,600	237,584
Wotje operations	297,600	237,584
	$ 942,400	$ 475,168

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, 2016, MEC incurred maintenance expenses associated with the outer islands solar units of $84,892. Accordingly, the remaining amount of $262,308 is restricted within net position.

(8) Related Party Transactions, Continued

On July 6, 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. 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. During the year ended September 30, 2016, MEC contributed $183,968 to RepMar for the purpose of establishing this required fund.

On October 26, 2015, RepMar entered into a sub-grant agreement with the International Union for Conservation of Nature and Natural Resources, in which the Ministry of Resources and Development 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; however, MEC has yet to incur any expenditures associated with this grant. Accordingly, the amount of $50,000 is restricted within net position.

(9) Commitment and Contingencies

Commitment

MEC purchases petroleum products from Winson Oil International (HK) Ltd. (Winson) on a consignment basis whereby Winson continues to hold ownership and title to the product while it is held in storage at the MEC terminal storage tanks. Title and risk on the product remains with Winson until the product passes the boundary of the MEC terminal. The value of consignment petroleum products as of September 30, 2016 and 2015 amounted to $2,121,022 and $4,613,792, respectively. MEC assumes responsibility for the proper and safe storage/handling of the product while under MEC storage. However, MEC carries insurance coverage on such consignment inventories.

Contingencies

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplates the continuation of MEC as a going concern. Management acknowledges that it is currently dependent on RepMar for cash 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 be minimal.

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, that may arise from this matter is required to be reflected in the accompanying financial statements.

(10) Risk Management

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

Insurance proceeds of $3,410,336 received in 2007 for fire damage to MEC's power plant building and engines were recorded net of estimated repair costs. Accrued remaining building and engine repairs amounted to $300,000 at September 30, 2016 and 2015.

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, 2016

	Generation	Distribution	Tank Farm	Jaluit	Wotje	Solar	MEC Gas	Admin.	TOTAL
Operating revenues:									
Fuel, propane and lube sales	$ -	$ -	$ 11,024,396	$ 8,070	$ 2,189	$ -	$ 711,838	$ -	$ 11,746,493
Cost of sales	-	-	9,456,324	-	-	-	424,308	-	9,880,632
Gross profit on sales	-	-	1,568,072	8,070	2,189	-	287,530	-	1,865,861
Electric and service billings	17,019,673	-	-	139,354	87,635	167,586	-	-	17,414,248
Service and other income	-	40,277	46,240	15,230	821	-	2,140	181,710	286,418
Less provision for doubtful accounts	(283,894)	-	-	-	-	-	-	(77,808)	(361,702)
Total electricity sales and other income	16,735,779	40,277	46,240	154,584	88,456	167,586	2,140	103,902	17,338,964
Total net operating revenue	16,735,779	40,277	1,614,312	162,654	90,645	167,586	289,670	103,902	19,204,825
Operating expenses:									
Advertising	462	-	-	-	-	-	-	8,394	8,856
Auto POL and maintenance	27,207	83,250	5,579	110	4,239	11,054	4,228	36,714	172,381
Bank charges	-	-	-	-	-	30	-	42,104	42,134
Communications	22,401	22,920	723	1,140	1,330	470	429	56,391	105,804
Depreciation and amortization	889,643	65,492	13,446	2,754	3,449	74,028	29,890	164,534	1,243,236
Donations	212	571	2,550	-	-	-	200	17,137	20,670
Entertainment	378	212	957	1,183	789	2	-	31,377	34,898
Equipment rental	19,808	1,050	14,300	-	1,800	5	-	109	37,072
Freight and handling	115,283	37,657	21,810	1,046	11,590	671	-	2,019	190,076
Fuel and lubes	6,765,328	-	36,365	81,843	91,152	-	-	-	6,974,688
Gross revenue tax	-	1,208	331,899	707	79	-	21,419	3,625	358,937
Import tax	76,010	(624)	-	-	-	-	-	8,208	83,594
Insurance	150,518	36,269	56,632	5,498	6,443	10,048	2,808	42,086	310,302
Lease rental	319	-	-	9,482	4,153	-	-	14,790	28,744
Membership and other fees	3,775	277	-	-	-	-	-	79,422	83,474
Office	263,102	5,433	26,694	1,886	3,540	1,109	808	57,967	360,539
Professional and consulting fees	-	-	-	-	-	-	647	9,863	10,510
Repairs and maintenance	633,655	301,381	18,416	13,395	30,510	92,791	3,946	26,446	1,120,540
Safety and uniforms	25,825	443	-	-	-	-	-	118	26,386
Salaries, wages and benefits	1,247,684	585,560	124,895	167,540	127,339	114,181	36,484	1,009,694	3,413,377
Security services	15,679	-	41,335	-	-	-	7,127	5,842	69,983
Staff training	3,670	-	-	-	-	-	-	43,205	46,875
Travel	59,894	25,091	19,916	1,990	8,151	5,345	663	61,995	183,045
Utility	2,167	1,203	537	9,031	-	-	-	88,526	101,464
Total operating expenses	10,323,020	1,167,393	716,054	297,605	294,564	309,734	108,649	1,810,566	15,027,585
Operating income (loss)	6,412,759	(1,127,116)	898,258	(134,951)	(203,919)	(142,148)	181,021	(1,706,664)	4,177,240
Nonoperating income (expense):									
RepMar subsidy	-	-	-	297,600	297,600	347,200	-	-	942,400
Other grants	1,695,382	-	-	-	-	-	-	-	1,695,382
Interest expense	-	-	-	-	-	-	-	(307,905)	(307,905)
	1,695,382	-	-	297,600	297,600	347,200	-	(307,905)	2,329,877
Change in net position	$ 8,108,141	$ (1,127,116)	$ 898,258	$ 162,649	$ 93,681	$ 205,052	$ 181,021	$ (2,014,569)	$ 6,507,117

Deloitte.

Deloitte & Touche LLP
361 South Marine Corps Drive
Tamuning, GU 96913
USA

Tel: +1 (671) 646-3884
Fax: +1 (671) 649-4265

www.deloitte.com

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, 2016, 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 April 19, 2017.

Internal Control Over Financial Reporting

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

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did identify certain deficiencies in internal control described in the accompanying Schedule of Findings and Responses as item 2016-001 that we consider to be material weaknesses.

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Compliance and Other Matters

As part of obtaining reasonable assurance about whether MEC's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Findings and Responses as items 2016-002 through 2016-004.

MEC's Response to Findings

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

Purpose of this Report

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

Deloitte & Touche LLP

April 19, 2017

Finding No. 2016-001

Construction-in-Progress

Criteria: Adequate internal control policies and procedures should be established to require proper monitoring of labor hours allocated to the construction of Deutz engine No. 7.

Condition: Numbers of hours allocated to the construction of Deutz engine No. 7 are not supported by adequate time records.

Cause: The cause of the above condition is a lack of established internal control policies and procedures pertaining to time record keeping related to the construction of Deutz engine No.7.

Effect: The effect of the above condition is uncertainty as to the appropriateness of the amount of salaries and wages initially capitalized.

Recommendation: We recommend that management adopt policies and procedures pertaining to the capitalization of salaries and wages allocated to the construction of Deutz engine No.7.

Prior Year Status: Recommendation concerning management to adopt policies and procedures pertaining to the capitalization of salaries and wages allocated to the construction of Deutz engine No.7, was reported as a finding in the audit of MEC for fiscal year 2015.

Auditee Response and Corrective Action Plan: Daily records are being maintained at the power plant indicating hours worked on respective engines. However, at time of timesheet preparation, proper coding to the respective engines were not entered and hence man-hours for engine#7 were not properly recorded. Since work had started back in 2012 and no formal method of tracking man-hours was established, management had to give its best realistic estimate on man-hours worked on engine#7.

In the absence of formal method of record keeping, the method used was to first identify employees who worked on #7, and after a brief examination of the man-hours record in daily records, an estimate for hours worked per week was derived and reviewed by the CTO who made further changes depending on projects that were also happening at the time and determined a more realistic man-hours worked per employee on engine#7 and costs associated with that.

For future reporting, management will ensure that a formal method of record keeping of man-hours is established and accurately recorded to ascertain appropriateness of capitalized amount.

Finding No. 2016-002

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 them.

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 that management establish policies and procedures in compliance with RepMar's Procurement Code.

Auditee Response and Corrective Action Plan: 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.

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.

Finding No. 2016-003

Local Noncompliance

Criteria: 48 MIRC Chapter 1, Income Tax Act of 1989, Section 105, states that the employer shall once every four (4) weeks or thirteen times per year, pay taxes withheld under Section 104 under Chapter 1. The employer shall, along with the taxes, within two (2) weeks following the preceding four (4) week period make a full, true and correct return showing all wages and salaries paid by the employer to the employees during the preceding four (4) week period and showing the tax due and withheld thereon as provided in Section 104 of the Chapter. Furthermore, 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 income taxes withheld for the year ended September 30, 2016 in a manner inconsistent with the criteria. Specifically, withholding taxes in the amount of $300,183 for the year ended September 30, 2016 were not timely remitted. In addition, income taxes withheld in the amount of $344,253 for previous years have not been paid. Furthermore, MEC filed and paid gross revenue taxes for the year ended September 30, 2016 in a manner inconsistent with the criteria. Specifically, gross revenue taxes in the amount of $358,937 for the year ended September 30, 2016 were not timely remitted. In addition, gross revenue taxes from previous years in the amount of $1,289,648 have not been paid.

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

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

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

Auditee Response and Corrective Action Plan: 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.

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.

Finding No. 2016-004

Local Noncompliance

Criteria: Memorandum of Agreement between Ministry of Finance and MEC states that MEC shall provide the Secretary of Finance or his/her duly authorized representative, within the deadlines noted herein, the following reports:

(a) Quarterly and Financial Status Report (FSR) indicating current budget, year to date expenditures, open encumbrances, and remaining budget balances for each sub-account budgeted.

(b) Detailed expenditure report, balance sheet, income statement and narrative report.

(c) Quarterly Progress Reports to be submitted within 15 days after the end of the quarter to which it applies. The report shall include accounting information and status of progress funded for each project funded under the Agreement. Quarterly reports shall be provided to the Secretary of Finance no later than 15 days after the quarters ending December 31, March 31, June 30 and September 30. The final FSR and Progress Report shall be provided to the Secretary of Finance within 45 days of the end of the fiscal year.

Condition: There were two MOA's entered into by MEC which require the above criteria. Copies of the above mentioned reports could not be provided.

Cause: The cause of the above condition is the lack of established policies and procedures requiring compliance with the criteria.

Effect: The effect of the above condition is noncompliance with the criteria.

Recommendation: We recommend that management establish policies and procedures to be in compliance with the Memorandum of Agreement.

Auditee Response and Corrective Action Plan: MEC agrees with this finding and will ensure policies and procedures are established to ensure compliance with Memorandum of Agreement.

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

Unresolved Prior Year Findings
Year Ended September 30, 2016

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