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, 2018 and 2017

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

Years Ended September 30, 2018 and 2017
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INDEPENDENT AUDITORS' REPORT

Board of Directors
Marshalls Energy Company, Inc.:

Report on the Financial Statements

We have audited the accompanying financial statements of the Marshalls Energy Company, Inc. (MEC), a component unit of the Republic of the Marshall Islands, which comprise the statements of net position as of September 30, 2018 and 2017, 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, 2018 and 2017, 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 June 7, 2019, 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.

Deloitte & Touche LLP

June 7, 2019

Marshalls Energy Company, Inc. (MEC) herewith presents a discussion and analysis of the company's financial performance for the fiscal year ended 30th September, 2018. It is to be read in conjunction with the financial statements following this section.

FINANCIAL HIGHLIGHTS

MEC's net position increased by $0.8 million in fiscal year 2018 compared to an increase of $2.9 million in fiscal year 2017. In 2018, total net utility operating revenues were $18.3 million, an increase of $0.4 million from $17.9 million in net utility operating revenues in 2017. Total utility operating expenses were $18.4 million and $17.1 million in 2018 and 2017, respectively. The increase of $1.3 million, or the same rate of 8%, which was the result of the net increase in fuel costs of 18% in 2018 and decrease in the other cost components by 10% resulting in the net increase of 8%. The increase in fuel costs relates to the increase of 14% in fuel prices experienced during the year and increase of 4% in fuel consumption for generation. Fuel costs continue to be a significant component of generation operating costs and represent 51% of total operating costs in 2018 compared to 47% in 2017.

Total net operating revenues for non-utility operations, fuel sales being the major component, were $16 million and $13.2 million in 2018 and 2017, respectively. Total non-utility operating expenses increased by $4.1 million, from $12 million in 2017 to $16.1 million in 2018. The increase relates to the increase in global fuel prices in 2018 compared to 2017.

MEC received subsidies from REPMAR in the amount of $1.1 million in 2018 compared to subsidies of $1.8 million in 2017. $0.6 million was received as cost recovery for the operations of Wotje and Jaluit power plants and $0.5 million for assistance and support to fund the gap in solar tariff for maintenance services towards solar unit in the outer islands.

In 2017, after a fire occurred on Engine#5, and Pielstick engine issues occurred with #1 and #2 requiring long hours of maintenance work and parts becoming more difficult to find or reproduce, it was decided that engine#3 parts would be used to improve the operations of engine#1 and #2 to ensure continuous power supply. Engine#3, which had accumulated work-in-progress, was deemed impaired and written off during the year as Impairment loss amounting to $1.4 million. Insurance claim, relating to the fire, was recorded as other non-operating income in the amount of $0.6 million and $0.3 million accrued engine works was reversed due to the realized impairment. This describes the major items in 2017 relating to total non-operating income, net. No major works or items were recorded in 2018.

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 assets 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, 2018.

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

	2018	2017	2016
Current and other assets	$ 21,532,051	$ 16,188,122	$ 11,771,774
Capital assets	7,199,765	8,230,984	10,694,777
Total assets	28,731,816	24,419,106	22,466,551
Current and other liabilities	13,583,990	8,648,328	8,259,478
Long-term debt outstanding	8,006,332	9,398,560	10,795,817
Total liabilities	21,590,322	18,046,888	19,055,295
Net position:			
Invested in capital assets	5,843,850	5,794,593	7,244,945
Restricted	-	238,794	312,308
Unrestricted	1,297,644	338,831	(4,143,000)
Total net position	$ 7,141,494	$ 6,372,218	$ 3,414,253

Total assets increased by $4.3 million (or 18%) from $24.4 million in 2017 to $28.7 million in 2018 and increased by $1.9 million from 2016 to $24.4 million in 2017. The increase in total assets mainly relates to the net impact of decrease in capital assets of $1.1 million and increase in current and other assets of $5.4 million. The decrease in capital assets of $1.1 million relates to annual depreciation of $1.1 million. The increase in current and other assets of $5.4 million mainly relates to increase in cash holding of $2.6 million and decrease in net accounts receivable of $0.1 million, which mainly relates to KAJUR's account receivable for fuel purchases and increase in fuel and supplies of $3.7 million. The increase in fuel and supplies mainly relates to the increase in fuel supplies, which relates to the annual purchasing obligated quota per fuel supply agreement.

Construction work in progress as of September 30, 2018 consists of tank refurbishment works. Refer to note #5 to the accompanying financial statements for additional information relating to capital assets.

Total liabilities increased by $3.6 million (or 20%) from $18.0 million in 2017 to $21.6 million in 2018. The increase relates to the net impact in the decrease in long-term debt of $1.4 million offset by an increase in unearned fuel purchase incentive of $1.8 million and increase in current liabilities of $3.2 million. The increase of $5 million mainly relate to the increase in accounts payable - fuel and the addition of the unearned fuel purchase incentive, both relate to the obligations under the fuel supply agreement and marketing assistance program agreement, respectively.

Refer to note #6 to the accompanying financial statements for additional information relating to long-term debt.

Refer to note #10 to the accompanying financial statements for additional information relating to the fuel supply arrangements.

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

	2018	2017	2016
Revenue:			
Utility revenue	$ 18,317,571	$ 17,895,474	$ 17,087,488
Non-utility revenue	16,023,676	13,181,277	12,003,501
Total Revenue	34,341,247	31,076,751	29,090,989
Expenses:			
Utility expenses	18,440,541	17,132,725	14,411,062
Non-utility expenses	16,076,545	11,954,964	10,318,720
Total expenses	34,517,086	29,087,689	24,729,782
Operating profit / (loss)	(175,839)	1,989,062	4,361,207
RMI subsidy	1,169,925	1,140,800	942,400
Impairment loss and engine repairs	-	300,000	-
Other grants	-	-	1,695,383
Interest expense	(224,810)	(302,057)	(307,905)
Other non-operating income	-	646,170	-
Contributions to RepMar	-	(91,869)	(183,968)
	945,115	296,327	2,145,910
Capital contributions	-	672,576	-
Change in net position	$ 769,276	$ 2,957,965	$ 6,507,117

The Statements of Revenue, Expenses and Changes in Net Position identify the various revenue and expense items that contributed to the change in net position. MEC's total revenue increased in 2018 by $3.2 million (or 11%) to a total of $34.3 million compared to $31.1 million in 2017.

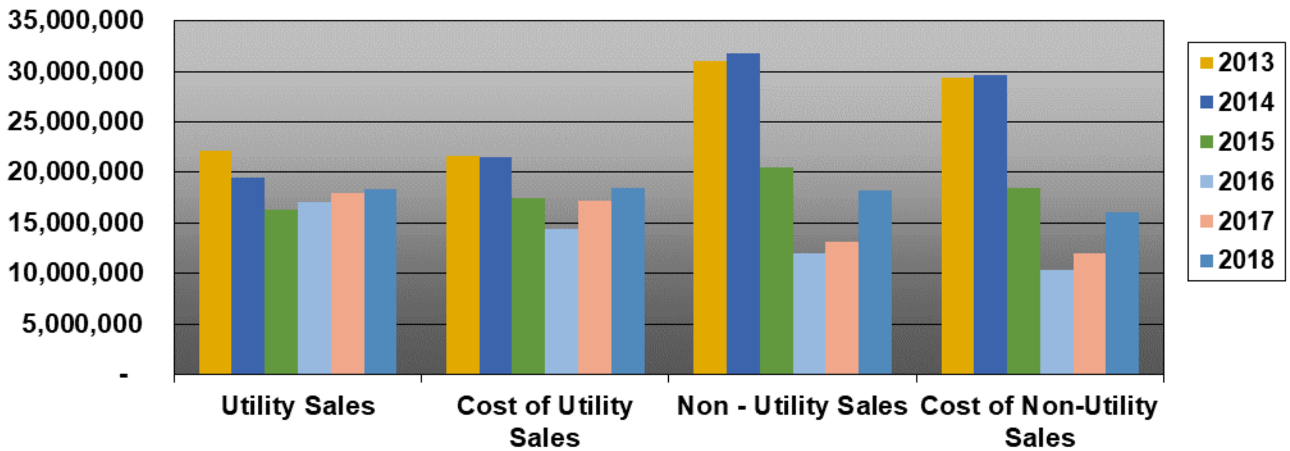
Utility revenue increased by $0.4 million (or 2.4%) from $17.9 million in 2017 to $18.3 million in 2018. The slight increase relates to increase in cash power sales compared to 2017.

Non-Utility revenue is mainly fuel sales. Non-utility revenue increased by $2.8 million (or 22%) in 2018 to $16 million compared to $13.1 million in 2017. The increase relates to increase in global fuel prices in 2017.

The operating (loss) earnings in 2018 were ($0.2) million compared to $2 million and $4.4 million in 2017 and 2016, respectively.

Total expenses increased by $5.4 million from $29.1 million in 2017 to $34.5 million in 2018. Non-utility expenses increased by $4.1 million while utility expenses increased by $1.3 million.

The graphic below shows the major components of the Statement of Revenue and Expense trend for the past six years:



MEC FOCUS IN THE COMING FISCAL YEAR

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

- Finalizing the Business Plan and other requirements under the SOE Act and implement the objectives set out in the plan.
- To perform a comprehensive review of the tariff structure to ensure that the current structure incorporates full cost recovery and asset replacement costs.
- To perform a comprehensive review of the non-utility operations with respect to fuel, propane and lube to ensure full cost recovery and competitive pricing and expand business where possible.
- To continue the cash power metering program and extend this program to include commercial and government customer.
- To rehabilitate critical infrastructures at the power plant, fuel and propane area.
- To develop and implement strict occupational, health and safety procedures plan

Management's Discussion and Analysis for the year ended September 30, 2017 is set forth in the report on the audit of MEC's financial statements dated May 9, 2018. That Discussion and Analysis explains the major factors impacting the 2017 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 30^{th} September, 2018. 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, 2018 and 2017

	2018	2017
ASSETS		
Utility plant:		
Electric plant in service	$ 29,579,112	$ 29,342,300
Less accumulated depreciation and amortization	(23,035,228)	(21,629,338)
	6,543,884	7,712,962
Construction work in progress	655,881	518,022
Net utility plant	7,199,765	8,230,984
Nonutility property	181,862	181,862
Less accumulated depreciation	(181,862)	(181,862)
Nonutility property, net	-	-
Total capital assets	7,199,765	8,230,984
Due from employees, net of current portion	20,584	52,191
Long-term replacement parts	324,717	318,128
Total non-current assets	7,545,066	8,601,303
Current assets:		
Cash	5,381,918	2,798,615
Time certificates of deposit	2,396,919	2,350,615
Accounts receivables, net	6,138,273	7,134,709
Due from employees	34,459	33,307
Fuel and supplies	6,530,528	2,794,768
Prepayments	604,653	605,789
Security deposit	100,000	100,000
Total current assets	21,186,750	15,817,803
Total assets	$ 28,731,816	$ 24,419,106
NET POSITION AND LIABILITIES		
Net position:		
Net investment in capital assets	$ 5,843,850	$ 5,794,593
Restricted	-	238,794
Unrestricted	1,297,644	338,831
Total net position	7,141,494	6,372,218
Commitment and contingencies		
Noncurrent liabilities:		
Long-term debt	6,544,096	7,933,845
Unearned fuel purchase incentive, net of current portion	1,653,885	-
Total noncurrent liabilities	8,197,981	7,933,845
Current liabilities:		
Current portion of long-term debt	1,462,236	1,464,715
Accounts payable - fuel	6,074,445	2,818,032
Accounts payable - other	375,006	756,579
Payable to affiliates	681,009	638,853
Accrued building and engine repairs	-	501,934
Accrued taxes	2,115,975	2,307,612
Other accrued liabilities	348,838	280,572
Unearned fuel purchase incentive, current portion	183,765	-
Unearned revenue - cash power	1,378,772	1,067,506
Unearned revenue - fuel	772,295	277,240
Total current liabilities	13,392,341	10,113,043
Total liabilities	21,590,322	18,046,888
Total net position and liabilities	$ 28,731,816	$ 24,419,106

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, 2018 and 2017

	2018	2017
Utility operations:		
Operating revenues:		
Electricity sales	$ 18,746,602	$ 17,858,727
Other	43,699	79,941
	18,790,301	17,938,668
Provision for doubtful accounts	(472,730)	(43,194)
Total net operating revenues	18,317,571	17,895,474
Operating expenses:		
Cost of fuel	9,487,166	8,039,877
Cost of power	4,524,191	4,585,559
Administrative and general	1,698,124	1,725,841
Distribution operations	1,325,170	1,416,468
Depreciation and amortization	1,405,890	1,364,980
Total operating expenses	18,440,541	17,132,725
Operating (loss) income from utility operations	(122,970)	762,749
Nonutility operations:		
Operating revenues:		
Fuel sales	17,426,085	12,341,147
Propane sales	614,322	718,012
Lubricants sales	27,939	13,325
Other	119,721	108,793
	18,188,067	13,181,277
Provision for doubtful accounts	(2,164,391)	-
Total net operating revenues	16,023,676	13,181,277
Operating expenses:		
Cost of fuel	15,007,283	11,078,875
Cost of propane and lubricants	370,888	437,425
Other	698,374	438,664
Total operating expenses	16,076,545	11,954,964
Operating (loss) income from nonutility operations	(52,869)	1,226,313
Operating (loss) earnings	(175,839)	1,989,062
Nonoperating income (expense):		
RepMar subsidies	1,169,925	1,140,800
Impairment loss	-	(1,396,717)
Reversal of accrued building and engine repairs	-	300,000
Contributions to RepMar	-	(91,869)
Insurance claim	-	646,170
Interest expense	(224,810)	(302,057)
Total nonoperating income, net	945,115	296,327
Earnings before capital contributions	769,276	2,285,389
Capital contributions:		
Republic of the Marshall Islands	-	672,576
Change in net position	769,276	2,957,965
Net position at beginning of year	6,372,218	3,414,253
Net position at end of year	$ 7,141,494	$ 6,372,218

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, 2018 and 2017

	2018	2017
Cash flows from operating activities:		
Cash received from customers	$ 36,144,004	$ 30,797,123
Cash received from fuel supplier	2,000,000	-
Cash payments to suppliers for goods and services	(31,208,092)	(24,818,132)
Cash payments to employees for services	(3,525,475)	(3,423,469)
Net cash provided by operating activities	3,410,437	2,555,522
Cash flows from noncapital financing activities:		
Operating RepMar subsidies received	1,169,925	1,140,800
Payment to RepMar	-	(91,869)
Principal paid on long-term debt	(311,752)	(383,816)
Interest paid on long-term debt	(67,848)	(75,518)
Net cash provided by noncapital financing activities	790,325	589,597
Cash flows from capital and related financing activities:		
RepMar capital contributions received	-	672,576
Acquisition and construction of capital assets	(374,671)	(298,604)
Principal paid on long-term debt	(1,080,476)	(1,013,441)
Interest paid on long-term debt	(116,008)	(267,149)
Net cash used for capital and related financing activities	(1,571,155)	(906,618)
Cash flows from investing activities:		
Net increase in time certificates of deposit	(46,304)	(251,299)
Net change in cash	2,583,303	1,987,202
Cash at beginning of year	2,798,615	811,413
Cash at end of year	$ 5,381,918	$ 2,798,615
Reconciliation of operating earnings to net cash provided by operating activities:		
Operating (loss) earnings	$ (175,839)	$ 1,989,062
Adjustments to reconcile operating earnings to net cash provided by operating activities:		
Depreciation and amortization	1,405,890	1,364,980
Provision for doubtful accounts	472,730	43,194
Loss on disposal of asset	-	700
Decrease (increase) in assets:		
Accounts receivable	(1,640,685)	(619,175)
Due from employees	30,455	34,754
Fuel and supplies	(3,735,760)	(580,721)
Prepayments	1,136	(441,459)
Long-term replacement parts	(6,589)	34,727
Increase (decrease) in liabilities:		
Accounts payable - fuel	3,215,459	132,821
Accounts payable - other	(381,573)	(242,342)
Payable to affiliates	42,156	(4,312)
Accrued building and engine repairs	(501,934)	501,934
Accrued taxes	(191,637)	14,591
Other accrued liabilities	68,266	30,415
Unearned fuel purchase incentive	1,837,650	-
Unearned income	806,321	296,353
Net cash provided by operating activities	$ 1,246,046	$ 2,555,522

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, 2018 and 2017

	2018	2017
Summary disclosure of noncash activities:		
Impairment loss on construction in progress:		
Impairment loss	$ -	$ 1,396,717
Construction in progress	-	(1,396,717)
	$ -	$ -
Accrual of insurance claims:		
Other receivable	$ -	$ 646,170
Other nonoperating income	-	(646,170)
	$ -	$ -
Reversal of accrued building and engine repairs:		
Accrued building and engine repairs	$ -	$ 300,000
Reversal of accrued building and engine repairs	-	(300,000)
	$ -	$ -

See accompanying notes to financial statements.

(1) Organization

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

(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, 2018 and 2017, MEC does not have nonexpendable restricted net position. 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, 2018 and 2017, MEC has expendable net position amounting to $0 and $238,794, respectively.
- 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, 2018 and 2017, the carrying amount of cash and time certificates of deposit was $7,778,837 and $5,149,230, respectively, and the corresponding bank balances were $6,758,674 and $5,171,477, respectively. Of the bank balance amounts, $3,575,308 and $765,852, respectively, were maintained in a financial institution subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2018 and 2017, bank deposits in the amount of $250,000 were FDIC insured. The remaining bank deposits of $3,183,366 and $4,405,625, 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).

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
Computer software	3 - 5 years

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

(2) Summary of Significant Accounting Policies, Continued

Deferred Outflows of Resources

In addition to assets, the 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.

New Accounting Standards

During the year ended September 30, 2018, MEC implemented the following pronouncements:

- GASB 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.

- GASB 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.

- GASB Statement No. 85, *Omnibus 2017*, which address practice issues that have been identified during implementation and application of certain GASB Statements including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefits).

- GASB Statement No. 86, *Certain Debt Extinguishment Issues*, which improves consistency in accounting and financial reporting for in-substance defeasance of debt.

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

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In November 2016, GASB issued 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. The provisions in Statement No. 83 are effective for fiscal years beginning after June 15, 2018. Management does not believe that the implementation of this statement will have a material effect on the financial statements.

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 April 2018, GASB issued 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 provisions in Statement No. 88 are effective for fiscal years beginning after June 15, 2018. Management does not believe that 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.

(2) Summary of Significant Accounting Policies, Continued

Estimates

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

Reclassifications

Certain reclassifications have been made to the 2017 financial statements to conform to the 2018 presentation. These reclassifications had no impact on operating loss, net position or cash flows as previously reported.

(3) Accounts Receivable

Accounts receivable at September 30, 2018 and 2017, consist of the following:

	2018	2017
RepMar and other affiliates	$ 8,940,419	$ 7,205,286
Other:		
Electricity	3,813,679	4,359,792
Solar	1,169,055	1,007,986
Fuel	505,390	273,623
Other	882,619	877,707
	15,311,162	13,724,394
Less allowance for uncollectible accounts	(9,172,889)	(6,589,685)
	$ 6,138,273	$ 7,134,709

(4) Fuel and Supplies

Fuel and supplies at September 30, 2018 and 2017, consist of the following:

	2018	2017
Fuel	$ 4,023,483	$ 280,402
Distribution and power plant supplies	2,285,791	2,194,190
Lubricants	180,388	248,909
Propane gas	40,866	71,267
	$ 6,530,528	$ 2,794,768

(5) Capital Assets

Capital asset activity for the years ended September 30, 2018 and 2017 is as follows:

	2018			
	October 1, 2017	Additions	Reclassifications	September 30, 2018
Utility Plant:				
Power plant engines	$ 20,090,438	$ -	$ -	$ 20,090,438
Plant and machinery	2,217,207	44,000	-	2,261,207
Land and building	1,846,877	-	-	1,846,877
Solar power systems	1,110,417	-	-	1,110,417
Vehicles	1,165,711	49,900	-	1,215,611
Leasehold improvements	641,012	-	-	641,012
Residences	561,073	-	-	561,073
Fences and seawalls	371,702	-	-	371,702
Leasehold land	330,000	-	-	330,000
Computer software	15,777	27,088	-	42,865
Furniture and fixtures	992,086	115,824	-	1,107,910
	29,342,300	236,812	-	29,579,112
Less accumulated depreciation and amortization	(21,629,338)	(1,405,890)	-	(23,035,228)
	7,712,962	(1,169,078)	-	6,543,884
Construction work-in-progress	518,022	137,859	-	655,881
	8,230,984	(1,031,219)	-	7,199,765
Nonutility Plant:				
LPG terminal	181,862	-	-	181,862
Less accumulated depreciation and amortization	(181,862)	-	-	(181,862)
	-	-	-	-
	$ 8,230,984	$ (1,031,219)	$ -	$ 7,199,765

	2017			
	October 1, 2016	Additions	Reclassifications	September 30, 2017
Utility Plant:				
Power plant engines	$ 20,047,301	$ 43,137	$ -	$ 20,090,438
Plant and machinery	2,204,441	12,766	-	2,217,207
Land and building	1,846,877	-	-	1,846,877
Solar power systems	1,110,417	-	-	1,110,417
Vehicles	1,281,555	90,548	(206,392)	1,165,711
Leasehold improvements	641,012	-	-	641,012
Residences	561,073	-	-	561,073
Fences and seawalls	371,702	-	-	371,702
Leasehold land	330,000	-	-	330,000
Computer software	-	15,777	-	15,777
Furniture and fixtures	857,010	136,376	(1,300)	992,086
	29,251,388	298,604	(207,692)	29,342,300
Less accumulated depreciation and amortization	(20,471,350)	(1,364,980)	206,992	(21,629,338)
	8,780,038	(1,066,376)	(700)	7,712,962
Construction work-in-progress	1,914,739	-	(1,396,717)	518,022
	10,694,777	(1,066,376)	(1,397,417)	8,230,984
Nonutility Plant:				
LPG terminal	181,862	-	-	181,862
Less accumulated depreciation and amortization	(181,862)	-	-	(181,862)
	-	-	-	-
	$ 10,694,777	$ (1,066,376)	$ (1,397,417)	$ 8,230,984

(5) Capital Assets, Continued

The generator set, known as Engine # 3, was in the process of being rebuilt with the aim of returning it to service to supplement the remaining engines in Station 1. The ongoing work to complete the generator set has suffered repeated delays. During the year ended September 30, 2017, MEC suspended further repairs to Engine # 3, deeming it no longer cost effective. During the year ended September 30, 2017, MEC reviewed work on Engine # 3 and considered such impaired and, as a result, MEC recognized an impairment loss of $1,396,717.

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, 2018 and 2017, the R&M Fund has a balance of $3,117 and $70,500, respectively.

(6) Long-Term Debt

Long-term debt at September 30, 2018 and 2017 is as follows:

	2018	2017
In 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. In 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, 2018 and 2017.	$ 1,355,915	$ 2,436,391

(6) Long-Term Debt, Continued

	2018	2017
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.	6,650,417	6,962,169
	8,006,332	9,398,560
Less current installments	(1,462,236)	(1,464,715)
Long-term debt	$ 6,544,096	$ 7,933,845

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

Year ending September 30,	Principal	Interest	Total
2019	$ 1,462,236	$ 182,599	$ 1,644,835
2020	590,021	89,004	679,025
2021	369,884	85,636	455,520
2022	375,470	80,050	455,520
2023	381,141	74,379	455,520
2024-2028	1,993,814	283,786	2,277,600
2029-2033	2,149,000	128,600	2,277,600
2034	684,766	5,076	689,842
	$ 8,006,332	$ 929,130	$ 8,935,462

(7) Change in Long-Term Liabilities

Changes in long-term liablities during the years ended September 30, 2018 and 2017 were as follows:

	2018				
	Balance October 1, 2017	Additions/ Reclassification	Reductions	Balance September 30, 2018	Balance due in One Year
RUS loan	$ 2,436,391	$ -	$ (1,080,476)	$ 1,355,915	$ 1,130,275
ADB Subsidiary loan	6,962,169	-	(311,752)	6,650,417	331,961
Unearned fuel purchase Incentive (see Note 10)	-	2,000,000	(162,350)	1 837,650	183,765
	$ 9,398,560	$ 2,000,000	$ (1,554,578)	$ 9,843,982	$ 1,646,001

	2017				
	Balance October 1, 2016	Additions/ Reclassification	Reductions	Balance September 30, 2017	Balance due In One Year
RUS loan	$ 3,449,832	$ -	$ (1,013,441)	$ 2,436,391	$1,074,332
ADB Subsidiary loan	7,345,985	-	(383,816)	6,962,169	390,383
	$10,795,817	$ -	$ (1,397,257)	$9,398,560	$1,464,715

(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 $88,922 and $86,296 to Plan participant accounts during the years ended September 30, 2018 and 2017, respectively, and total combined plan assets were $1,490,260 and $1,163,871 as of September 30, 2018 and 2017, 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, 2018 and 2017, and the related receivable and payable balances as of September 30, 2018 and 2017, are as follows:

	2018			
	Revenues	Expenses	Receivables	Payables
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 Telecommunication Authority	585,003	83,855	73,271	17,300
College of Marshall Islands	396,907	-	70,412	-
Other	1,096,935	126,056	121,952	-
	$ 9,977,104	$ 1,191,803	$ 8,940,419	$ 681,009

	2017			
	Revenues	Expenses	Receivables	Payables
RepMar	$ 2,525,593	$ 543,416	$ 363,983	$ 451,651
Kwajalein Atoll Joint Utilities Resources, Inc.	3,299,494	-	3,509,387	-
Majuro Water and Sewer Company, Inc.	428,709	1,261	2,565,568	1,261
Marshall Islands Social Security Administration	28,059	286,058	2,271	139,002
Majuro Resort, Inc.	423,304	46,203	534,788	-
Marshall Islands National Telecommunication Authority	535,761	113,032	68,019	17,166
College of Marshall Islands	376,961	-	33,903	-
Other	1,032,585	139,409	127,367	29,773
	$ 8,650,466	$ 1,129,379	$ 7,205,286	$ 638,853

The allowance for uncollectable accounts pertaining to receivables from affiliates amounted to $5,564,732 and $3,046,308 as of September 30, 2018 and 2017, respectively.

(9) Related Party Transactions, Continued

During the years ended September 30, 2018 and 2017, MEC received subsidies and contributions from RepMar as follows:

	2018	2017
Outer islands solar	$ 619,960	$ 496,000
Jaluit and Wotje operations	549,965	644,800
Capital improvement projects of Jaluit and Wotje	-	672,576
	$ 1,169,925	$ 1,813,376

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 years ended September 30, 2018 and 2017, MEC incurred maintenance expenses associated with the outer islands solar units of $216,316 and $45,992, respectively. Accordingly, the remaining amount of $0 and $216,316, respectively, is restricted within net position.

As of September 30, 2018 and 2017, MEC is liable for current and delinquent gross revenue taxes to RepMar, totaling $2,067,016 and $2,029,904, respectively. In addition, MEC is liable for current and delinquent withholding payroll taxes to RepMar, totaling $48,959 and $277,708, respectively. Accrued taxes payable exclude any related penalties and interest.

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. 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. During the years ended September 30, 2018 and 2017, MEC contributed $0 and $91,869, respectively, to RepMar for the purpose of establishing this required fund. As of September 30, 2018, MEC has fully satisfied the requirement to make counterpart fund payments to RepMar.

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. During the years ended September 30, 2018 and 2017, MEC incurred expenditures of $22,478 and $27,522, respectively, associated with this grant. As of September 30, 2018 and 2017, the amount of $0 and $22,478, respectively, is restricted within net position.

(10) Commitments and Contingencies

Commitments

MEC has purchased 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, 2018 and 2017 amounted to $0 and $4,416,406, respectively. MEC assumed responsibility for the proper and safe storage/handling of the product while under MEC storage. However, MEC carries insurance coverage on such consignment inventories. During the year ended September 30, 2018, MEC terminated its consignment contract with Winson.

On August 1, 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. At September 30, 2018, MEC recorded a current and noncurrent liability of $183,765 and $1,653,885, respectively, in the accompanying statement of net position for the balance of the unearned fuel purchase incentive.

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.

MEC has a material amount of unpaid gross revenue and withholding payroll taxes payable to RepMar as of September 30, 2018. 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, 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 and $501,934 at September 30, 2018 and 2017, respectively. During the year ended September 30, 2017, MEC filed an estimated insurance claim of $646,170 for the fire damage to MEC's power plant engines, which is included as a component of nonoperating income in the accompanying financial statements.

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, 2018

	Generation	Distribution	Tank Farm	Jaluit	Wotje	Solar	MEC Gas	Admin.	TOTAL
Operating revenues:									
Fuel, propane and lube sales	$ -	$ -	$ 17,441,727	$ 12,061	$ 236	$ -	$ 614,322	$ -	$ 18,068,346
Cost of sales	-	-	15,023,412	-	-	-	354,759	-	15,378,171
Gross profit on sales	-	-	2,418,315	12,061	236	-	259,563	-	2,690,175
Electric and service billings	18,212,590	-	-	194,085	152,417	187,510	-	-	18,746,602
Service and other income	-	49,957	21,930	11,714	315	5,098	2,910	71,496	163,420
Less provision for doubtful accounts	(311,445)	-	(2,164,391)	-	-	(161,285)	-	-	(2,637,121)
Total electricity sales and other income	17,901,145	49,957	(2,142,461)	205,799	152,732	31,323	2,910	71,496	16,272,901
Total net operating revenue	17,901,145	49,957	275,854	217,860	152,968	31,323	262,473	71,496	18,963,076
Operating expenses:									
Fuel and Lubes	9,688,748	11,889	-	147,224	123,431	-	-	-	9,971,292
Salaries, Wages and Benefits	1,254,999	577,341	108,509	144,885	148,881	194,514	42,836	1,094,976	3,566,941
Repairs and Maintenance	897,087	470,177	22,528	119,950	47,550	48,279	23,479	13,679	1,642,729
Depreciation and Amortization	1,056,638	70,046	13,261	682	638	74,028	18,583	172,014	1,405,890
Gross Revenue Tax	138	1,496	503,285	689	17	15	17,969	62,145	585,754
Office	73,939	4,514	9,634	20,342	4,894	339	2,065	37,720	153,447
Insurance	176,179	9,249	91,956	9,196	9,196	-	3,065	31,295	330,136
Freight and Handling	81,716	36,491	88,902	41,332	28,554	10,959		11,459	299,413
Auto POL and Maintenance	16,209	98,837	5,794	1,051	1,401	7,553	3,084	34,748	168,677
Utility	63,898	1,991	3,626	4,491	-	7,500	-	83,692	165,198
Travel	9,465	5,874	11,483	9,437	8,406	5,996	-	62,974	113,635
Communications	30,737	4,823	2,266	2,108	2,438	800	760	39,626	83,558
Professional and Consulting Fees	41,283	-	86,608	688	-	-	-	12,750	141,329
Import Tax	95,808	29,395	1,335	10,501	3,258	116	81	11,433	151,927
Security Services	15,679	-	18,530	-	-	-	32,782	1,992	68,983
Membership and Other Fees	4,785	1,030	45	-	-	110	45	83,189	89,204
Bank Charges	-	-	-	-	-	-	-	65,066	65,066
Entertainment	258	360	61	104	492	-	-	25,743	27,018
Staff Training	-	5,020	-	-	-	-	-	6,845	11,865
Safety and Uniforms	3,065	2,453	771	-	-	-	226	1,193	7,708
Equipment Rental	2,697	820	7,650	16,600	-	400	-	210	28,377
Lease Rental	-	-	-	6,858	6,389	-	-	13,050	26,297
Donations	2,596	743	-	1,001	-	936	4,190	14,321	23,787
Advertising	-	-	352	-	-	-	-	10,332	10,684
Total operating expenses	13,515,924	1,332,549	976,596	537,139	385,545	351,545	149,165	1,890,452	19,138,915
Operating income (loss)	4,385,221	(1,282,592)	(700,742)	(319,279)	(232,577)	(320,222)	113,308	(1,818,956)	(175,839)
Nonoperating income (expense):									
RepMar subsidies	-	-	-	299,782	250,182	619,961	-	-	1,169,925
Interest expense	-	-	-	-	-	-	-	(224,810)	(224,810)
	-	-	-	299,782	250,182	619,961	-	(224,810)	945,115
Change in net position	$ 4,385,221	$ (1,282,592)	$ (700,742)	$ (19,497)	$ 17,605	$ 299,739	$ 113,308	$ (2,043,766)	$ 769,276

See accompanying independent auditors' report.

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

Board of Directors
Marshalls Energy Company, Inc.:

We have audited, in accordance with 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, 2018, 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 7, 2019.

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 and therefore, material weaknesses or significant deficiencies may exist that have not been identified. We did identify certain deficiencies in internal control, described in the accompanying Schedule of Findings and Questioned Costs as item 2018-003 that we consider to be material weaknesses.

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 2018-001 and 2018-002.

Deloitte.

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.

Deloitte & Touche LLP

June 7, 2019

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INDEPENDENT AUDITORS' REPORT ON COMPLIANCE FOR EACH 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 Each 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 major federal program for the year ended September 30, 2018. MEC's 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 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 major federal program. However, our audit does not provide a legal determination of MEC's compliance.

Opinion on the 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 its major federal program for the year ended September 30, 2018.

Deloitte.

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, 2018. We have issued our report thereon dated June 7, 2019, 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.

Deloitte & Touche LLP

June 7, 2019

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

Schedule of Expenditures of Federal Awards
Year Ended September 30, 2018

Federal Grantor/Program Title	Federal CFDA Number	Federal Expenditures
U.S. Department of Agriculture:		
Rural Utilities Services:		
Rural Electrification Loans and Loan Guarantees (1)	10.850	$ 2,436,391

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

See notes to the Schedule of Expenditures of Federal Awards.

Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 2018

(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, 2018. 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 2018, including the September 30, 2017 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, 2018 for CFDA program 10.850 Rural Electrification Loans and Loan Guarantees is $1,355,916.

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?	Yes
• 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:

CFDA Number	Name of Federal Program
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

Reference Number	Findings
2018-001	Local Noncompliance
2018-002	Local Noncompliance
2018-003	Unearned Revenue

SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

No matters were reported.

Finding No. 2018-001

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 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 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.

Finding No. 2018-002

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 gross revenue taxes for the year ended September 30, 2018 in a manner inconsistent with the criteria. In addition, gross revenue taxes from previous years in the amount of $1,916,773 have not been paid. Income taxes withheld in the amount of $48,959 for previous years 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 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.

Finding No. 2018-003

Unearned Revenue

Criteria: Unearned revenue related to unused cash power should be reviewed periodically and cash power meter readings be performed at cut-off date to determine the unused portion.

Condition: MEC performed cash power meter readings to determine unused portion of cash power as of September 30, 2018. However, unearned revenue for the unused portion did not agree to supporting meter readings. MEC performed reconciliation of unearned revenue and meter readings in May 2019, which resulted in a proposed audit adjustment of $118,338.

Cause: The cause of the above condition is the lack of policies and procedures to monitor unearned revenue and perform meter readings of cash power user at cut-off date.

Effect: The effect of the above condition is possible misstatement of unearned revenue and cash power sales.

Recommendation: We recommend management establish policies and procedures to determine validity of unearned revenue as at cut off date.

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, 2018

Finding Number	CFDA Number	Questioned Costs	Status
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, 2018

Finding Number	Planned Corrective Action	Anticipated Completion Date	Responsible Contact Person
2018-001	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.	September 30, 2019	CFO, Leihani S. Anjain
2018-002	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.	September 30, 2019	CFO, Leihani S. Anjain
2018-003	Management agrees with this finding and ensures that proper policies and procedures will be in place to ensure that cashpower readings are effectively carried out, recorded and verified.	September 30, 2019	CFO, Leihani S. Anjain