

*Financial Statements, Required Supplementary
Information, and Report on Internal Control and
Compliance*

Marshalls Energy Company, Inc.

(A Component Unit of the Republic of the Marshall Islands)

*Year ended September 30, 2022
with Report of Independent Auditors*



Marshall's Energy Company, Inc.
(A Component Unit of the Republic of the Marshall Islands)

Financial Statements, Required Supplementary Information,
and Report on Internal Control and Compliance

Year ended September 30, 2022

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Report of Independent Auditors

RMI Combined Utilities Board of Directors
Marshall's Energy Company, Inc.

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of the business-type activities of Marshall's Energy Company, Inc. (MEC), a component unit of the Republic of the Marshall Islands, as of and for the year ended September 30, 2022, and the related notes to the financial statements, which collectively comprise MEC's basic financial statements as listed in the table of contents (collectively referred to as the "financial statements").

In our opinion, the accompanying financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities of MEC as of September 30, 2022, and the changes in financial position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS) and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States (*Government Auditing Standards*). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of MEC, and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management 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, and for 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about MEC's ability to continue as a going concern for twelve months beyond the financial statement date, including any currently known information that may raise substantial doubt shortly thereafter.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS and *Government Auditing Standards* will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS and *Government Auditing Standards*, we

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of the internal control relevant to the audit 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 MEC's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of the accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about MEC's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

Required Supplementary Information

Accounting policies generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 4 through 10 be presented to supplement the basic financial statements. Such information is the responsibility of management and, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with GAAS, 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 basic financial statements and other knowledge we obtained during our audit of the basic 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 Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated January 13, 2025, 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.

Ernst & Young LLP

January 13, 2025

Marshall's Energy Company, Inc.
(A Component Unit of the Republic of the Marshall Islands)

Management's Discussion and Analysis

Year ended September 30, 2022

Marshall's Energy Company, Inc. (MEC or the Company) herewith presents a discussion and analysis of the Company's financial performance for the fiscal year ended September 30, 2022. It is to be read in conjunction with the financial statements following this section.

FINANCIAL HIGHLIGHTS

MEC is the utilities Company generating, distributing and selling electricity to customers on Majuro, Jaluit and Wotje. MEC also sells petroleum products such as diesel, lubricants, gasoline, and LPG to its customers.

Financial Performance

For the fiscal year ended September 30, 2022, MEC report very poor performance due to external challenges mainly because due to the high price of fuel during the year. Key financial highlights for the year include:

- **Revenue:** Total revenues for 2022 were \$45.2 million, representing an increase of \$10.2 million (or 29%) compared to \$35 million for 2021. Utility revenue increased by \$1.4 million (or 7.7%) to \$19.5 million, whilst non-utility revenue (mainly diesel sales) increased by \$8.8 million (or 52%) to \$25.7 million. The increase in non-utility revenue was driven by a combination of higher fuel prices and increase in gallons sold despite global fuel price increases.
- **Expenses:** Total expenses for 2022 were \$53.4 million, representing an increase of \$22.7 million (or 74%) compared to \$30.6 million for 2021. Utility expenses increased by \$9.8 million (or 60%) to \$26.3 million, whilst non-utility expenses increased by \$12.8 million (or 90%) to \$27.1 million. The increase in utility expense was driven by higher fuel prices, which also impacted non-utility expense together with an increase in gallons sold.
- **Global fuel prices and tariff adjustment:** The war between Russia and Ukraine that began in February 2022 caused global fuel prices to increase exponentially and MEC was not able to adjust its tariff accordingly. Cost of fuel for utility operations increased by 102% while revenue increased by only 8% and unrelated to fuel costs.
- **Operating loss:** MEC reported an unprecedented operating loss of \$8.2 million. Utility operations incurred a loss of \$6.8 million, which was attributable to the increase in global fuel prices and no tariff adjustment for fuel cost recovery. The non-utility operations incurred a loss of \$1.4 million, which was the result of a provision for doubtful accounts charged during the year relating to KAJUR in the amount of \$3.3 million.

Marshall's Energy Company, Inc.
(A Component Unit of the Republic of the Marshall Islands)

Management's Discussion and Analysis, continued

FINANCIAL HIGHLIGHTS, CONTINUED

- **Nonoperating income:** Net nonoperating income for 2022 was \$1.7 million. MEC received operational subsidies from RepMar in the amount of \$0.5 million in 2022. These operational subsidies were received as cost recovery for the operations of Wotje and Jaluit power plants. MEC also received Japan Government Grant Aid of \$1.4 million for powerplant fuel support.
- **Capital contributions:** MEC recorded capital contributions of \$7.3 million relating to the Asian Development Bank (ADB) grant for the tank farm refurbishment project and the World Bank (WB) grant for the sustainable energy development project.

FINANCIAL ANALYSIS OF MEC

The Statement of Net Position and the Statement of Revenues, Expenses and Changes in Net Position provide an indication of MEC's financial condition. MEC's net position reflects the difference between total assets and total liabilities. An increase in net position over time normally indicates an improvement in financial condition. As illustrated in the figures below, MEC's net position decreased for the year ended September 30, 2022. The Summary Statements of Net Position for MEC are presented below:

Summary Statements of Net Position
As of September 30

	2022	2021	\$ Change 2022-2021	% Change 2022-2021	2020
Assets:					
Current and other assets	\$ 30,909,156	\$ 32,661,372	\$ (1,752,216)	(5.4)%	\$ 23,531,792
Capital assets	<u>21,720,120</u>	<u>10,503,906</u>	<u>11,216,214</u>	106.8%	<u>11,300,905</u>
Total assets	<u>52,629,276</u>	<u>43,165,278</u>	<u>9,463,998</u>	21.9%	<u>34,832,697</u>
Liabilities:					
Current and other liabilities	22,639,157	13,667,660	8,971,497	65.6%	9,863,089
Long-term debt	<u>5,104,165</u>	<u>5,480,032</u>	<u>(375,867)</u>	(6.9)%	<u>5,850,336</u>
Total liabilities	<u>27,743,322</u>	<u>19,147,692</u>	<u>8,595,630</u>	44.9%	<u>15,713,425</u>
Net position:					
Net investment in capital					
assets	24,900,132	17,369,030	7,531,102	43.4%	12,359,846
Restricted	175,598	216,674	(41,076)	(19.0)%	358,453
Unrestricted	<u>(189,776)</u>	<u>6,431,882</u>	<u>(6,621,658)</u>	(103.0)%	<u>6,400,973</u>
Total net position	<u>\$ 24,885,954</u>	<u>\$ 24,017,586</u>	<u>\$ 868,368</u>	3.6%	<u>\$ 19,119,272</u>

Total assets increased by \$9.4 million (or 22%) from \$43.2 million in 2021 to \$52.6 million in 2022. This increase was the result of an increase in capital assets by \$11.2 million (or 107%) from \$10.5 million in 2021 to \$21.7 million in 2022 offset by a decrease in current and other assets of \$1.8 million (or 5.4%) from \$32.7 million in 2021 to \$30.9 million in 2022.

Marshall's Energy Company, Inc.
(A Component Unit of the Republic of the Marshall Islands)

Management's Discussion and Analysis, continued

FINANCIAL ANALYSIS OF MEC, CONTINUED

The decrease in current and other assets of \$1.8 million (or 5.4%) mainly relates to the decrease in cash and deposits of \$2.5 million and \$2.7 million, respectively, to fund the acquisition of capital assets offset by the increase in fuel and supplies inventory of \$4.5 million, which relates to a combination of: (1) an increase in fuel prices and fuel inventory valuation at year end together with a \$2.5 million increase related to a Japan grant in aid received by MEC in 2022. The increase in capital assets of \$11.7 million (or 107%) is result of the \$3.2 million acquisition of MV Meram and ongoing \$7.3 million construction work-in-progress associated with the tank farm refurbishment project funded by the ADB and the sustainable energy development project funded by the WB. The increase in current and other liabilities of \$9 million (or 66%) mainly relates to the increase in accounts payable associated with fuel purchases. The decrease in long-term debt of \$0.4 million pertains to pay down of the low interest ADB loan that matures in 2035.

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. The summary of MEC's Statements of Revenues, Expenses and Changes in Net Position are presented below:

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

	2022	2021	\$ Change 2022-2021	% Change 2022-2021	2020
Operating revenues:					
Utility revenues	\$ 19,546,778	\$ 18,147,656	\$ 1,399,122	7.7%	\$ 19,120,009
Nonutility revenues	25,680,688	16,919,345	8,761,343	51.8%	12,639,510
Total operating revenues	45,227,466	35,067,001	10,160,465	29.0%	31,759,519
Operating expenses:					
Utility expenses	26,317,624	16,479,522	9,838,102	59.7%	17,058,578
Nonutility expenses	27,089,659	14,266,773	12,822,886	89.9%	12,645,273
Total operating expenses	53,407,283	30,746,295	22,660,988	73.7%	29,703,851
Operating (loss) profit	(8,179,817)	4,320,706	(12,500,523)	(289.3)%	2,055,668
Nonoperating revenues:					
RMI subsidies	496,496	515,840	(19,344)	(3.8)%	1,932,372
Japan Grant Aid	1,364,508	16,528	1,347,980		2,100,611
Other	105,409	119,305	(13,896)	(11.6)%	-
	1,966,413	651,673	1,314,740	201.7%	4,032,983
Nonoperating expenses:					
Interest expense and other	230,576	74,065	156,511	211.3%	103,685
	(6,443,980)	4,898,314	(11,342,294)		5,984,966
Capital contributions	7,312,348	-	7,312,348	100.0%	5,512,725
Change in net position	\$ 868,368	\$ 4,898,314	\$ (4,029,946)	(82.3)%	\$ 11,497,691

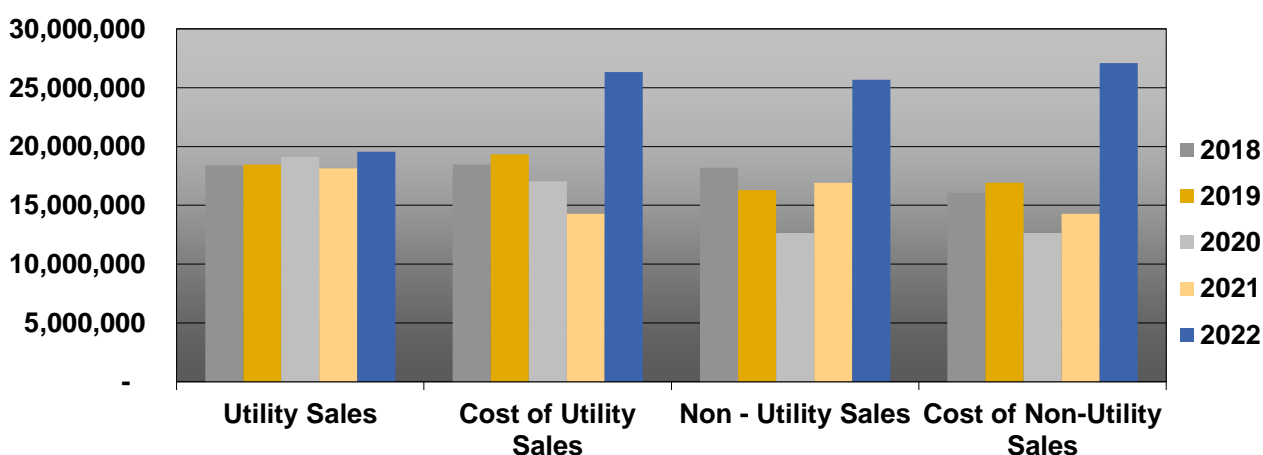
Marshall's Energy Company, Inc.
(A Component Unit of the Republic of the Marshall Islands)

Management's Discussion and Analysis, continued

FINANCIAL ANALYSIS OF MEC, CONTINUED

MEC reported an unprecedented operating loss of \$8.2 million. Utility operations incurred a loss of \$6.8 million, which was attributable to the increase in global fuel prices and no tariff adjustment for fuel cost recovery. Non-utility operations incurred a loss of \$1.4 million, which was the result of a \$3.3 million provision for doubtful accounts charged during the year relating to uncollected KAJUR receivables.

Total operating revenues increased by \$10.2 million (or 29%) from \$35 million in 2021 to \$45.2 million in 2022. Utility revenues increased by \$1.4 million (or 7.7%) from \$18.1 million in 2021 to \$19.5 million in 2022. The increase relates to increase in sales of electric regular sales and cash power sales in 2022 compared to 2021 as no changes in the electric tariffs occurred. Non-utility revenues are mainly diesel fuel sales, which increased by \$8.8 million (or 52%) from \$16.9 million in 2021 to \$25.7 million in 2022. The increase relates is a combination of higher fuel prices and increase in gallons sold compared to prior year. Total operating expenses increased by \$22.7 million (or 74%) from \$30.7 million in 2021 to \$53.4 million in 2022. Utility expenses increased by \$9.8 million (or 60%) from \$16.5 million in 2021 to \$26.3 million in 2022. This increase included \$7.5 million relating to increase in cost of diesel fuel due to the global increase in fuel prices, \$1.3 million relating to increase in cost of power - relating to work done on generators and distribution network, and \$0.9 million relating to increase in administration expenses. Non-utility expenses increased by \$12.8 million (or 90%) from \$14.3 million in 2021 to \$27.1 million in 2022. This increase related to a combination of higher global fuel prices and an increase in gallons sold. The graphic below shows the major components of the Statement of Revenue and Expenditures trend for the past five years:



Management's Discussion and Analysis for the year ended September 30, 2021 is set forth in MEC's report on the audit of financial statements, which is dated October 13, 2022. That Management Discussion and Analysis explains the major factors impacting the 2021 financial statements.

Marshall's Energy Company, Inc.
(A Component Unit of the Republic of the Marshall Islands)

Management's Discussion and Analysis, continued

CAPITAL ASSETS AND DEBT

Net capital assets increased by \$11.2 million or 107% from \$10.5 million in 2021 to \$21.7 million in 2022. The increase is due primarily to the \$3.2 million acquisition of MV Meram and \$7.3 million capitalized CWIP costs associated with the tank farm refurbishment project funded by the ADB and the sustainable energy development project funded by the WB less the increase in accumulated depreciation of \$1.2 million. A summary of MEC's capital assets as of September 30, 2022 compared with 2021 and 2020 is presented below:

Summary Schedule of Capital Assets
As of September 30

	2022	2021	\$ Change 2022-2021	% Change 2022-2021	2020
Utility plant:	\$ 72,413,789	\$ 67,840,455	\$ 4,573,334	6.7%	\$ 67,702,263
Nonutility plant	209,969	209,969	-	0.0%	209,969
	72,623,758	68,050,424	4,573,334	6.7%	67,912,232
Accumulated depreciation	(59,369,075)	(58,218,647)	(1,150,428)	2.0%	(57,198,279)
	13,254,683	9,831,777	3,422,906	34.8%	10,713,953
CWIP	8,465,437	672,129	7,793,308	1159.5%	586,952
	<u>\$ 21,720,120</u>	<u>\$ 10,503,906</u>	<u>\$ 11,216,214</u>	106.8%	<u>\$ 11,300,905</u>

Please refer to Note 5 to the accompanying financial statements for additional information regarding MEC's capital assets.

A summary of MEC's long-term debt as of September 30, 2022 compared with 2021 and 2020 is presented below:

Summary Schedule of Long-term Debt
As of September 30

	2022	2021	\$ Change 2022-2021	% Change 2022-2021	2020
Asian Development Bank	<u>\$ 5,104,165</u>	<u>\$ 5,480,032</u>	<u>\$ (375,867)</u>	(6.9)%	<u>5,850,336</u>

In 2010, MEC obtained a \$10 million loan from the ADB through RepMar for the purpose of paying off a bank loan. This loan matures in 2035. Please refer to Note 8 to the accompanying financial statements for additional information regarding MEC's long-term debt.

Marshall's Energy Company, Inc.
(A Component Unit of the Republic of the Marshall Islands)

Management's Discussion and Analysis, continued

MEC FOCUS IN THE COMING FISCAL YEAR

MEC finalized its 3-year Business Plan (BP) in September 2022. The BP is a legal requirement under the SOE Act, 2015. The plan outlines the key objectives and strategic actions for fiscal years 2023 to 2025. An important component in the key objectives is the implementation of recommendations set out in the report issued to MEC under the Asian Development Bank (ADB) funded Technical Assistance grant for Capacity Building and Energy Sector Reform for Renewable Investments in the Pacific. The BP will drive the operational and management strategies and is MEC's key focus over the next 3 years to achieving the MEC vision and enhancing the quality of life for the people of the RMI. The BP contains a total of 42 strategic actions, spread over 16 key objectives and covers 7 key areas.

In 2017, RepMar entered into a \$2,000,000 grant agreement with the ADB for the Majuro Power Network Strengthening Project, which includes proposed assistance to MEC with the installation of advanced metering infrastructure (AMI) on the Majuro distribution network. In 2018, RepMar entered into a \$12,700,000 grant agreement with the ADB for the Energy Security Project for the purpose of funding the refurbishment of MEC's existing tank farm. An additional \$7,000,000 grant was agreed to in 2021 under the Energy Security Project. Both projects faced implementation delays because of travel restrictions related to the COVID 19 pandemic, which impacted the procurement process and timeline.

The contract for the AMI system was awarded in December 2022. Meters have been delivered in 2024 and installation is underway. The contract for the Tank Farm Rehabilitation was signed in December 2021 and has reached a key milestone, with the first of the refurbished tanks (Tank 3) back in operation providing MEC with an additional 750,000-gallon fuel capacity. Work continues on Tank #s 4 and 7 with an expected hand over in the first quarter of 2025.

In addition to ADB assistance, RepMar entered into a \$34,000,000 financing agreement with the World Bank in 2017 under the Sustainable Energy Development Project to support the RMI's energy sector objectives of increasing the use of renewable energy while reducing greenhouse gas omission. The project included three major components: (1) renewable energy investments; (2) promotion of energy efficiency and loss reduction program; and (3) technical assistance, capacity building, and project management. In 2020, a \$21 million contract was entered into with a Chinese consortium for the supply and installation of a solar PV system, power station refurbishment, and battery energy storage system to be operated by MEC. The COVID 19 pandemic hindered the commencement of this contract resulting in the extension of the timeline for completion. MEC has since initiated a campaign under this project to secure the power grid through detection and prevention of meter tampering and illegal power connections. Initial investigations proved fruitful in the discovery of numerous instances of both tampering of meters as well as illegal hook ups.

In late 2024, RepMar entered into a \$60,000,000 financing agreement with the World Bank for the Renewable Energy Generation and Access Increase Project. A portion of these grant proceeds are allocated to modernize the power grids in Majuro and Ebeye to make them more resilient and capable of harnessing more renewable energy.

Marshalls Energy Company, Inc.
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Management's Discussion and Analysis, continued

MEC FOCUS IN THE COMING FISCAL YEAR, CONTINUED

On September 23, 2022, MEC welcomed the arrival of its new fuel tanker, MV Meram, into Majuro. The fuel tanker has the ability to store 160,000 gallons of fuel and is capable of delivering fuel to multiple islands. Prior to the surge in global fuel prices stemming from the war in Ukraine, MEC typically spent over \$500K a year in freight and charter costs. This acquisition will ensure that MEC can deliver fuel to Ebeye, Wotje and Jaluit in a timely manner ensuring that power rationing will no longer be required. MEC has also advised the RepMar Appropriations Committee that MEC will require a \$4.5 million subsidy to keep pace with the price of fuel since it has not yet been granted approval by the RMI Cabinet to raise electricity tariffs. Last year, MEC was paying \$2 million to \$2.5 million each month for diesel. Since the Ukraine war, that cost has increased to over \$5 million per month. Whilst MEC waits for RMI Cabinet approval to increase tariffs, MEC has had to dig into cash reserves to cover the increased cost of diesel.

In January 2024, the RMI President declared a State of Emergency regarding the power crisis in Majuro. In order to stabilize the situation, MEC entered into supply agreement with Aggreko for the rental of 6 generators.

ADDITIONAL 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 September 30, 2022. 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.

Marshall's Energy Company, Inc.
(A Component Unit of the Republic of the Marshall Islands)

Statement of Net Position

September 30, 2022

Assets

Current assets:

Cash	\$ 3,668,498
Restricted cash	175,598
Time certificates of deposit	5,125,648
Accounts receivables, net	5,102,450
Fuel and supplies	12,056,942
Deposit on acquisition of supplies	704,590
Prepayments	165,367
Security deposit	23,200
Total current assets	<u>27,022,293</u>

Utility plant:

Electric plant in service	72,413,789
Less accumulated depreciation and amortization	(59,338,454)
	13,075,335
Construction work in progress	8,465,437
Net utility plant	<u>21,540,772</u>

Nonutility property	209,969
Less accumulated depreciation	(30,621)
Nonutility property, net	<u>179,348</u>

Total capital assets 21,720,120

Lease asset 712,456

Long-term replacement parts 3,174,407

Total non-current assets 25,606,983

Total assets \$ 52,629,276

Marshall's Energy Company, Inc.
(A Component Unit of the Republic of the Marshall Islands)

Statement of Net Position, continued

September 30, 2022

Liabilities and Net Position

Current liabilities:

Current portion of long-term debt	\$ 381,574
Accounts payable - fuel	11,513,586
Accounts payable - other	225,877
Payable to affiliates	2,468,296
Accrued leave	162,646
Accrued taxes	13,037
Advance from fuel supplier, current portion	480,000
Lease liability, current portion	99,170
Unearned revenue - power	3,762,896
Unearned revenue - fuel	<u>937,286</u>

Total current liabilities 20,044,368

Long-term debt	4,722,591
Lease liability, net of current portion	607,681
Counterpart fund payable	1,135,858
Advance from fuel supplier, net of current portion	1,080,000
Accrued leave, net of current portion	<u>152,824</u>

Total liabilities 27,743,322

Commitments and contingencies

Net position:

Net investment in capital assets	24,187,676
Restricted	175,598
Unrestricted	(<u>522,680</u>)

Total net position 24,885,954

Total liabilities and net position \$ 52,629,276

Marshall's Energy Company, Inc.
(A Component Unit of the Republic of the Marshall Islands)

Statement of Revenues, Expenses and Changes in Net Position

Year ended September 30, 2022

Utility operations:

Operating revenues:

Electricity sales	\$ 19,520,759
Other	<u>26,019</u>

Total net operating revenues	<u>19,546,778</u>
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Operating expenses:

Cost of fuel	14,811,425
Cost of power	5,375,513
Administrative and general	2,580,758
Distribution operations	2,191,478
Depreciation and amortization	<u>1,358,450</u>

Total operating expenses	<u>26,317,624</u>
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Operating loss from utility operations	<u>(6,770,846)</u>
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Nonutility operations:

Operating revenues:

Fuel sales	28,129,498
Propane sales	299,066
Lubricants sales	250,591
Other	<u>339,688</u>
	29,018,843

Provision for doubtful accounts	<u>(3,338,155)</u>
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Total net operating revenues	<u>25,680,688</u>
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Operating expenses:

Cost of fuel	25,728,619
Cost of propane and lubricants	336,139
Other	<u>1,024,901</u>

Total operating expenses	<u>27,089,659</u>
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Operating loss from nonutility operations	<u>(1,408,971)</u>
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Operating loss	<u>(8,179,817)</u>
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Marshalls Energy Company, Inc.
(A Component Unit of the Republic of the Marshall Islands)

Statement of Revenues, Expenses and Changes in Net Position, continued

Year ended September 30, 2022

Nonoperating income (expense):	
Japan Grant Aid	1,364,508
RepMar subsidies	496,496
Other grants	88,398
Gain on sale of capital assets	17,011
Interest expense	(83,326)
Contribution to KAJUR	(147,250)
Total nonoperating income, net	<u>1,735,837</u>
Loss before capital contributions	(<u>6,443,980</u>)
Capital contributions:	
World Bank	4,706,281
Asian Development Bank	<u>2,606,067</u>
	<u>7,312,348</u>
Change in net position	868,368
Net position at beginning of year	<u>24,017,586</u>
Net position at end of year	<u><u>\$ 24,885,954</u></u>

See accompanying notes.

Marshall's Energy Company, Inc.
(A Component Unit of the Republic of the Marshall Islands)

Statement of Cash Flows

Year ended September 30, 2022

Cash flows from operating activities:	
Cash received from customers	\$ 45,076,916
Cash payments to suppliers for goods and services	(41,210,149)
Cash payments to employees for services	(3,873,518)
Net cash used in operating activities	(6,751)
Cash flows from noncapital financing activities:	
Operating RepMar subsidies received	496,496
Other grants received	88,398
Repayment of advance from fuel supplier	(440,000)
Counterpart funding paid	(285,540)
Principal paid on long-term debt	(375,867)
Interest paid on long-term debt	(83,326)
Net cash used in noncapital financing activities	(599,839)
Cash flows from capital and related financing activities:	
Proceeds from sale of capital assets	17,011
Purchase of bucket truck on behalf of KAJUR	(147,250)
Acquisition and construction of capital assets	(2,513,988)
Net cash used in capital and related financing activities	(2,644,227)
Cash flows from investing activities:	
Net increase in time certificates of deposit	(2,066,434)
Net change in cash	(5,317,251)
Cash at beginning of year	9,161,347
Cash at end of year	\$ 3,844,096
Consisting of:	
Cash	\$ 3,668,498
Restricted cash	175,598
	\$ 3,844,096

See accompanying notes.

Marshall's Energy Company, Inc.
(A Component Unit of the Republic of the Marshall Islands)

Statement of Cash Flows, continued

Year ended September 30, 2022

Reconciliation of operating loss to net cash used in operating activities:

Operating loss	\$ (8,179,817)
Adjustments to reconcile operating loss to net cash used in operating activities:	
Depreciation and amortization	1,358,450
Provision for doubtful accounts	3,338,155
Change in assets and liabilities:	
Accounts receivable	(2,698,723)
Fuel and supplies	(2,015,087)
Deposits and other prepayments	(600,841)
Long-term replacement parts	992,370
Accounts payable - fuel	8,953,890
Accounts payable - other	(237,342)
Payable to affiliates	(84,801)
Accrued leave	91,183
Accrued taxes	1,058
Other accrued liabilities	(79,678)
Unearned income	(789,982)
Lease liability	(55,586)
Net cash used in operating activities	\$ (<u>6,751</u>)

Noncash noncapital financing activities:

Government of Japan Fuel Grant in Aid:	
Fuel and supplies	\$ (2,500,366)
Counterpart fund payable	1,135,858
Japan Grant aid	1,364,508
	\$ <u>---</u>

Noncash capital and related financing activities:

Construction of capital assets funded by Asian Development Bank Grant:	
Capital assets	\$ (2,606,067)
Capital contributions	2,606,067
	\$ <u>---</u>
Construction of capital assets funded by World Bank Grant:	
Capital assets	\$ (4,706,281)
Capital contributions	4,706,281
	\$ <u>---</u>

See accompanying notes.

Marshalls Energy Company, Inc.
(A Component Unit of the Republic of the Marshall Islands)

Notes to Financial Statements

Year ended September 30, 2022

1. Organization

Marshalls Energy Company, Inc. (MEC) was granted a corporate charter by the Cabinet of the Republic of the Marshall Islands (RepMar) on February 2, 1984. MEC's principal lines of business are predominantly the generation and transmission of electricity and the buying and selling of petroleum products. Other lines of business include the rental of equipment and accommodation facilities. The principal markets for the generation and transmission of electricity are government agencies, businesses and residential customers located on the atolls of Majuro, Jaluit and Wotje. Petroleum products are sold primarily to foreign and domestic fishing vessels as well as Kwajalein Atoll Joint Utilities Resources, Inc. (KAJUR), 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 6-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 50-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 50-year period commencing on December 1, 1996.

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

MEC is governed by an eight-member RMI Combined Utilities Board of Directors appointed by the Cabinet of RepMar. The RMI Combined Utilities Board of Directors also have governance over KAJUR, which is a component unit 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. The Governmental Accounting Standards Board (GASB) is the recognized standard-setting body for establishing governmental accounting and financial reporting principles.

Marshall's Energy Company, Inc.
(A Component Unit of the Republic of the Marshall Islands)

Notes to Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

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.

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 requires MEC to maintain such permanently. As of September 30, 2022, MEC does not have nonexpendable 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 by the passage of time. As of September 30, 2022, MEC has expendable net position of \$175,598 associated with a repairs and maintenance fund established in accordance with the Subsidiary Loan Agreement between RepMar and the Asian Development Bank (ADB).
- 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.

Marshall's Energy Company, Inc.
(A Component Unit of the Republic of the Marshall Islands)

Notes to Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

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.

For purposes of the statements of net position and cash flows, cash and cash equivalents are defined as cash on hand and cash held in demand and savings accounts as well as short-term investments with a maturity date within three months of the date acquired by MEC. Deposits maintained in time certificates of deposit with original maturity dates greater than three months are separately classified in the statement of net position. As of September 30, 2022, the carrying amount of cash and certificates of deposit was \$8,969,744 and the corresponding bank balance was \$9,133,095. Of the bank balance amount, \$1,861,747 was maintained in a financial institution subject to Federal Deposit Insurance Corporation (FDIC) insurance. The remaining amount of \$7,051,219 was maintained in a financial institution not subject to depository insurance.

As of September 30, 2022, bank deposits in the amount of \$250,000 were FDIC insured. MEC does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk.

Marshall's Energy Company, Inc.
(A Component Unit of the Republic of the Marshall Islands)

Notes to Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

Cash and Time Certificates of Deposit, continued

As of September 30, 2022, a cash deposit of \$175,598 was restricted for repairs and maintenance of capital assets directly related to power generation and distribution in accordance with the Subsidiary Loan Agreement between RepMar and the ADB. (See note 5).

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 income. 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).

Prepayments

Prepayments represent certain payments made to vendors or persons for services reflecting costs applicable to future accounting periods.

Long-term Replacement Parts

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

Plant and Nonutility Property

Plant and nonutility property with a cost that equals or exceeds \$500 is capitalized. Such assets are stated at cost. Depreciation of plant and nonutility property and amortization of leasehold land and residences are calculated on the straight-line method based on the estimated useful lives of the respective assets. Costs pertaining to distribution and line supplies are expensed during the year of installation as MEC considers the estimated useful lives of these supplies to be less than one year.

Marshall's Energy Company, Inc.
(A Component Unit of the Republic of the Marshall Islands)

Notes to Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

Plant and Nonutility Property, continued

The estimated useful lives of these assets are as follows:

	<u>Estimated Useful Lives</u>
Power plant engines	5 - 30 years
Tank farm	30 years
Distribution	30 years
Plant and machinery	2 - 20 years
Vehicles	3 - 5 years
Leasehold improvements	20 years
Residences	3 - 25 years
Fences and seawalls	8 - 20 years
Leasehold land	20 years
Solar power systems	15 - 20 years
Furniture and fixtures	1 - 5 years
Land and building	20 years
Computer software	3 - 5 years

Leases

MEC is a party as lessee for various noncancellable long-term land leases. MEC determines if an arrangement is a lease or contains a lease at inception of a contract. A contract is determined to be or contain a lease if the contract conveys the right to control the use of identified property, land, or equipment in exchange for consideration. Leases result in the recognition of right-to-use lease assets and lease liabilities on the statement of net position. Lease assets represent the right to use an underlying asset for the lease term and lease liabilities represent the obligation to make lease payments arising from the lease, measured on a discounted basis.

Deferred Outflows of Resources

In addition to assets, the statement 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.

Marshall's Energy Company, Inc.
(A Component Unit of the Republic of the Marshall Islands)

Notes to Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

Deferred Inflows of Resources

In addition to liabilities, the statement of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element represents an acquisition of net position that applies to a future period and so will not be recognized as an inflow of resources (additions to net position) until then. MEC has no items that qualify for reporting in this category.

Compensated Absences

MEC recognizes the cost of accrued annual leave at the time such leave is earned. As of September 30, 2022, MEC recorded accrued annual leave of \$315,470 which is included within the statement of net position as accrued leave. Unused annual or vacation leave hours in excess of the 208 hours annual limit will not be carried over into a succeeding payroll year. Annual or vacation time can be taken up to a maximum of twenty (20) days in a payroll year.

Unearned Revenue

Unearned revenue is recognized when cash, receivables or other assets are recorded prior to being earned and primarily represents amounts received for cash power and fuel sales prior to the end of the fiscal year but are utilized or delivered in the subsequent accounting period.

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 (GRT) of 3% on revenues. Pursuant to the Income Tax Act of 1989, as amended, sales of electricity by public utility companies are exempt from GRT. Accordingly, MEC is exempt from GRT on the sale of electric services. MEC is required to pay GRT on all other revenues. As of September 30, 2022, MEC is liable for current and delinquent GRT of \$1,746,943, which is included within the statement of net position as payable to affiliates. 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.

Marshall's Energy Company, Inc.
(A Component Unit of the Republic of the Marshall Islands)

Notes to Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

Recently Adopted Accounting Pronouncements

In 2020, GASB issued Statement No. 95, *Postponement of the Effective Dates of Certain Authoritative Guidance*, which postponed the effective dates of GASB Statement No. 84, 89, 90, 91, 92 and 93 by one year and GASB Statement No. 87 by 18 months; however, earlier application of the provisions addressed in GASB Statement No. 95 is encouraged and is permitted to the extent specified in each pronouncement as originally issued. In accordance with GASB Statement No. 95, MEC's management has elected to postpone implementation of these statements.

During the year ended September 30, 2022, MEC implemented the following pronouncements:

- GASB Statement No. 87, *Leases*, which increases the usefulness of governments' financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and as inflows of resources or outflows of resources recognized based on the payment provisions of the contract. As a result of adoption of GASB Statement No. 87, MEC has recognized right-to-use leased assets and related lease liabilities in the initial amount of \$762,437.
- GASB Statement No. 89, *Accounting for Interest Cost Incurred Before the End of a Construction Period*, which enhances the relevance and comparability of information about capital assets and the cost of borrowing for a reporting period and simplifies accounting for interest cost incurred before the end of a construction period. The implementation of this statement did not have a material effect on the accompanying financial statements.
- GASB Statement No. 92, *Omnibus 2020*, which enhances comparability in accounting and financial reporting and improves the consistency of authoritative literature by addressing practice issues that have been identified during implementation and application of certain GASB Statements. The implementation of this statement did not have a material effect on the accompanying financial statements.
- GASB Statement No. 97, *Certain Component Unit Criteria, and Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans - an amendment of GASB Statements No. 14 and No. 84, and a supersession of GASB Statement No. 32*, which increases consistency and comparability related to the reporting of fiduciary component units; mitigates costs associated with the reporting of certain pension plans and other postemployment benefit (OPEB) plans as fiduciary component units; and enhances the relevance, consistency, and comparability of the accounting and financial reporting for Internal Revenue Code (IRC) Section 457 deferred compensation plans (Section 457 plans) that meet the definition of a pension plan and for benefits provided through those plans. The implementation of this statement did not have a material effect on the accompanying financial statements.

Marshall's Energy Company, Inc.
(A Component Unit of the Republic of the Marshall Islands)

Notes to Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

Recently Adopted Accounting Pronouncements, continued

- GASB Statement No. 98, *The Annual Comprehensive Financial Report*, which establishes the term annual comprehensive financial report and its acronym ACFR. That new term and acronym replace instances of comprehensive annual financial report and its acronym in generally accepted accounting principles for state and local governments. The implementation of this statement did not have a material effect on the accompanying financial statements.
- GASB Statement No. 99, *Omnibus 2022*, which provides clarification guidance on several of its recent statements that addresses different accounting and financial reporting issues identified during implementation of the new standards and during the GASB's review of recent pronouncements. GASB Statement No. 99:
 - 1) Amends guidance in GASB Statement No. 24, *Accounting and Financial Reporting for Certain Grants and Other Financial Assistance*, requiring that the accounting and financial reporting of Supplemental Nutrition Assistance Program (SNAP) transactions should follow the provisions of GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, as amended. These provisions were effective upon issuance and implementation did not have a material effect on the accompanying financial statements.
 - 2) Requires disclosures related to nonmonetary transactions, in the notes to financial statements, of the measurement attribute(s) applied to the assets transferred rather than the basis of accounting for those assets. These provisions were effective upon issuance and implementation did not have a material effect on the accompanying financial statements.
 - 3) Provides guidance on accounting for pledges of future revenues when resources are not received by the pledging government. The guidance addresses the process of blending a component unit created to issue debt on behalf of a primary government when that component unit is required to be presented as a blended component unit. This guidance was effective upon issuance and implementation did not have a material effect on the accompanying financial statements.
 - 4) Provides clarification of provisions in GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, as amended, related to the focus of the government-wide financial statements. This guidance was effective upon issuance and implementation did not have a material effect on the accompanying financial statements.

Marshall's Energy Company, Inc.
(A Component Unit of the Republic of the Marshall Islands)

Notes to Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

Recently Adopted Accounting Pronouncements, continued

- 5) Provides terminology updates related to certain provisions of GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, and terminology used in GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. These updates were effective upon issuance and implementation did not have a material effect on the accompanying financial statements.
- 6) GASB Statement No. 93, *Replacement of Interbank Offered Rates*, which amended GASB Statement No. 53 to address transition away from the London Interbank Offered Rate (LIBOR). GASB Statement No. 99 extends the period during which the LIBOR is considered an appropriate benchmark interest rate to when LIBOR ceases to be determined using methodology in place as of December 31, 2021. This guidance was effective upon issuance and implementation did not have a material effect on the accompanying financial statements.

Upcoming Accounting Pronouncements

In May 2019, GASB issued Statement No. 91, *Conduit Debt Obligations*. The primary objectives of this Statement are to provide a single method of reporting conduit debt obligations by issuers and eliminate diversity in practice associated with (1) commitments extended by issuers, (2) arrangements associated with conduit debt obligations, and (3) related note disclosures. This Statement achieves those objectives by clarifying the existing definition of a conduit debt obligation; establishing that a conduit debt obligation is not a liability of the issuer; establishing standards for accounting and financial reporting of additional commitments and voluntary commitments extended by issuers and arrangements associated with conduit debt obligations; and improving required note disclosures. Management does not believe that this Statement, upon implementation, will have a material effect on the financial statements. In accordance with GASB Statement No. 95, GASB Statement No. 91 will be effective for fiscal year ending September 30, 2023.

In March 2020, GASB issued Statement No. 94, *Public-Private and Public-Public Partnerships and Availability Payment Arrangements*. The primary objective of this Statement is to improve financial reporting by addressing issues related to public-private and public-public partnership arrangements. This Statement also provides guidance for accounting and financial reporting for availability payment arrangements. Management does not believe that this Statement, upon implementation, will have a material effect on the financial statements. GASB Statement No. 94 will be effective for fiscal year ending September 30, 2023.

Marshalls Energy Company, Inc.
(A Component Unit of the Republic of the Marshall Islands)

Notes to Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

Upcoming Accounting Pronouncements, continued

In May 2020, GASB issued Statement No. 96, *Subscription-Based Information Technology Arrangements*. This Statement provides guidance on the accounting and financial reporting for subscription-based information technology arrangements (SBITAs) for government end users (governments). This Statement (1) defines a SBITA; (2) establishes that a SBITA results in a right-to-use subscription asset - an intangible asset - and a corresponding subscription liability; (3) provides the capitalization criteria for outlays other than subscription payments, including implementation costs of a SBITA; and (4) requires note disclosures regarding a SBITA. Management does not believe that this Statement, upon implementation, will have a material effect on the financial statements. GASB Statement No. 96 will be effective for fiscal year ending September 30, 2023.

In April 2022, GASB issued Statement No. 99, *Omnibus 2022*. This Statement contains guidance whose effective dates are in future periods. Management is evaluating the effect that this Statement, upon implementation, will have on the financial statements. GASB Statement No. 99:

- 1) Modifies guidance in GASB Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*, to bring all guarantees under the same financial reporting requirements and disclosures effective for fiscal year ending September 30, 2024.
- 2) Provides guidance on classification and reporting of derivative instruments within the scope of GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, effective for fiscal year ending September 30, 2024.
- 3) Provides clarification of provisions in GASB Statement No. 87 related to the determination of the lease term, classification of a lease as a short-term lease, recognition and measurement of a lease liability and a lease asset, and identification of lease incentives effective for fiscal year ending September 30, 2023.
- 4) Provides clarification of provisions in GASB Statement No. 94, *Public-Private and Public-Public Partnerships and Availability Payment Arrangements*, related to (a) the determination of the public-private and public-public partnership (PPP) term and (b) recognition and measurement of installment payments and the transfer of the underlying PPP asset. Effective for fiscal year ending September 30, 2023.

Marshall's Energy Company, Inc.
(A Component Unit of the Republic of the Marshall Islands)

Notes to Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

Upcoming Accounting Pronouncements, continued

- 5) Provides clarification of provisions in GASB Statement No. 96, *Subscription-Based Information Technology Arrangements*, related to the subscription-based information technology arrangement (SBITA) term, classification of a SBITA as a short-term SBITA, and recognition and measurement of a subscription liability. Effective for fiscal year ending September 30, 2023.
- 6) Modifies accounting and reporting guidance in GASB Statement No. 53 related to termination of hedge. Guidance is effective for fiscal year ending September 30, 2023.

In June 2022, GASB issued Statement No. 100, *Accounting Changes and Error Corrections - An Amendment of GASB Statement No. 62*. This Statement enhances accounting and financial reporting requirements for accounting changes and error corrections and requires that (a) changes in accounting principles and error corrections be reported retroactively by restating prior periods, (b) changes to or within the financial reporting entity be reported by adjusting beginning balances of the current period, and (c) changes in accounting estimates be reported prospectively by recognizing the change in the current period. Requirements applicable to changes in accounting principles apply to the implementation of a new pronouncement if there is no specific transition guidance in the new pronouncement. The Statement also requires that aggregate amounts of adjustments to, and restatements of, beginning net position, fund balance, or fund net position, as applicable, be displayed by reporting unit in the financial statements. Management is evaluating the effect that this Statement, upon implementation, will have on the financial statements. GASB Statement No. 100 will be effective for fiscal year ending September 30, 2024.

In June 2022, GASB issued Statement No. 101, *Compensated Absences*. The primary objective of the Statement is to better meet the information needs of financial statement users by updating the recognition and measurement guidance for compensated absences. This Statement requires that liabilities for compensated absences be recognized for leave that has not been used and leave that has been used but not yet paid, provided the services have occurred, the leave accumulates, and the leave is more likely than not to be used for time off or otherwise paid in cash or noncash means. In estimating the leave that is more likely than not to be used or otherwise paid or settled, a government should consider relevant factors such as employment policies related to compensated absences and historical information about the use or payment of compensated absences. Leave that is more likely than not to be settled through conversion to defined benefit postemployment benefits should not be included in a liability for compensated absences. Management is evaluating the effect that this Statement, upon implementation, will have on the financial statements. GASB Statement No. 101 will be effective for fiscal year ending September 30, 2025.

Marshalls Energy Company, Inc.
(A Component Unit of the Republic of the Marshall Islands)

Notes to Financial Statements, continued

2. Summary of Significant Accounting Policies, continued

Estimates

The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and deferred outflows of resources, liabilities and deferred inflows of resources, and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

3. Accounts Receivable

Accounts receivable as of September 30, 2022, net of allowance for uncollectible accounts, consist of the following:

RepMar and affiliates	\$ 14,102,776
Other:	
Electricity	4,989,751
Solar	1,846,366
Fuel	488,805
Other	<u>559,236</u>
	21,986,934
Less allowance for uncollectible accounts	<u>(16,884,484)</u>
	<u>\$ 5,102,450</u>

4. Fuel and Supplies

Fuel and supplies as of September 30, 2022, consist of the following:

Fuel	\$ 8,396,112
Distribution and power plant supplies	2,967,804
Lubricants	652,340
Propane gas	<u>40,686</u>
	<u>\$ 12,056,942</u>

Marshall's Energy Company, Inc.
(A Component Unit of the Republic of the Marshall Islands)

Notes to Financial Statements, continued

5. Capital Assets

Capital asset activities for the year ended September 30, 2022, were as follows:

	October <u>1, 2021</u>	<u>Additions</u>	Transfers and <u>Disposals</u>	September <u>30, 2022</u>
Nondepreciable capital assets:				
Construction work-in-progress	\$ <u>672,129</u>	\$ <u>8,623,882</u>	\$(<u>830,574</u>)	\$ <u>8,465,437</u>
Depreciable capital assets:				
Utility plant:				
Power plant engines	23,314,238	---	---	23,314,238
Tank farm	23,900,000	---	---	23,900,000
Solar power systems	8,564,830	---	---	8,564,830
Plant and machinery	2,593,827	815,040	---	3,408,867
Distribution	3,316,665	---	---	3,316,665
Ship	---	3,178,222	---	3,178,222
Buildings	1,864,041	---	---	1,864,041
Vehicles	1,081,665	436,998	(158,041)	1,360,622
Furniture and fixtures	1,234,965	70,907	---	1,305,872
Leasehold improvements	641,012	---	---	641,012
Residences	561,073	154,000	---	715,073
Fences and seawalls	371,702	---	---	371,702
Leasehold land	330,000	---	---	330,000
Computer software	<u>66,437</u>	<u>76,208</u>	---	<u>142,645</u>
	67,840,455	4,731,375	(158,041)	72,413,789
Less accumulated depreciation	(<u>58,198,525</u>)	(<u>1,297,970</u>)	<u>158,041</u>	(<u>59,338,454</u>)
	<u>9,641,930</u>	<u>3,433,405</u>	---	<u>13,075,335</u>
Non-utility plant:				
LPG terminal	209,969	---	---	209,969
Less accumulated depreciation	(<u>20,122</u>)	(<u>10,499</u>)	---	(<u>30,621</u>)
	<u>189,847</u>	(<u>10,499</u>)	---	<u>179,348</u>
	<u>\$ 10,503,906</u>	<u>\$ 12,046,788</u>	\$(<u>830,574</u>)	<u>\$ 21,720,120</u>

In accordance with the Subsidiary Loan Agreement between RepMar and the Asian Development Bank (ADB), MEC created a separate bank account dedicated for repair and maintenance funds (R&M Fund). Starting October 1, 2010, MEC made automatic \$35,000 monthly transfers into the R&M Fund from its revenue accounts. Amounts in the R&M Fund shall be used exclusively for repair, maintenance, procurement of spare parts, materials and equipment (and related labor costs) directly related to power generation and distribution. As of September 30, 2022, the R&M Fund has a balance of \$175,598.

Marshalls Energy Company, Inc.
(A Component Unit of the Republic of the Marshall Islands)

Notes to Financial Statements, continued

6. Lease Asset

Right-of-use asset activities for the year ended September 30, 2022, were as follows:

Right-of-use asset	\$	---	\$	762,437	\$	---	\$	762,437
Less accumulated amortization		<u>---</u>		<u>(49,981)</u>		<u>---</u>		<u>(49,981)</u>
	\$	<u>---</u>	\$	<u>712,456</u>	\$	<u>---</u>	\$	<u>712,456</u>

7. Leases

MEC is a lessee under non-cancelable leases for apartments and certain parcels of land. The terms of the agreements range from 2 to 50 years generally at fixed monthly, quarterly or annual payments with no variable payments or escalation clauses. The calculated interest rate used was 1.5%.

The following is a summary of principal and interest requirements to maturity for the lease liabilities as of September 30, 2022:

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2023	\$ 99,170	\$ 9,986	\$ 109,156
2024	92,953	8,503	101,456
2025	77,357	7,249	84,606
2026	52,846	6,151	58,997
2027	8,615	5,729	14,344
2028 - 2032	41,278	26,692	67,970
2033 - 2037	32,704	24,016	56,720
2038 - 2042	35,232	21,488	56,720
2043 - 2047	37,955	18,765	56,720
2048 - 2052	40,888	15,832	56,720
2053 - 2057	44,048	12,672	56,720
2058 - 2062	47,452	9,268	56,720
2063 - 2067	51,120	5,600	56,720
2068 - 2072	<u>45,234</u>	<u>1,650</u>	<u>46,884</u>
	<u>\$ 706,852</u>	<u>\$ 173,601</u>	<u>\$ 880,453</u>

Marshall's Energy Company, Inc.
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Notes to Financial Statements, continued

8. Long-Term Debt

Long-term debt as of September 30, 2022, is as follows:

	<u>Interest Rate</u>	<u>Maturity Dates</u>	
Asian Development Bank (ADB)	1.5%	2035	<u>\$5,104,165</u>

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

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2023	\$ 381,574	\$ 73,946	\$ 455,520
2024	387,337	68,183	455,520
2025	393,187	62,333	455,520
2026	399,126	56,394	455,520
2027	405,154	50,366	455,520
2028 - 2032	2,119,430	158,170	2,277,600
2033 - 2035	<u>1,018,357</u>	<u>18,086</u>	<u>1,036,443</u>
	<u>\$5,104,165</u>	<u>\$487,478</u>	<u>\$5,591,643</u>

Change in Long-term Debt

A summary of changes in long-term debt for the year ended September 30, 2022, is as follows:

	<u>Balance October 1, 2021</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance September 30, 2022</u>	<u>Due Within One Year</u>
Loan payable:					
ADB	<u>\$5,480,032</u>	<u>\$ ---</u>	<u>\$(375,867)</u>	<u>\$5,104,165</u>	<u>\$381,574</u>

Debt Covenants

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

Marshall's Energy Company, Inc.
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Notes to Financial Statements, continued

9. Change in Long-Term Liabilities

Changes in other long-term liabilities during the year ended September 30, 2022, is as follows:

	October <u>1, 2021</u>	<u>Additions</u>	<u>Reductions</u>	September <u>30, 2022</u>	Due Within <u>One Year</u>
Accrued leave	\$ 224,287	\$304,546	\$(213,363)	\$ 315,470	\$162,646
Advance from fuel supplier	2,000,000	---	(440,000)	1,560,000	480,000
Counterpart fund payable	285,540	1,135,858	(285,540)	1,135,858	---
Lease liability	<u>---</u>	<u>762,437</u>	<u>(55,586)</u>	<u>706,851</u>	<u>99,170</u>
	<u>\$2,509,827</u>	<u>\$2,202,841</u>	<u>\$(994,489)</u>	<u>\$3,718,179</u>	<u>\$741,816</u>

10. Employee Retirement Plan

MEC and KAJUR 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 \$75,549 to Plan participant accounts during the year ended September 30, 2022, and total combined plan assets was \$1,566,448 as of September 30, 2022.

11. 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 year ended September 30, 2022, and the related receivable and payable balances as of September 30, 2022, are as follows:

	<u>Revenues</u>	<u>Expenses</u>	<u>Receivables</u>	<u>Payables</u>
RepMar	\$3,121,359	\$1,063,086	\$ 1,476,584	\$2,200,739
Kwajalein Atoll Joint Utilities Resources, Inc.	3,205,896	---	7,850,868	---
Majuro Water and Sewer Company, Inc.	350,534	10,980	3,780,989	8,300
Marshall Islands Social Security Administration	44,835	717,603	2,159	193,449
Majuro Resort, Inc.	204,941	144,399	315,155	---
Marshall Islands National Telecommunications Authority	520,422	77,926	106,648	22,443
College of Marshall Islands	539,775	---	158,096	---
Other	<u>1,604,748</u>	<u>189,619</u>	<u>412,277</u>	<u>43,365</u>
	<u>\$9,592,510</u>	<u>\$2,203,613</u>	<u>\$14,102,776</u>	<u>\$2,468,296</u>

Marshall's Energy Company, Inc.
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Notes to Financial Statements, continued

11. Related Party Transactions, continued

As of September 30, 2022, the allowance for uncollectable accounts of \$16,884,484 includes \$7,678,587 associated with Kwajalein Atoll Joint Utilities Resources, Inc. and \$3,780,989 associated with Majuro Water and Sewer Company, Inc.

During the year ended September 30, 2022, MEC purchased a bucket truck for the benefit of Kwajalein Atoll Joint Utilities Resources, Inc. (KAJUR) at a cost of \$147,250, which is recognized as a contribution to KAJUR in the accompanying financial statements.

During the year ended September 30, 2022, MEC was the subrecipient of RepMar grant funding in the amount of \$496,496 from the 11th European Development Fund (EDF11) under the ACP-EU Partnership Agreement to support reform of the energy sector in RMI.

In 2017, MEC entered into a project agreement with the ADB associated with a \$2,000,000 grant agreement (Grant Number 0554 RMI (SF)) between RepMar and the ADB for the Majuro Power Network Strengthening Project, the objective of which is to: (1) install advanced metering infrastructure on the Majuro distribution network and; (2) prepare and endorse MEC's business process reengineering and the management improvement action plans. During the year ended September 30, 2022, no amounts were made available to MEC under this grant agreement.

In 2018, MEC entered into a memorandum of understanding with RepMar associated with a \$34,000,000 financing agreement (Grant Number D261-MH) between RepMar and the World Bank for the Sustainable Energy Development Project, the objective of which is to increase the share of renewable energy generation on Majuro atoll and enhance the reliability of electricity supply and improve energy efficiency on Majuro atoll and Ebeye island. During the year ended September 30, 2022, \$4,706,281 was made available to MEC under this financing agreement whereby payments were either made directly by the World Bank to vendors or reimbursement to RepMar for capital-related costs associated with the supply and installation of a solar PV system, power station refurbishment, and battery energy storage system to be operated by MEC.

In 2018, MEC entered into a project agreement with the ADB associated with a \$12,700,000 grant agreement (Grant Number 0637 RMI (SF)) between RepMar and the ADB for the Energy Security Project, the objective of which is to achieve sustained, safe, and reliable operation of the Majuro tank farm and continued supply of fuel to power generation facilities throughout the Marshall Islands. On December 17, 2021, an additional grant was approved by the ADB (Grant Number 0817 RMI (SF)) in the amount of \$7,000,000. During the year ended September 30, 2022, \$2,606,067 was made available to MEC under this grant agreement whereby payments were made directly by the ADB to the vendor for capital-related costs associated with MEC's tank farm refurbishment.

Marshall's Energy Company, Inc.
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Notes to Financial Statements, continued

11. Related Party Transactions, continued

In 2022, the Government of Japan and RepMar entered into a grant agreement for Grant Aid in the amount of JPY300,000,000 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, 2022, MEC received the equivalent gallons of fuel from the supplier in the amount of \$2,500,366. As part of the agreement, MEC was required to establish a counterpart fund with RepMar in the amount of \$1,135,858 no later than July 21, 2024. During the year ended September 30, 2022, MEC recognized grant aid from the Government of Japan of \$1,364,858 associated with this grant agreement. As of September 30, 2022, MEC has reported a long-term liability of \$1,135,858 to set aside the counterpart fund payments to RepMar.

As of September 30, 2022, MEC is liable for certain delinquent gross revenue taxes payable to RepMar. Accrued taxes payable exclude related penalties and interest.

12. Commitments

Fuel Purchase Agreement

In 2020, MEC entered into a diesel fuel supply agreement ("the supply agreement") with a new supplier for an initial period of five years with automatic renewal for an additional period of five years, unless one of the parties serves a notice of intention not to renew the contract at least 180 days prior to the expiry of the contract. Concurrently, MEC entered into an operations assistance program agreement ("the OAP agreement") with the supplier whereby the supplier provided a \$2,000,000 drawdown facility to MEC as working capital assistance. On September 8, 2021, the supplier advanced \$2,000,000 to MEC under this agreement, payable in monthly payments of \$40,000, commencing October 8, 2021, and maturing November 12, 2025. The amount of OAP repaid as of September 30, 2022, was \$440,000. As of September 30, 2022, MEC has reported a liability of \$1,560,000 in the accompanying statement of net position representing outstanding advance from fuel supplier.

Grant Number 0554 RMI (SF) - Majuro Power Network Strengthening Project

The ADB has made grant proceeds of \$2,000,000 available to MEC under Grant Number 0554 RMI (SF) for the purpose of exclusively financing Project expenditures in accordance with grant agreement provisions. As of September 30, 2022, remaining commitments associated with unused grant proceeds amount to \$1,832,502.

Marshall's Energy Company, Inc.
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Notes to Financial Statements, continued

12. Commitments, continued

Grant Numbers 0637 and 0817 RMI (SF) - Energy Security Project

The ADB has made grant proceeds of \$19,700,000 available to MEC under Grant Number 0637 RMI (SF) and Grant Number 0817 RMI (SF) for the purpose of exclusively financing Project expenditures in accordance with respective grant agreement provisions. As of September 30, 2022, remaining commitments associated with unused grant proceeds amount to \$17,051,691.

Grant Number D261-MH - Sustainable Energy Development Project

The World Bank has made grant proceeds of \$34,000,000 available, in part, to MEC under Grant Number D261-MH for the purpose of exclusively financing Project expenditures in accordance with financing agreement provisions. As of September 30, 2022, remaining commitments associated with unused grant proceeds amount to \$23,334,335.

13. Contingencies

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America, which contemplates the continuation of MEC as a going concern. Management acknowledges that it is currently dependent on RepMar and its affiliates to pay for actual services rendered and goods sold to maintain its operations. Management also acknowledges that operations are heavily dependent on fuel, and that global fuel prices are highly volatile. Should Repmar and its affiliates choose to delay or discontinue payments for actual services rendered and goods sold, and if fuel prices rise, MEC management may have to consider alternative measures including, among other possibilities, an increase in electricity and fuel rates to maintain MEC as a going concern.

MEC is a party to several legal proceedings arising from its operations; however, no provision for any liability was made in the accompanying financial statements due to the uncertainty of the legal proceeding outcomes. Although financial exposure has yet to be determined, MEC's management believes that the provision for any liability will not be material to the accompanying financial statements.

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

Marshall's Energy Company, Inc.
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Notes to Financial Statements, continued

13. Contingencies, continued

MEC has a material amount of unpaid gross revenue and withholding payroll taxes payable to RepMar as of September 30, 2022. The nonpayment of taxes is an effort to address increasing accounts receivable balances due from related parties via an offsetting exercise to reduce each party's liabilities. MEC's management believes that no provision for any additional liability, if any, which may arise from this matter is required to be reflected in the accompanying financial statements.

14. 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.

15. Subsequent Events

In February 2023, MEC was awarded a Government of Japan Grant Aid for the Economic and Social Development Program in the amount of \$2,010,909 with related required counterpart funding of \$952,461.

On November 28, 2023, MEC entered into an agreement with Aggreko (NZ) Limited for a temporary 5MWH power plant rental for a minimal rental period of 2 years.

On October 17, 2024, MEC entered into a project agreement with the World Bank associated with a \$60,000,000 financing agreement (Grant Number E331-MH) between RepMar and the World Bank for the Renewable Energy Generation and Access Increase Project, the objective of which is to increase renewable energy generation and enhance the reliability and quality of electricity service on Majuro atoll and the outer islands.

Report of Independent Auditors 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
Marshall's 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 business-type activities of Marshall's Energy Company, Inc. (MEC), which comprise the statement of net position as of September 30, 2022, 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 January 13, 2025.

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) as a basis for designing 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 identified certain deficiencies in internal control, described in the accompanying Schedule of Findings and Responses as items 2022-001 and 2022-002 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 financial statements. 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 an instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards*, and which is described in the accompanying Schedule of Findings and Responses as item 2022-003.

MEC's Response to Findings

Government Auditing Standards requires the auditor to perform limited procedures on MEC's response to the findings identified in our audit and described in the accompanying Schedule of Findings and Responses. MEC's response was not subjected to the other auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the response.

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.

Ernst + Young LLP

January 13, 2025

Marshall's Energy Company, Inc.
(A Component Unit of the Republic of the Marshall Islands)

Schedule of Findings and Responses

Year ended September 30, 2022

Finding No. 2022-001

Collection of KAJUR and MWSC Receivables

Criteria: Effective internal controls over financial operations, including procedures to ensure the timely collection of receivables, are required to safeguard assets and ensure accurate financial reporting.

Condition: As of September 30, 2022, MEC recorded receivables of \$21,986,934 for which a corresponding allowance for uncollectible accounts of \$16,884,484 has been established. Receivables include delinquent amounts due from Kwajalein Atoll Joint Utilities Resources, Inc. (KAJUR) and Majuro Water and Sewer Company, Inc. (MWSC) of \$7,850,868 and \$3,780,989, respectively, representing a combined receivable amount of \$11,631,857. The established allowance for uncollectible accounts includes a combined \$11,459,576 associated with the KAJUR and MWSC receivables.

Cause: MEC has not implemented a formal process for follow-up on delinquent receivables. Additionally, negotiations by management with RepMar officials to include budget allotments in the annual Appropriation Act to satisfy these delinquent accounts have been ineffective.

Effect: Increased risk of financial loss due to uncollectible accounts and potential overstatement of assets in financial statements resulting in negative impact on cash flows.

Recommendation: We recommend management establish a formal policy for receivable management, including timelines and procedures for follow-up on overdue accounts. Furthermore, we recommend management escalate collection efforts through continued negotiations with RepMar officials.

Auditee Response and Corrective Action Plan: MEC maintains and follows robust standard operating procedures for receivables management. However, KAJUR and MWSC represent exceptional cases that fall outside our standard collection process because they, like MEC, provide essential utility services to their communities. Disconnecting power to these entities would severely impact water and sewerage services to hospitals, schools, and households in Ebeye and Majuro. This puts MEC in a difficult position of balancing its financial responsibilities with the broader public interest.

Management has consistently and vigorously raised concerns about these significant outstanding debts with RepMar officials for over many years through various channels including: a) Annual budget hearings with Nitijela; b) Meetings with the Ministry of Finance; and c) Briefings to the Cabinet. Despite our continued efforts, these receivables continue to grow, placing an increasingly unsustainable burden on MEC's operations.

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Schedule of Findings and Responses, continued

Finding No. 2022-001, continued

Collection of KAJUR and MWSC Receivables, continued

Auditee Response and Corrective Action Plan, continued:

We will continue to engage with RepMar officials to seek resolution, including pursuing budget allocation requests and exploring other potential government interventions to address this critical issue. This situation requires urgent government attention as it threatens not only MEC's financial sustainability but also our mandate to provide reliable power services to the people of the Marshall Islands.

Marshall's Energy Company, Inc.
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Schedule of Findings and Responses, continued

Finding No. 2022-002

Capital Asset Contributions

Criteria: Under Generally Accepted Accounting Principles (GAAP), including those established by the Governmental Accounting Standards Board (GASB), entities are required to recognize contributed capital assets and related capital contributions at their estimated fair value at the time of construction. Furthermore, effective internal controls should ensure the timely and accurate recording of all capital asset transactions.

Condition: MEC does not have a process in place to identify, track, and record contributed capital assets and related capital contributions. As a result, several contributed capital assets under construction funded by the Asian Development Bank's Energy Security Project and the World Bank's Sustainable Energy Development Project with a cost of \$2,606,067 and \$4,706,281, respectively, were omitted from the financial statements. Audit adjustments were proposed to correct this omission.

Cause: Lack of a formalized system for identifying and recording capital asset contributions.

Effect: Financial statements are misstated, as capital assets and related capital contributions are not reported at their appropriate value; noncompliance with GAAP and potential audit opinion modifications; and failure to account for capital asset contributions may lead to an incomplete understanding of MEC's financial position.

Recommendation: We recommend management establish policies and procedures to ensure all contributed capital assets and related capital contributions are identified, valued, and recorded in the financial system. Furthermore, we recommend management implement periodic training for staff on the importance of identifying and recording contributed capital assets to ensure compliance with accounting standards.

Auditee Response and Corrective Action Plan: MEC agrees with this finding and will establish policies and procedures to ensure that capital contributed assets and related capital contributions are recorded and the staff is trained to ensure compliance with the accounting standards.

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Schedule of Findings and Responses, continued

Finding No. 2022-003

Local Noncompliance

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

Condition: MEC filed and paid gross revenue taxes for the year ended September 30, 2022 in a manner inconsistent with the criteria, which included gross revenue taxes from previous years in the amount of \$1,670,833 representing quarters ended June 2014 through June 2017 that have not been paid.

Cause: Lack of policies and procedures to monitor timely payment of gross revenue taxes.

Effect: 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.

Prior Year Status: Recommendation concerning management to establish policies and procedures pertaining to compliance with the RepMar Income Tax Act of 1989, as amended, was reported by the predecessor auditors as a finding in the audit of MEC for fiscal years 2016 through 2021.

Auditee Response and Corrective Action Plan: MEC understands this noncompliance. However, it's important to note that MEC has paid \$1,500,179 in Gross Revenue Tax (GRT) for diesel fuel supplied to KAJUR's power plants. These fuel transactions should have been tax-exempt as they represent inter-governmental transfers between state-owned enterprises.

Both Nitijela Committees and the Ministry of Finance have acknowledged that RepMar should not have collected taxes on these fuel transactions. MEC has been actively working with the Ministry of Finance Taxation Office to implement an offset arrangement. This approach is not unprecedented - a similar exercise previously resulted in a successful \$2.3 million offset of outstanding obligations and accounts receivable between RepMar and several SOEs.

MEC will continue to collaborate with RepMar officials to finalize this offset arrangement, which would appropriately resolve both the tax compliance issue and reduce the outstanding receivables between government entities.