MARSHALLS ENERGY COMPANY, INC.

FINANCIAL STATEMENTS AND
ADDITIONAL INFORMATION AND
INDEPENDENT AUDITORS' REPORT

YEARS ENDED SEPTEMBER 30, 2006 AND 2005

Deloitte

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INDEPENDENT AUDITORS' REPORT

Board of Directors
Marshalls Energy Company, Inc.:

We have audited the accompanying statements of net assets of the Marshalls Energy Company, Inc. (MEC), a component unit of the Republic of the Marshall Islands, as of September 30, 2006 and 2005, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of MEC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of MEC as of September 30, 2006 and 2005, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that MEC will continue as a going concern. As discussed in Note 10 to the financial statements, MEC's recurring losses from operations and net deficiency raise substantial doubt about its ability to continue as a going concern. Management's plans concerning these matters are also described in Note 10. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

The Management's Discussion and Analysis on pages 3 through 6 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of MEC's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements of MEC taken as a whole. The accompanying Schedule of Revenues, Expenses and Changes in Net Assets by Source for the year ended September 30, 2005 (page 22) is presented for purposes of additional analysis and is not a required part of the basic financial statements of MEC. This schedule is the responsibility of MEC's management. Such information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 30, 2007, on our consideration of MEC's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Deloitte + Touche LLP

June 30, 2007

MARSHALLS ENERGY COMPANY, INC.

Management's Discussion and Analysis
Year Ended September 30, 2006

Marshalls Energy Company, Inc. (MEC) herewith presents a discussion and analysis of the company's financial performance for the financial year ended 30th September, 2006. It is to be read in conjunction with the financial statements following this section.

FINANCIAL HIGHLIGHTS

MEC's net assets decreased by $4,042,966 in 2006 compared to a decreased in net assets of $3,165,938 in 2005. This decrease occurred as a result of severe financial difficulties experienced during the entire financial year which were due mainly to a significant shortage of working capital which, in turn inhibited the company's ability to purchase sufficient quantities of fuel to supply the regular customer base that had been established in prior years. Consequently, MEC was unable to maintain the normal level of fuel sales experienced in previous years. The result was a greatly reduce revenue stream which caused an increase in the operating loss suffered for the year.

Had it not been for an increase in electricity billing revenue of $1.8 million or 19% for the year, the loss would have been substantially higher. The increase in billing revenue was due to the approval by Cabinet in October 2005, of the Pricing Template which allowed MEC to adjust electricity tariffs in line with the movements of published world oil prices, without the need to seek Cabinet approval. Increases were implemented in November 2005 and July 2006. The most significant component of generation operating costs was fuel and lubricant oils, the cost of which for the year increased by 26% or $2.3 million. Other generation operating costs actually fell by 12% or $323,000 for the year.

Non-utility revenue, of which fuel sales is the major component, decreased by a huge $4.3 million or 31% for the year. This was as a direct result of the severe shortage of working capital mentioned above, which caused a significant reduction in fuel sales.

FINANCIAL ANALYSIS

The Statement of Net Assets and the Statement of Revenues, Expenses and Changes in Net Assets provides an indication of MEC's financial condition. MEC's net assets reflect the difference between total assets and total liabilities. An increase in net assets over time normally indicates an improvement in financial condition.

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

	2006	2005	2004
Current and other assets	$ 6,991,585	$ 4,719,675	$ 5,379,672
Capital assets	10,769,790	11,526,838	12,276,709
Total assets	17,761,375	16,246,513	17,656,381
Current liabilities	8,305,482	6,549,877	4,405,685
Non-current liabilities	12,706,140	8,903,917	9,292,039
Total liabilities	21,011,622	15,453,794	13,697,724
Net assets:			
Invested in capital assets	1,865,874	2,110,951	2,495,689
Restricted	439,971	115,129	-
Unrestricted	(5,556,092)	(1,433,361)	1,462,968
Total net assets	$ (3,250,247)	$ 792,719	$ 3,958,657

MARSHALLS ENERGY COMPANY, INC.

Management's Discussion and Analysis
Year Ended September 30, 2006

Total assets increased by $1.5 million or 8% from $16,246,513 in 2005 to $17,761,375 in 2006. This is represented by an increase in cash (for fuel purchases) of $1.1 million, increase in miscellaneous equipment of $373,000, an increase in accumulated depreciation of $1.1 million, a reduction in Receivables of $155,000. Again it is pleasing to report that net accounts receivable have been reduced further to $2,256,104 in 2006 compared to $2,411,082 in 2005 and $2,940,249 million in 2004. Further reductions are anticipated in the near future even though electricity billings are increasing due to the rising world oils prices.

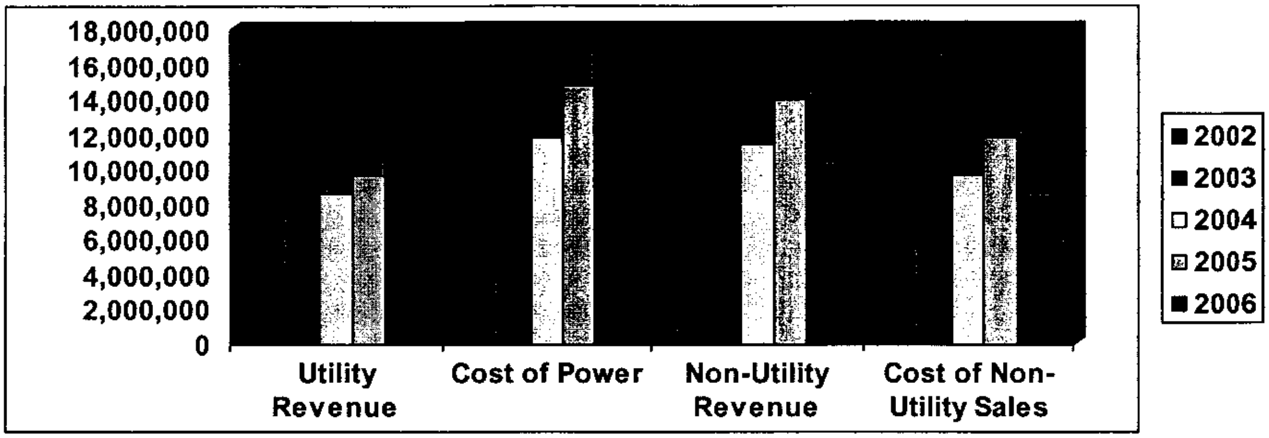
Noncurrent liabilities increases as a direct result of the debt owed to Mobil for fuel purchased in September 2005 which became the subject of a two year repayment agreement. This had the effect of converting the debt into a long-term liability. Total liabilities increased by $5.5 million primarily due to monies owing on fuel purchased.

The Statement of Revenue, Expenses and Changes in Net Assets identifies the various revenue and expense items that contributed to the change in net assets. As indicated below, MEC's total revenue decreased by $2.5 million or 11% to a total of $21,272,620 compared to $23,774,391 in 2005 and $20,125,506 in 2004. This was primarily due to the shortage in working capital which prevented the company from purchasing sufficient fuel to maintain fuel sales at levels achieved in previous years. Electricity billings increased by $1.8 million or 19% to $11,513,582 compared to $9,712,058 in 2005 and $8,619,539 in 2004. Non-Utility revenue, which is basically fuel sales, decreased by $4.3 million or 31% to $9,759,038 compared to $14,062,333 in 2005 and $11,505,967 in 2004. No compact funding was received in either 2006 or 2005. RepMar subsidies of $420,000 and $400,000 were received in 2006 from RepMar for the operation of the power stations in Jaluit and Wotje, and for assistance in purchasing fuel for the Majuro power stations.

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

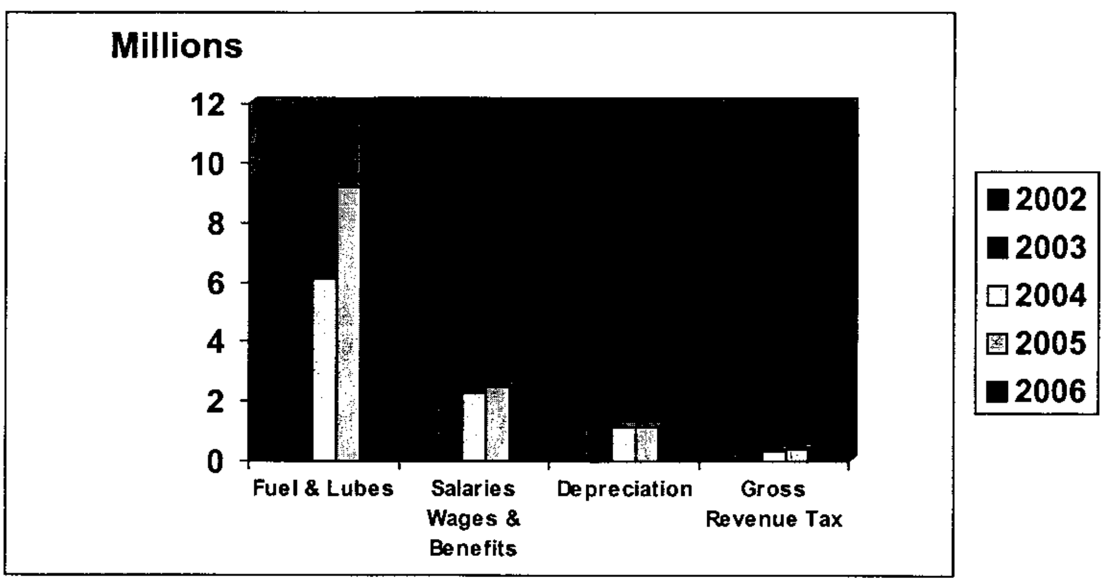
	2006	2005	2004
Revenue:			
Utility Revenue	$ 11,513,582	$ 9,712,058	$ 8,619,539
Non-Utility Revenue	9,759,038	14,062,333	11,505,967
Total Operating Revenue	21,272,620	23,774,391	20,125,506
Expenses:			
Utility Expenses	17,152,117	14,869,874	11,848,489
Non-Utility Expenses	8,014,783	11,864,242	9,655,826
Total Operating Expenses	25,166,900	26,734,116	21,504,315
Capital Contributions	650,000	400,000	173,994
RepMar Subsidy	820,000	-	-
Less Interest Expense	(1,618,686)	(606,213)	(636,616)
Change in Net Assets	$ (4,042,966)	$ (3,165,938)	$ (1,841,431)

The graphic below shows the major components of revenue for 2006 compared with 2002 through to 2005:



Total expenses decreased by $1.6 million or 7% from $26,734,116 in 2005 to $25,166,900 in 2006 compared to $21,504,315 in 2004. The main reason for this was the reduction of $4 million in the cost of sales of fuel, which was offset by the increase in the cost of fuel used for generation. The cost of fuel as a percentage of total generation operating costs rose from 77% in 2005 to 83% in 2006. This represents an increase in fuel and lube costs of $2.3 million for 2006 compared to 2005, and $5.3 million when compared to 2004. Excluding cost of sales and cost of fuel and lubricants used for generation, operating expenses decreased by $304,053 for 2006 compared to 2005. This reflects management's continuing commitment to maintain tight and effective control over expenses.

The following graphic shows the major components of operating expenses excluding the cost of fuel sold, for 2006 compared with 2002 through 2005:



CAPITAL ASSETS

Total Capital Assets before depreciation increased by $375,711 through the acquisition of miscellaneous plant and equipment amounting to $47,842 and the completion of the Mejit Solar Project totaling $327,869. The net Provision for Depreciation increased by $1,130,048 in 2006. This gives a decrease in Net Capital Assets of $757,048.

ECONOMIC FACTORS

MEC will continue to monitor operating expenses and maintain tight fiscal constraints and control over utility receivables in order to further improve cash collections and the net asset position. MEC, as a viable ongoing concern, will continue to be dependent on the financial support of RepMar in the form of:

a) timely payment by RepMar for services provided,
b) the collection of long outstanding utility receivables, and
c) continuing improvements in operations.

Even though there were two tariff increases during the year in November 2005 and July 2006, further increases have been necessary in January 2007, June 2007, and July 2007 due to the continuing escalation of world fuel prices. Despite these increases MEC has been able to maintain electricity tariffs at levels which are still about the lowest in the Pacific.

ADDITIONAL FINANCIAL INFORMATION

This discussion and analysis is designed to provide MEC's customers and other stake holders with an overview of the company's operations and financial condition as at September 30, 2006. Should the reader have questions regarding the information included in this report, or wish to request additional financial information, please contact the Marshalls Energy Company, Inc. General Manager at P.O. Box 1439, Majuro, Marshall Islands, MH96960.

MARSHALLS ENERGY COMPANY, INC.

Statements of Net Assets
September 30, 2006 and 2005

ASSETS	2006	2005
Utility plant:		
Electric plant in service	$ 19,817,904	$ 19,442,193
Construction work in progress	282,160	284,871
Total utility plant	20,100,064	19,727,064
Less accumulated depreciation and amortization	(9,385,176)	(8,263,816)
Net utility plant	10,714,888	11,463,248
Other assets:		
Nonutility property	181,862	181,862
Less accumulated depreciation	(126,960)	(118,272)
Nonutility property, net	54,902	63,590
Restricted cash	195,000	-
Current assets:		
Cash and cash equivalents	1,842,380	712,274
Accounts receivable:		
Electricity	2,851,006	2,979,131
Affiliates	1,257,353	1,100,697
Other	268,532	444,837
Total accounts receivable	4,376,891	4,524,665
Less allowance for uncollectible accounts	(2,120,787)	(2,113,583)
Net accounts receivable	2,256,104	2,411,082
Materials and supplies	2,663,490	1,585,628
Prepayments	34,611	10,691
Total current assets	6,796,585	4,719,675
Total assets	$ 17,761,375	$ 16,246,513

See accompanying notes to financial statements.

MARSHALLS ENERGY COMPANY, INC.

Statements of Net Assets, Continued
September 30, 2006 and 2005

LIABILITIES AND NET ASSETS (DEFICIT)	2006	2005
Net assets (deficit):		
Invested in capital assets, net of related debt	$ 1,865,874	$ 2,110,951
Restricted	439,971	115,129
Unrestricted	(5,556,092)	(1,433,361)
Total net assets (deficit)	(3,250,247)	792,719
Commitment and contingencies		
Long-term debt	12,706,140	8,903,917
Current liabilities:		
Short-term debt	3,000,000	-
Current portion of long-term debt	2,934,062	511,970
Accounts payable	128,463	5,526,789
Payable to affiliates	1,187,375	56,073
Accrued taxes	178,589	29,772
Other current and accrued liabilities	876,993	425,273
Total current liabilities	8,305,482	6,549,877
Total net assets and liabilities	$ 17,761,375	$ 16,246,513

See accompanying notes to financial statements.

MARSHALLS ENERGY COMPANY, INC.

Statements of Revenues, Expenses and Changes in Net Assets (Deficit)
Years Ended September 30, 2006 and 2005

	2006	2005
Utility operations:		
Operating revenues	$ 11,513,582	$ 9,712,058
Operating expenses:		
Cost of power	13,341,441	11,178,752
Administrative and general	1,380,853	1,461,846
Depreciation and amortization	1,088,841	1,089,242
Distribution operations	893,650	977,161
Taxes	291,318	240,290
Distribution maintenance	148,810	101,530
Consumer accounts	7,204	71,053
Total operating expenses	17,152,117	15,119,874
Operating loss from utility operations	(5,638,535)	(5,407,816)
Nonutility operations:		
Operating revenues:		
Fuel and gas sales	9,500,398	13,882,183
Other	258,640	180,150
Total operating revenues	9,759,038	14,062,333
Operating expenses:		
Cost of sales	7,175,688	11,231,959
Other	839,095	632,283
Total operating expenses	8,014,783	11,864,242
Operating income from nonutility operations	1,744,255	2,198,091
Operating loss	(3,894,280)	(3,209,725)
Nonoperating income (expense):		
RepMar subsidy	820,000	-
Interest expense	(1,618,686)	(606,213)
Bad debt recovery	-	250,000
Total nonoperating (expense) income, net	(798,686)	(356,213)
Capital contributions	650,000	400,000
Change in net assets	(4,042,966)	(3,165,938)
Net assets at beginning of year	792,719	3,958,657
Net assets (deficit) at end of year	$ (3,250,247)	$ 792,719

See accompanying notes to financial statements.

MARSHALLS ENERGY COMPANY, INC.

Statements of Cash Flows
Years Ended September 30, 2006 and 2005

	2006	2005
Cash flows from operating activities:		
Cash received from customers	$ 21,420,294	$ 24,482,505
Cash payments to suppliers for goods and services	(21,140,321)	(21,569,939)
Cash payments to employees for services	(2,028,534)	(2,108,855)
Net cash (used for) provided by operating activities	(1,748,561)	803,711
Cash flows from noncapital financing activities:		
Subsidy from RepMar	820,000	-
Proceeds from short-term borrowing and long-term debt	5,000,000	-
Principal paid on long-term debt	(1,019,010)	-
Interest paid on short-term borrowings and long-term debt	(909,229)	-
Net cash provided by noncapital financing activities	3,891,761	-
Cash flows from capital and related financing activities:		
Capital contributions	650,000	400,000
Acquisition and construction of capital assets	(373,000)	(379,882)
Principal paid on long-term debt (RUS)	(511,971)	(365,133)
Interest paid on long-term debt (RUS)	(583,123)	(456,285)
Net cash used for capital and related financing activities	(818,094)	(801,300)
Net change in cash and cash equivalents	1,325,106	2,411
Cash and cash equivalents at beginning of year	712,274	709,863
Cash and cash equivalents at end of year	$ 2,037,380	$ 712,274
Reconciliation of operating loss to net cash (used for) provided by operating activities:		
Operating loss	$ (3,894,280)	$ (3,209,725)
Adjustments to reconcile operating loss to net cash (used for) provided by operating activities:		
Depreciation and amortization	1,130,048	1,129,753
Provision for uncollectible accounts receivable	7,204	71,053
(Increase) decrease in assets:		
Accounts receivable:		
Electricity	128,125	197,017
Affiliates	(156,656)	(10,303)
Other	176,305	521,400
Materials and supplies	(1,077,862)	121,420
Prepayments	(23,920)	11,821
Increase (decrease) in liabilities:		
Accounts payable	159,811	2,114,353
Payable to affiliates	1,131,302	(2,672)
Accrued taxes	148,817	(30,244)
Other current and accrued liabilities	522,545	(110,162)
Net cash (used for) provided by operating activities	$ (1,748,561)	$ 803,711

See accompanying notes to financial statements.

MARSHALLS ENERGY COMPANY, INC.

Statements of Cash Flows, Continued
Years Ended September 30, 2006 and 2005

	2006	2005
Summary disclosure of noncash activities:		
Transfer of accounts payable to long-term debt		
Accounts payable	$ (5,558,137)	$ -
Accrued interest	(197,159)	-
Long-term debt	5,755,296	-
	$ -	$ -
Transfer of completed projects to utility plant		
Solar power systems	$ 327,869	$ -
Construction work-in progress	(327,869)	-
	$ -	$ -

See accompanying notes to financial statements.

MARSHALLS ENERGY COMPANY, INC.

Notes to Financial Statements
September 30, 2006 and 2005

(1) Organization

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

MEC's articles of incorporation have authorized the issuance of 100,000 shares of $1 par value common stock. RepMar owns 75,000 of these shares and MEC retains the remaining 25,000 shares in treasury. These amounts are included in unrestricted net assets in the accompanying statements of net assets.

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

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

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

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

(2) Summary of Significant Accounting Policies

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

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

(2) Summary of Significant Accounting Policies, Continued

GASB issued Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, which was subsequently amended by Statement No. 37, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, and modified by Statement No. 38, *Certain Financial Statement Disclosures*. These statements establish financial reporting standards for governmental entities which require that management's discussion and analysis of the financial activities be included with the basic financial statements and notes and modifies certain other financial statement disclosure requirements.

To conform to the requirements of GASB 34, equity is presented in the following net asset categories:

- Invested in capital assets - capital assets, net of accumulated depreciation and related debt, plus construction or improvement of those assets.
- Restricted net assets - resources in which MEC is legally or contractually obligated to spend resources in accordance with restrictions either externally imposed by creditors, grantors, contributors, and the like, or imposed by law.
- Unrestricted; net assets that are not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action of management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

Estimates

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

Basis of Accounting

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

Cash and Cash Equivalents

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

(2) Summary of Significant Accounting Policies, Continued

Cash and Cash Equivalents, Continued

For purposes of the statements of net assets and cash flows, cash and cash equivalents is defined as cash on hand, cash held in demand accounts, and time certificates of deposit maturing within ninety days. As of September 30, 2006 and 2005, cash and cash equivalents are $2,037,380 and $712,274, respectively, and the corresponding bank balances are $1,983,991 and $389,697, respectively. Of bank balances as of September 30, 2006 and 2005, $1,981,399 and $387,105, respectively, are maintained in one financial institution subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2006 and 2005, bank deposits in the amount of $100,000 are FDIC insured. MEC does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk.

Receivables

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

Materials and Supplies

Fuel and supplies are valued at the lower of cost (first-in, first-out) or market (net realizable value). Bulk fuel inventories held on consignment for power plant use and for resale are not reflected in the accompanying statements of net assets.

Plant and Nonutility Property

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

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

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

(2) Summary of Significant Accounting Policies, Continued

Restricted Net Assets

During the years ended September 30, 2006 and 2005, MEC received from RepMar $650,000 and $400,000, respectively, for installation of solar power systems in the outer islands. At September 30, 2006 and 2005, the unspent portion of these funds was $439,971 and $115,129, respectively.

New Accounting Standards

During fiscal year 2006, the MEC implemented the following pronouncements:

- GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, which establishes standards for impairment of capital assets when service utility has declined significantly and unexpectedly.
- GASB Statement No. 44, *Economic Condition Reporting: The Statistical Section, an amendment to NCGA Statement 1,* which improves the understandability and usefulness of statistical section information and adds information from the new financial reporting model for state and local governments required by GASB Statement No. 34.
- GASB Statement No. 46, *Net Assets Restricted by Enabling Legislation (an amendment to GASB Statement No. 34)*, which requires that limitations on the use of net assets imposed by enabling legislation be reported as restricted net assets.
- GASB Statement No. 47, *Accounting for Termination of Benefits*, which establishes guidance for state and local governmental employers on accounting and financial reporting for termination of benefits.
- GASB Technical Bulletin No. 2004-2, *Recognition of Pension and Other Postemployment Benefits Expenditures/Expense and Liabilities by Cost-Sharing Employers*, which clarifies the requirements of GASB Statement Nos. 27 and 45 for recognition of pension and other postemployment benefit expenditures/expense and liabilities by cost-sharing employers.

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

In April 2004, GASB issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which establishes uniform financial reporting for other postemployment benefit plans by state and local governments. The provisions of this Statement are effective for periods beginning after December 15, 2007. Management does not believe that the implementation of this Statement will have a material effect on the financial statements of MEC.

In June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, which establishes standards for the measurement, recognition, and display of other post employment benefits expense/expenditures and related liabilities, note disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employers. The provisions of this Statement are effective for periods beginning after December 15, 2008. Management does not believe that the implementation of this Statement will have a material effect on the financial statements of MEC.

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In September 2006, GASB issued Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfer of Assets and Future Revenues*. GASB Statement No. 48 establishes criteria that governments will use to ascertain whether certain transactions should be regarded as a sale or a collateralized borrowing. The statement also includes a provision that stipulates that governments should not revalue assets that are transferred between financial reporting entity components. The provisions of this Statement are effective for periods beginning after December 15, 2006. Management does not believe that the implementation of this statement will have a material effect on the financial statements of MEC.

Reclassifications

Certain reclassifications have been made to the 2005 financial statements in order to conform with the 2006 presentation.

(3) Restricted Cash

MEC has restricted a reserve cash deposit as of September 30, 2006 and 2005 in the amount of $195,000 and $0, respectively; that collateralizes a $2,000,000 loan. The loan requires MEC to establish a restricted reserve account in an amount of not less than three months of loan payments.

(4) Materials and Supplies

Materials and supplies at September 30, 2006 and 2005, consist of the following:

	2006	2005
Distribution and power plant supplies	$ 1,331,978	$ 1,513,312
Lubricants	31,345	54,629
Fuel	1,300,167	17,687
	$ 2,663,490	$ 1,585,628

(5) Capital Assets

Capital asset activity for the years ended September 30, 2006 and 2005, was as follows:

	2006			
	October 1, 2005	Additions	Deletions	September 30, 2006
Utility Plant:				
Power plant engines	$ 14,720,739	$ -	$ -	$ 14,720,739
Plant and machinery	1,787,661	22,011	-	1,809,672
Vehicles	868,421	20,000	-	888,421
Leasehold improvements	641,012	-	-	641,012
Residences	548,284	-	-	548,284
Fences and seawalls	371,702	-	-	371,702
Leasehold land	330,000	-	-	330,000
Solar power systems	-	327,869	-	327,869
Furniture and fixtures	174,374	5,831	-	180,205

(5) Capital Assets, Continued

	2006			
	October 1, 2005	Additions	Deletions	September 30, 2006
Nonutility Plant:				
LPG terminal	181,862	-	-	181,862
	19,624,055	375,711	-	19,999,766
Less accumulated depreciation	(8,382,088)	(1,130,048)	-	(9,512,136)
	11,241,967	(754,337)	-	10,487,630
Construction work-in-progress	284,871	325,158	(327,869)	282,160
	$ 11,526,838	$ (429,179)	$ (327,869)	$ 10,769,790

	2005			
	October 1, 2004	Additions	Deletions	September 30, 2005
Utility Plant:				
Power plant engines	$ 14,720,739	$ -	$ -	$ 14,720,739
Plant and machinery	1,674,494	113,167	-	1,787,661
Vehicles	833,721	34,700	-	868,421
Leasehold improvements	641,012	-	-	641,012
Residences	548,284	-	-	548,284
Fences and seawalls	371,702	-	-	371,702
Leasehold land	330,000	-	-	330,000
Furniture and fixtures	172,472	1,902	-	174,374
Nonutility Plant:				
LPG terminal	181,862	-	-	181,862
	19,474,286	149,769	-	19,624,055
Less accumulated depreciation	(7,252,335)	(1,129,753)	-	(8,382,088)
	12,221,951	(979,984)	-	11,241,967
Construction work-in-progress	54,758	230,113	-	284,871
	$ 12,276,709	$ (749,871)	$ -	$ 11,526,838

(6) Taxes Payable

Pursuant to the Income Tax Act of 1989, as amended by the Income Tax Amendment Act of 1991, sales of electricity by public utility companies are exempt from gross revenue tax. Accordingly, MEC is required to pay gross revenue tax on all revenue with the exception of electricity sales at the rate of 3%. As of September 30, 2006 and 2005, MEC is liable for gross revenue tax to RepMar amounting to $148,130 and $40,820, respectively.

Pursuant to the Import Duties Act of 1989, as amended by the Import Duties (Amendment) Act of 1996, MEC is exempted from import duties. Pursuant to the Import Duties (Amendment) Act, 2005, no import duty shall be levied on residual fuel oils and diesel oil imported by MEC solely for the purpose of power generation. MEC is, however, required to pay import duty on diesel oil imported for resale.

(7) Short-Term Debt

Represents a ninety-day promissory note drawn on a $3 million bank line of credit, with interest at 2.5% over the bank reference rate and guaranteed unconditionally by RepMar. Notes outstanding as of September 30, 2006 and 2005 were $3,000,000 and $0, respectively.

The change in short-term debt for the year ended September 30, 2006, is as follows:

Beginning of Year	Additions	Payments	End of Year
$ -	$ 8,500,000	$ 5,500,000	$ 3,000,000

The line was not utilized during the year ended September 30, 2005.

(8) Long-Term Debt

Long-term debt at September 30, 2006 and 2005, is as follows:

	2006	2005
On November 18, 1997, MEC entered into a loan agreement with the Federal Financing Bank (FFB) in the amount of $12.5 million for the construction of a new power plant, with loan repayments guaranteed by the Rural Utilities Service (RUS). MEC is required to submit drawdown requests to RUS for approval of loan advances. Interest rates are calculated based on the FFB rates at the date of the loan advances and range from 5.49% to 7.25% per annum. Principal and interest are payable in quarterly installments of $273,770 through January 2, 2018. The mortgage notes have been unconditionally guaranteed by RepMar, under which RepMar will make debt service payments to RUS in the event of default by MEC, and have been collateralized by a leasehold mortgage and security agreement over the assets of MEC. These notes are subject to certain coverage ratio requirements. MEC is not in compliance with these ratio requirements as of September 30, 2006 and 2005.	$ 8,903,916	$ 9,415,887
On April 28, 2006, MEC entered into a debt repayment agreement with a fuel company for unpaid invoices including related interest in the amount of $5,755,296, with interest at 18%. Originally, principal and interest are payable in 6 monthly equal payments of $200,000 and in 18 monthly payments of $322,307. $3,210,664 of this debt was refinanced through acquisition of a $12 million loan on May 25, 2007 (see note 12).	5,090,475	-

(8) Long-Term Debt, Continued

	2006	2005
On January 13, 2006, MEC entered into a bank loan of $2 million for purchase of diesel fuel. Interest is calculated at 2.5% over the bank's reference rate adjusted on the first day of the month following a change. The minimum reference rate is 7.5% per annum. During fiscal year 2006, interest rates ranged from 10% to 10.75% per annum. Principal and interest are payable in monthly equal payments of $64,500 to January 10, 2009. The note has been unconditionally guaranteed by RepMar, under which the bank shall exercise a lien upon and right of set-off against money, securities, deposits and property of RepMar in possession of the bank in the event of default. A portion of this note, in the amount of $1,226,490, was subsequently refinanced through acquisition of a $12 million loan on May 25, 2007 (see note 12).	1,645,811	-
	15,640,202	9,415,887
Less current installments	(2,934,062)	(511,970)
Long-term debt	$ 12,706,140	$ 8,903,917

Changes in long-term debt during the years ended September 30, 2006 and 2005 are as follows:

2006

Long-Term Debt:	Balance October 1, 2005	Additions	Reductions	Balance September 30, 2006	Balance due in One Year
RUS loan	$ 9,415,887	$ -	$ 511,971	$ 8,903,916	$ 550,389
Fuel vendor debt	-	5,755,296	664,821	5,090,475	1,940,984
Commercial bank loan	-	2,000,000	354,189	1,645,811	442,689
	$ 9,415,887	$ 7,755,296	$ 1,530,981	$ 15,640,202	$ 2,934,062

2005

Long-Term Debt:	Balance October 1, 2004	Additions	Reductions	Balance September 30, 2005	Balance due in One Year
RUS loan	$ 9,781,020	$ -	$ 365,133	$ 9,415,887	$ 511,970

MEC has presented future debt maturities in accordance with the Financial Accounting Standard No.6, *Classification of Short-Term Obligations Expected to be Refinanced.*

Annual repayment requirements to maturity for principal and interest under the provision of existing RUS requirements and the loan specified in Note 12 are as follows:

Year ending September 30,	Principal	Interest	Total
2007	$ 2,934,062	$ 1,292,109	$ 4,226,171
2008	1,082,698	980,835	2,063,533
2009	1,017,765	787,273	1,805,038
2010	4,272,740	644,455	4,917,195
2011	711,396	383,697	1,095,093
2012-2016	4,310,299	1,165,182	5,475,481
2017-2018	1,311,242	62,933	1,374,175
	$ 15,640,202	$ 5,316,484	$ 20,956,686

(9) Related Party Transactions

MEC is wholly-owned by RepMar and is therefore affiliated with all RepMar-owned and affiliated entities. RepMar subscribes for electricity generated by MEC and is charged for electricity usage using the same rates as those charged to commercial establishments tariff rate. 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.

Total transactions for the years ended September 30, 2006 and 2005, and the related receivables from and payables to affiliates, are as follows:

	2006			
	Revenues	Expenses	Receivables	Payables
RepMar	$ 1,636,398	$ 609,458	$ 200,817	$1,076,366
Majuro Water and Sewer Company, Inc.	269,562	7,038	770,960	462
Marshall Islands Social Security Administration	54,080	224,807	11,944	110,470
Majuro Resort, Inc.	315,075	4,175	89,613	77
Other	1,570,719	133,825	184,019	-
	$ 3,845,834	$ 979,303	$ 1,257,353	$1,187,375

	2005			
	Revenues	Expenses	Receivables	Payables
RepMar	$ 2,641,052	$ 585,992	$ 292,627	$ 16,058
Majuro Water and Sewer Company, Inc.	220,412	14,575	524,410	502
Marshall Islands Social Security Administration	28,253	159,511	2,664	36,427
Majuro Resort, Inc.	287,073	26,095	73,898	505
Other	1,135,293	53,847	207,098	2,581
	$ 4,312,083	$ 840,020	$ 1,100,697	$ 56,073

For the years ended September 30, 2006 and 2005, MEC received capital contributions from RepMar of $650,000 and $400,000, respectively. During the years ended September 30, 2006 and 2005, MEC received operating subsidies from RepMar of $820,000 and $0, respectively.

As of September 30, 2006 and 2005, MEC maintained a demand deposit account with an affiliated financial institution of $2,592.

(10) Commitment and Contingencies

Commitment

During the year ended September 30, 2005, MEC purchased petroleum products from Mobil Oil Micronesia, Inc. (Mobil) on a consignment basis whereby Mobil continued to hold ownership and title to the product while it is held in storage at the MEC terminal storage tanks. Title and risk on the product remained with Mobil until the product passed the boundary of the MEC terminal. The value of consignment petroleum products as of September 30, 2005 approximates $6,570,189. MEC assumed responsibility for the proper and safe storage/handling of the product while under MEC storage. However, MEC carried insurance coverage on such consignment inventories. As of September 30, 2006, the forgoing arrangement was discontinued.

(10) Commitment and Contingencies, Continued

Contingencies

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplates the continuation of MEC as a going concern. However, MEC has sustained substantial operating losses in recent years. In addition, MEC has used a substantial amount of working capital in its operations. Further, at September 30, 2006, current liabilities exceeded current assets by $1,508,897, and total liabilities exceed total assets by $3,250,247. Management acknowledges that it is currently dependent on RepMar and its affiliates to pay for actual services rendered in order to maintain MEC as a going concern. Should RepMar and its affiliates choose to discontinue payment for services rendered, MEC management may have to consider alternative measures including, among other possibilities, an increase in electricity and fuel rates to maintain MEC as a going concern.

In view of these matters, realization of a major portion of the assets in the accompanying statement of net assets at September 30, 2006, is dependent upon continued operations of MEC, which in turn is dependent upon MEC's ability to meet its future debt service requirements, and the success of future operations. Management believes that actions presently being taken to revise MEC's operating requirements, which include entering into new fuel supply contracts with fishing companies, aggressively collecting past due accounts, and maintaining the approved pricing template allowing MEC to automatically adjust tariffs for movements in world oil prices, provide the opportunity for MEC to continue as a going concern.

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 because management believes that no unfavorable outcome is likely to occur.

(11) Risk Management

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

(12) Subsequent Events

On May 25, 2007 obtained a $12 million, 10-year amortization, 3-year maturity term loan. The proceeds will be used to pay off the balance of debt owed a fuel supplier and due to a commercial bank and for working capital purposes. A guarantee of this debt has been provided by RepMar.

MEC increased electricity tariff rates effective January 1, 2007 and June 1, 2007.

On October 27, 2006 and March 15, 2007, MEC received advances from RepMar in the amount of $1,000,000 and $1,730,000, respectively, for purchases of fuel.

MARSHALLS ENERGY COMPANY, INC.

Schedule of Revenues, Expenses and Changes in Net Assets by Source
Year Ended September 30, 2006
(With comparative information for the year ended September 30, 2005)

	Generation	Distribution	Contracts	Tank Farm	Jaluit	Wotje	Namdrik	Mejit	Wodmej	Wotho	MEC-Gas	Admin - istration	Totals 2006	Totals 2005
Operating revenues:														
Fuel and gas sales	$ -	$ -	$ -	$ 9,052,371	$ -	$ -	$ -	$ -	$ -	$ -	$ 448,027	$ -	$ 9,500,398	$ 13,882,183
Cost of sales	-	-	-	(7,010,751)	-	-	-	-	-	-	(164,937)	-	(7,175,688)	(11,231,959)
Gross profit on sales	-	-	-	2,041,620	-	-	-	-	-	-	283,090	-	2,324,710	2,650,224
Electric and service billings	11,317,676	11,107	-	-	112,161	67,887	2,855	1,896	-	-	-	-	11,513,582	9,712,058
Other income	4,434	84,198	10,800	64,489	19,333	120	2,251	240	3,700	-	851	68,224	258,640	180,150
Total operating revenues, net	11,322,110	95,305	10,800	2,106,109	131,494	68,007	5,106	2,136	3,700	-	283,941	68,224	14,096,932	12,542,432
Operating expenses:														
Fuel and lubricants	11,245,750	-	-	-	453,851	23,076	-	-	-	-	-	-	11,722,677	9,179,569
Salaries, wages and benefits	919,895	470,930	4,050	106,481	191,664	134,821	2,837	378	-	-	38,473	604,342	2,473,871	2,478,847
Repairs and supplies	388,749	524,276	-	82,981	23,367	12,281	298	250	-	-	38,163	47,901	1,118,266	1,413,512
Depreciation and amortization	825,627	104,076	-	31,740	8,736	-	-	21,858	-	-	9,468	105,468	1,106,973	1,129,755
Gross revenue tax	132	177	-	273,810	553	-	-	-	-	-	13,687	-	288,359	414,658
Freight	46,356	28,403	-	60,349	1,818	27,944	15	-	-	-	108,046	11,839	284,770	211,562
Diesel import tax	-	-	-	269,668	-	-	-	-	-	-	-	-	269,668	171,334
Insurance	47,906	17,784	-	26,225	6,256	6,752	412	-	-	-	3,127	13,260	121,722	167,339
Office	22,671	5,995	-	3,839	11,154	792	32	-	-	-	4,234	88,714	137,431	146,720
Bad debts	-	-	-	-	-	-	-	-	-	-	-	7,204	7,204	71,053
Travel	10,896	1,002	-	-	-	-	-	-	-	-	-	35,369	47,267	57,098
Staff training	-	-	-	-	-	-	-	-	-	-	-	67,814	67,814	53,694
Professional fees	-	-	-	-	-	-	-	-	-	-	-	16,544	16,544	53,063
Communications	5,961	4,372	-	463	-	-	-	-	-	-	906	38,483	50,185	41,555
Entertainment	-	-	-	-	-	-	-	-	-	-	-	14,394	14,394	30,852
Laundry and uniforms	19,525	5,630	-	-	-	2,717	-	-	-	-	-	3,172	31,044	30,088
Equipment rental	18,253	-	-	-	-	-	-	-	-	-	-	-	18,253	15,038
Import tax	11,005	10,713	-	-	-	-	-	-	-	-	12,060	-	33,778	-
Advertising	-	-	-	-	-	-	-	-	-	-	-	-	-	6,389
Customer claims	-	-	-	-	-	-	-	-	-	-	-	-	-	3,337
Bank charges	-	-	-	-	-	-	-	-	-	-	-	106,075	106,075	-
Miscellaneous	4,558	-	-	5,000	15,433	6,475	-	-	-	-	-	43,451	74,917	76,694
Total operating expenses	13,567,284	1,173,358	4,050	860,556	712,832	214,858	3,594	22,486	-	-	228,164	1,204,030	17,991,212	15,752,157
Operating income (loss)	(2,245,174)	(1,078,053)	6,750	1,245,553	(581,338)	(146,851)	1,512	(20,350)	3,700	-	55,777	(1,135,806)	(3,894,280)	(3,209,725)
Nonoperating income (expense):														
RepMar Subsidies	400,000	-	-	-	210,000	210,000	-	-	-	-	-	-	820,000	-
Interest expense	(580,722)	-	-	-	-	-	-	-	-	-	-	(1,037,964)	(1,618,686)	(606,213)
Bad debt recovery	-	-	-	-	-	-	-	-	-	-	-	-	-	250,000
Total nonoperating income (expense), net	(180,722)	-	-	-	210,000	210,000	-	-	-	-	-	(1,037,964)	(798,686)	(356,213)
Capital contributions	-	-	-	-	-	-	-	-	400,000	250,000	-	-	650,000	400,000
Change in net assets	$(2,425,896)	$ (1,078,053)	$ 6,750	$ 1,245,553	$ (371,338)	$ 63,149	$ 1,512	$ (20,350)	$ 403,700	$ 250,000	$ 55,777	$ (2,173,770)	$ (4,042,966)	$ (3,165,938)

See accompanying independent auditors' report.