MARSHALLS ENERGY COMPANY, INC.

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

FINANCIAL STATEMENTS AND ADDITIONAL INFORMATION AND INDEPENDENT AUDITORS' REPORT

YEARS ENDED SEPTEMBER 30, 2008 AND 2007

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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, 2008 and 2007, and the related statements of revenues, expenses and changes in net deficiency and of 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, 2008 and 2007, and the changes in its net deficiency 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 8 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 8. 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 7 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 Deficiency by Source for the year ended September 30, 2008 (page 23) 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 for the year ended September 30, 2008 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 May 21, 2009, on our consideration of MEC's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on 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

May 21, 2009

MARSHALLS ENERGY COMPANY, INC.

Management's Discussion and Analysis
Years Ended September 30, 2008 and 2007

Marshalls Energy Company, Inc. (MEC) herewith presents a discussion and analysis of the Company's financial performance for the financial year ended 30th September, 2008. It is to be read in conjunction with the financial statements following this section.

FINANCIAL HIGHLIGHTS

MEC's net assets decreased by $4.10 million in 2008 compared to a decrease in net assets of $3.63 million in 2007. This decrease occurred as a result of continued financial difficulties experienced during the financial year which were due mainly to a significant shortage of working capital exacerbated by the unprecedented increases in world oil prices. These factors had the effect of inhibiting the Company's ability to purchase sufficient quantities of fuel to supply the regular customer base that had been established in prior years. Utility revenue increased by $4.96 million while non-utility revenue, of which fuel sales is the major component, increased by $4.66 million. Even though fuel sales increased in volume and value in 2008 compared to 2007, gross margins were reduced due to the increased competition on the high seas for sales.

The increase in billing revenue was facilitated by the approval by Cabinet in October 2005, of the Pricing Template which allows MEC to automatically adjust electricity tariffs in line with the movements of published world oil prices, without the need to seek Cabinet approval. MEC was able to continue increasing the price of electricity to cover the increased cost of fuel used in generation. Increases were made in December 2007, March 2008, April 2008 and June 2008. The effect of the increase meant a corresponding increase in electricity revenue of 36%. At the same time, the increases in fuel costs meant an increase in fuel and lubricant costs used for generation of 34.4%. The most significant component of generation operating costs continued to be fuel and lubricants, the 2008 cost of which represented 83% of total generation costs compared to 81% in 2007. Fuel and lubricants accounted for $3.88 million of the $3.90 million increase in the total cost of generation for 2008.

FINANCIAL ANALYSIS OF MEC

The Statement of Net Assets and the Statement of Revenues, Expenses and Changes in Net Deficiency 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. As illustrated in the figures below, MEC's net assets declined again for the year ended 30th September 2008. However, due to the rapid decline in world fuel prices experienced from October 2008, it is projected that the recent history of declining net asset value will slow and possibly begin to increase.

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

	2008	2007	2006
Current and other assets	$ 9,073,480	$ 10,689,710	$ 6,991,585
Capital assets	9,479,186	9,925,415	10,769,790
Total assets	18,552,666	20,615,125	17,761,375
Current liabilities	13,142,299	9,302,997	8,305,482
Non-current liabilities	16,389,299	18,194,956	12,706,140
Total liabilities	29,531,598	27,497,953	21,011,622
Net assets:			
Invested in capital assets, net of related debt	1,783,922	1,631,202	1,865,874
Restricted	-	373,056	439,971
Unrestricted	(12,762,854)	(8,887,086)	(5,556,092)
Total net assets	$ (10,978,932)	$ (6,882,828)	$ (3,250,247)

Total assets decreased by $2.06 million or 10% from $20,615,125 in 2007 to $18,552,666 in 2008. The decrease is primarily due to the decrease in cash balances of $2.95 million. Net cash used for operating activities and capital and related financing activities amounted to $6.26 million and $1.71 million, respectively. This was partially offset by net cash provided by noncapital financing activities of $5.02 million, resulting in an overall decrease in cash balances of $2.95 million.

Total liabilities increased by $2.03 million (7%) compared to the increase experienced in 2007 of $6.4 million (31%). Most of the increase is represented by the increases in balance owing for advances from RepMar of $4.42 million and the increase in accounts payable of $0.36 million. Changes in MEC's long-term debt are further discussed in note 6 to the financial statements. The increase was offset by the decrease in long term debt owed to RUS and the Bank of Guam of $1.6 million and the decrease in accrued repair costs for Power Plant I of $.99 million.

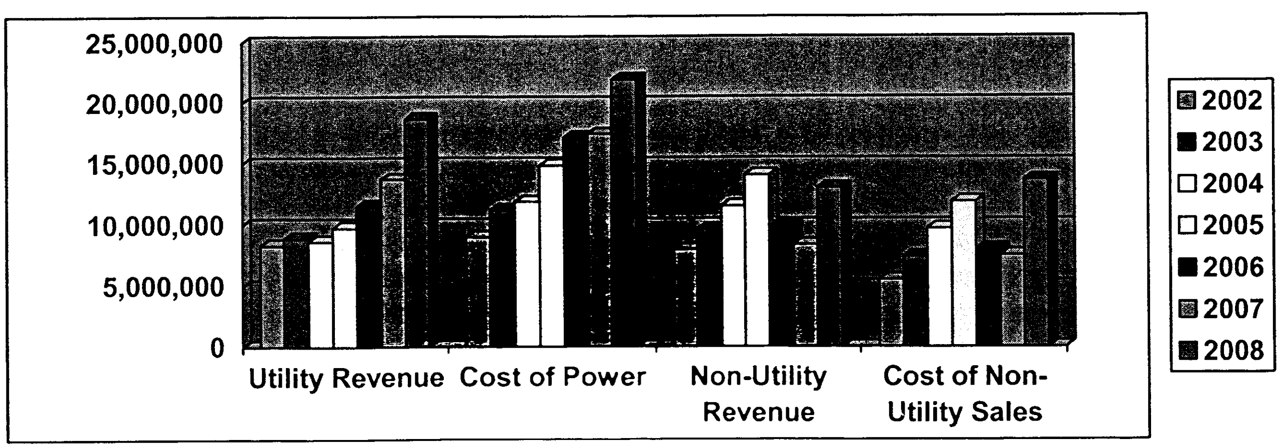
The Statement of Revenue, Expenses and Changes in Net Deficiency identifies the various revenue and expense items that contributed to the change in net assets. MEC's total revenue increased significantly in 2008 by $9.61 million to a total of $31,709,720 compared to $22,097,840 in 2007 and $21,272,620 in 2006. This was due to the significant increase in world fuel prices which were necessarily passed on to both electricity and fuel customers in the form of higher prices. Electricity billings increased by $4.96 million from $13.73 million in 2007 to $18.69 million, a 36% increase in 2008. Non-Utility revenue, which is mainly fuel sales, increased by $4.66 million or 56% to $13,018,799 from $8,363,152 in 2007 and $9,759,038 in 2006. No Compact funding was received in 2008, 2007 or 2006. Operating subsidies of $355,618 were received in 2008 compared to $874,250 in 2007 and $820,000 in 2006.

The operating loss before capital contributions for 2008 of $2,943,881 was almost identical to 2007 increasing by only $48,343 for the year. Operating subsidies were reduced from $874,250 in 2007 ($820,000 in 2006) to $355,618 in 2008 and interest expense reduced from $1,611,293 in 2007 ($1,618,686 in 2006) to $1,507,841 in 2008. The $463,523 increase in net loss in 2008 compared to 2007 is explained by the reduction in operating subsidies of $518,632.

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

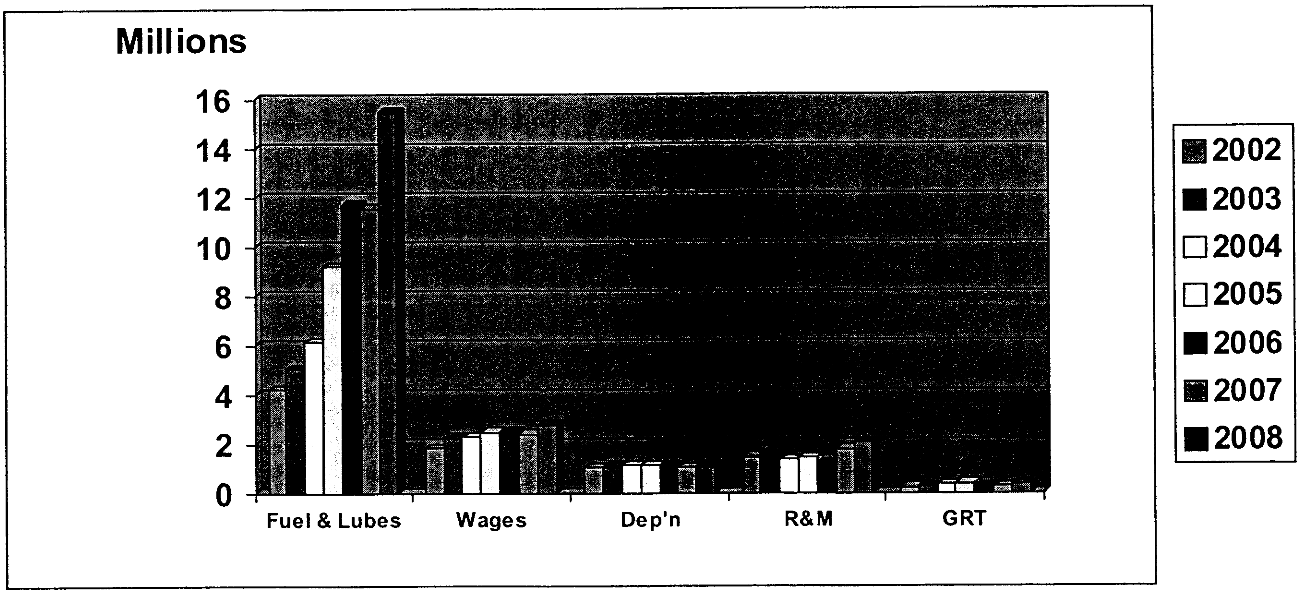
	2008	2007	2006
Revenue:			
Utility revenue	$ 18,690,921	$ 13,734,688	$ 11,513,582
Non-utility revenue	13,018,799	8,363,152	9,759,038
Total revenue	31,709,720	22,097,840	21,272,620
Expenses:			
Utility expenses	21,967,695	17,465,012	17,152,117
Non-utility expenses	12,685,906	7,528,366	8,014,783
Total expenses	34,653,601	24,993,378	25,166,900
Income (loss) before capital contributions	(2,943,881)	(2,895,538)	(3,894,280)
Interest expense	(1,507,841)	(1,611,293)	(1,618,686)
Capital contributions	-	-	650,000
RMI operating subsidy	355,618	874,250	820,000
Change in net assets	$ (4,096,104)	$ (3,632,581)	$ (4,042,966)

The graphic below shows the major components of revenue from 2002 through to 2008:



Total expenses increased from $25.17 million in 2006 and $24.99 million in 2007 to $34.65 in 2008 due almost entirely to increased fuel costs. The cost of fuel as a percentage of total generation operating costs rose from 81% in 2007 to 83% in 2008. Total fuel costs for generation did not increase proportionately to the price increases due to the reduction in fuel consumption for generation because customers used less electricity due to the higher tariffs. The cost of fuel and lubricants used for generation increased to $15.45 million in 2008 compared to $11.55 million in 2007 and $11.69 million in 2006.

The following graphic shows the major components of operating expenses excluding the cost of fuel sold, from 2002 through to 2008:



CASH FLOW

Net cash used for operating activities for 2008 was $6.26 million compared to $3.50 million in 2007 and $1.7 million in 2006. As illustrated in the above graph, most of the cash was used to pay for fuel purchases. The source of cash used for fuel purchases was supplemented by cash advances from June 2008 onwards totaling $6.7 million received from RepMar. Of this amount, $758,590 was for advance payment of two months of government electricity bills. As of April 30, 2009, $2.5 million had been repaid to RepMar by way of offsets against government electricity bills.

CAPITAL ASSETS

Total capital assets before depreciation increased by $641,473 mainly as a result of MEC's continued investment in alternative energy systems, namely solar power, which represented $476,621 in 2008 additions. For additional information concerning capital assets, please refer to note 4 to the financial statements.

MARSHALLS ENERGY COMPANY, INC.

Management's Discussion and Analysis
Years Ended September 30, 2008 and 2007

Management's Discussion and Analysis for the year ended September 30, 2007 is set forth in the report on the audit of MEC's financial statements, which is dated May 16, 2008. That Discussion and Analysis explains the major factors impacting the 2007 financial statements.

ECONOMIC FACTORS

MEC will continue to closely 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) Collection of long outstanding utility receivables, and
c) Continuing improvements in operations.

There were four tariff increases during the year. These took effect in December 2007, March 2008, April 2008 and June 2008 due to the continued escalation of world fuel prices. Fortunately, due to a decline in world fuel prices in the later part of 2008, MEC has been able to reduce tariffs twice since 30th September 2008. Despite the wildly fluctuating fuel prices, MEC has been able to maintain electricity tariffs at levels which are one of 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 30th September 2008. 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, 2008 and 2007

ASSETS	2008	2007
Utility plant:		
Electric plant in service	$ 20,618,184	$ 19,976,711
Construction work in progress	61,273	79,606
Total utility plant	20,679,457	20,056,317
Less accumulated depreciation and amortization	(11,241,416)	(10,182,442)
Net utility plant	9,438,041	9,873,875
Other assets:		
Nonutility property	181,862	181,862
Less accumulated depreciation	(140,717)	(130,322)
Nonutility property, net	41,145	51,540
Current assets:		
Cash and cash equivalents	1,235,531	4,186,044
Accounts receivable:		
Electricity	5,099,940	3,141,291
Affiliates	1,478,741	1,653,221
Other	713,927	298,205
Total accounts receivable	7,292,608	5,092,717
Less allowance for uncollectible accounts	(2,397,909)	(2,464,345)
Net accounts receivable	4,894,699	2,628,372
Fuel and supplies	2,901,472	3,867,933
Prepayments	41,778	7,361
Total current assets	9,073,480	10,689,710
Total assets	$ 18,552,666	$ 20,615,125

See accompanying notes to financial statements.

MARSHALLS ENERGY COMPANY, INC.

Statements of Net Assets, Continued
September 30, 2008 and 2007

LIABILITIES AND NET DEFICIENCY	2008	2007
Net assets (deficiency):		
Invested in capital assets, net of related debt	$ 1,783,922	$ 1,631,202
Restricted	-	373,056
Deficiency	(12,762,854)	(8,887,086)
Total net deficiency	(10,978,932)	(6,882,828)
Commitment and contingencies		
Long-term debt	16,389,299	18,194,956
Current liabilities:		
Current portion of long-term debt	1,953,031	1,743,841
Accounts payable - fuel	2,512,547	2,867,741
Accounts payable - other	808,057	99,730
Advances from RepMar	4,981,548	563,669
Payable to affiliates	43,746	192,469
Accrued building and engine repairs	2,415,882	3,406,431
Accrued taxes	318,145	156,218
Other current and accrued liabilities	109,343	272,898
Total current liabilities	13,142,299	9,302,997
Total liabilities	29,531,598	27,497,953
Total net deficiency and liabilities	$ 18,552,666	$ 20,615,125

See accompanying notes to financial statements.

MARSHALLS ENERGY COMPANY, INC.

Statements of Revenues, Expenses and Changes in Net Deficiency
Years Ended September 30, 2008 and 2007

	2008	2007
Utility operations:		
Operating revenues	$ 18,690,921	$ 13,734,688
Operating expenses:		
Cost of power	17,842,047	13,597,123
Administrative and general	1,481,397	1,494,544
Depreciation and amortization	1,027,392	1,005,621
Distribution operations	1,246,920	1,005,312
Taxes	264,509	229,087
Distribution maintenance	105,430	133,325
Total operating expenses	21,967,695	17,465,012
Operating loss from utility operations	(3,276,774)	(3,730,324)
Nonutility operations:		
Operating revenues:		
Fuel and gas sales	12,663,515	8,121,580
Other	355,284	241,572
Total operating revenues	13,018,799	8,363,152
Operating expenses:		
Cost of sales	12,111,200	6,897,624
Other	574,706	630,742
Total operating expenses	12,685,906	7,528,366
Operating income from nonutility operations	332,893	834,786
Operating loss	(2,943,881)	(2,895,538)
Nonoperating income (expense):		
RepMar subsidy	355,618	874,250
Interest expense	(1,507,841)	(1,611,293)
Total nonoperating (expense) income, net	(1,152,223)	(737,043)
Change in net assets	(4,096,104)	(3,632,581)
Net assets (deficiency) at beginning of year	(6,882,828)	(3,250,247)
Net assets (deficiency) at end of year	$ (10,978,932)	$ (6,882,828)

See accompanying notes to financial statements.

MARSHALLS ENERGY COMPANY, INC.

Statements of Cash Flows
Years Ended September 30, 2008 and 2007

	2008	2007
Cash flows from operating activities:		
Cash received from customers	$ 27,102,682	$ 20,820,061
Cash received from insurance claim	-	3,410,336
Cash payments to suppliers for goods and services	(30,986,867)	(25,276,181)
Cash payments to employees for services	(2,378,176)	(2,453,025)
Net cash used for operating activities	(6,262,361)	(3,498,809)
Cash flows from noncapital financing activities:		
Subsidy from RepMar	355,618	874,250
Net cash advances received from RepMar	6,758,590	399,369
Net repayment of short-term borrowings	-	(3,000,000)
Interest paid on short-term borrowings	-	(382,653)
Proceeds from issuance of long-term debt	-	12,000,000
Principal paid on long-term debt	(1,005,851)	(1,921,621)
Interest paid on long-term debt	(1,085,115)	(743,481)
Net cash provided by noncapital financing activities	5,023,242	7,225,864
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets	(623,140)	(204,216)
Principal paid on long-term debt	(590,616)	(689,309)
Interest paid on long-term debt	(497,638)	(684,866)
Net cash used for capital and related financing activities	(1,711,394)	(1,578,391)
Net change in cash and cash equivalents	(2,950,513)	2,148,664
Cash and cash equivalents at beginning of year	4,186,044	2,037,380
Cash and cash equivalents at end of year	$ 1,235,531	$ 4,186,044
Reconciliation of operating loss to net cash used for operating activities:		
Operating loss	$ (2,943,881)	$ (2,895,538)
Adjustments to reconcile operating loss to net cash used for operating activities:		
Depreciation and amortization	1,069,369	1,048,591
Provision for uncollectible accounts receivable	-	449,396
(Increase) decrease in assets:		
Accounts receivable:		
Electricity	(3,206,433)	(1,301,634)
Affiliates	(984,883)	(395,868)
Other	(415,722)	(29,673)
Materials and supplies	966,461	(1,204,443)
Prepayments	(34,417)	27,250
Increase (decrease) in liabilities:		
Accounts payable - fuel	(355,194)	(2,222,734)
Accounts payable - other	708,327	(28,733)
Payable to affiliates	(148,723)	74,905
Accrued building and engine repairs	(990,549)	3,406,431
Accrued taxes	161,927	(22,371)
Other current and accrued liabilities	(88,643)	(404,388)
Net cash used for operating activities	$ (6,262,361)	$ (3,498,809)

See accompanying notes to financial statements.

MARSHALLS ENERGY COMPANY, INC.

Statements of Cash Flows, Continued
Years Ended September 30, 2008 and 2007

	2008	2007
Information on Noncash Financing Activities:		
Off-set of advances received from RepMar:		
Decrease in electricity receivables	$ 1,181,348	$ 905,511
Decrease in receivables from affiliates	1,159,363	-
Decrease in advance from RepMar	(2,340,711)	(905,511)
	$ -	$ -

See accompanying notes to financial statements.

(1) Organization

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

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: Omnibus,* and modified by Statement No. 38, *Certain Financial Statement Note Disclosures*. These statements established 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 Statement No. 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.

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.

For purposes of the statements of net assets and cash flows, cash and cash equivalents is defined as cash on hand and cash held in demand accounts. As of September 30, 2008 and 2007, cash and cash equivalents are $1,235,531 and $4,186,044, respectively, and the corresponding bank balances are $1,166,385 and $3,924,547, respectively. Of bank balances as of September 30, 2008 and 2007, $739,648 and $3,917,903, respectively, are maintained in one financial institution subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2008 and 2007, 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.

(2) Summary of Significant Accounting Policies, Continued

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.

Fuel and Supplies

Fuel and supplies are valued at the lower of cost (first-in, first-out) or market (net realizable value).

Plant and Nonutility Property

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

Power plant engines	20 years
Plant and machinery	3 - 10 years
Vehicles	2 - 4 years
Leasehold improvements	20 years
Residences	20 years
Fences and seawalls	10 years
Leasehold land	20 years
Solar Power 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.

Restricted Net Assets

MEC initially received $650,000 from RepMar for installation of solar power systems in the outer islands. At September 30, 2008 and 2007, the unspent portion of these funds was $-0- and $373,056, respectively.

New Accounting Standards

During fiscal year 2008, MEC implemented GASB Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans* and GASB Statement No. 50, *Pension Disclosures an amendment of GASB Statements No. 25 and 27*. GASB Statement No. 43 establishes uniform financial reporting for other postemployment benefit plans by state and local governments and GASB Statement No. 50 more closely aligns the financial reporting requirements for pensions with those for other post-employment benefits. The implementation of these pronouncements did not have a material effect on the accompanying financial statements.

(2) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

In June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Post employment Benefits Other Than Pensions*. GASB Statement No. 45 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, 2007. Management does not believe that the implementation of this statement will have a material effect on the financial statements of MEC.

In December 2006, GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. GASB Statement No. 49 provides guidance and consistency under which a governmental entity would be required to report a liability related to pollution remediation. 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 2007, GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. GASB Statement No. 51 addresses whether and when intangible assets should be considered capital assets for financial reporting purposes. The provisions of this statement are effective for periods beginning after June 15, 2009. Management does not believe that the implementation of this statement will have a material effect on the financial statements of MEC.

In November 2007, GASB issued Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*. GASB Statement No. 52 improves the quality of financial reporting by requiring endowments to report their land and other real estate investments at fair value, creating consistency in reporting among similar entities that exist to invest resources for the purpose of generating income. The provisions of this statement are effective for periods beginning after June 15, 2008. Management does not believe that the implementation of this statement will have a material effect on the financial statements of MEC.

In June 2008, GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. GASB Statement No. 53 is intended to improve how state and local governments report information about derivative instruments - financial arrangements used by governments to manage specific risks or make investments - in their financial statements. The provisions of this statement are effective for periods beginning after June 15, 2009. Management does not believe that the implementation of this statement will have a material effect on the financial statements of MEC.

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.

(3) Fuel and Supplies

Fuel and supplies at September 30, 2008 and 2007, consist of the following:

	2008	2007
Distribution and power plant supplies	$ 1,221,776	$ 1,093,203
Lubricants	40,934	139,897
Fuel	1,638,762	2,634,833
	$ 2,901,472	$ 3,867,933

(4) Capital Assets

Capital asset activity for the years ended September 30, 2008 and 2007 was as follows:

	2008			
	October 1, 2007	Additions	Deletions	September 30, 2008
Utility Plant:				
Power plant engines	$ 14,720,739	$ -	$ -	$ 14,720,739
Plant and machinery	1,815,632	32,586	-	1,848,218
Vehicles	710,986	100,001	-	810,987
Leasehold improvements	641,012	-	-	641,012
Residences	548,284	12,789	-	561,073
Fences and seawalls	371,702	-	-	371,702
Leasehold land	330,000	-	-	330,000
Solar power systems	633,796	476,621	-	1,110,417
Furniture and fixtures	204,560	19,476	-	224,036
Nonutility Plant:				
LPG terminal	181,862	-	-	181,862
	20,158,573	641,473	-	20,800,046
Less accumulated depreciation and amortization	(10,312,764)	(1,069,369)	-	(11,382,133)
	9,845,809	(427,896)	-	9,417,913
Construction work-in-progress	79,606	458,288	(476,621)	61,273
	$ 9,925,415	$ 30,392	$ (476,621)	$ 9,479,186

	2007			
	October 1, 2006	Additions	Deletions	September 30, 2007
Utility Plant:				
Power plant engines	$ 14,720,739	$ -	$ -	$ 14,720,739
Plant and machinery	1,809,672	5,960	-	1,815,632
Vehicles	888,421	70,528	(247,963)	710,986
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	305,927	-	633,796
Furniture and fixtures	180,205	24,355	-	204,560
Nonutility Plant:				
LPG terminal	181,862	-	-	181,862
	19,999,766	406,770	(247,963)	20,158,573
Less accumulated depreciation and amortization	(9,512,136)	(1,048,591)	247,963	(10,312,764)
	10,487,630	(641,821)	-	9,845,809
Construction work-in-progress	282,160	103,373	(305,927)	79,606
	$ 10,769,790	$ (538,448)	$ (305,927)	$ 9,925,415

(5) Short-Term Debt

Short-term debt consisted of ninety-day promissory notes drawn on a $3 million bank line of credit, with interest at 2.5% over the bank reference rate and guaranteed unconditionally by RepMar. The line was closed during 2007 upon acquisition of a $12 million term loan.

The change in short-term debt during the year ended September 30, 2007, is as follows:

Balance October 1,2006	Additions	Payments	Balance September 30, 2007
$ 3,000,000	$ 5,380,000	$ 8,380,000	$ -

(6) Long-Term Debt

Long-term debt at September 30, 2008 and 2007 is as follows:

	2008	2007
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, 2008 and 2007.	$ 7,623,991	$ 8,214,607
On May 25, 2007, MEC obtained a bank loan of $12 million to refinance debts to a fuel supplier and a commercial bank and to finance working capital requirements. The loan is amortized over a period of 10 years and matures in 3 years. Interest is calculated at 1.75% over the bank's reference rate with a minimum rate of 6.5%. As of September 30, 2008 and 2007, interest rate was 6.75% and 7.5%, respectively. Principal and interest are payable in monthly equal payments of $160,000 to May 1, 2010. The loan is guaranteed, unconditionally and absolutely, by RepMar.	10,718,339	11,724,190
	18,342,330	19,938,797
Less current installments	(1,953,031)	(1,743,841)
Long-term debt	$ 16,389,299	$ 18,194,956

(6) Long-Term Debt, Continued

Changes in long-term debt during the years ended September 30, 2008 and 2007 are as follows:

	2008				
	Balance October 1, 2007	Additions	Reductions	Balance September 30, 2008	Balance due in One Year
RUS loan	$ 8,214,607	$ -	$ 590,616	$ 7,623,991	$ 628,047
Commercial bank loan	11,724,190	-	1,005,851	10,718,339	1,324,984
	$19,938,797	$ -	$1,596,467	$18,342,330	$1,953,031

	2007				
	Balance October 1, 2006	Additions	Reductions	Balance September 30, 2007	Balance due in One Year
RUS loan	$ 8,903,916	$ -	$ 689,309	$ 8,214,607	$ 582,177
Fuel vendor debt	5,090,475	-	5,090,475	-	-
Commercial bank loan	1,645,811	12,000,000	1,921,621	11,724,190	1,161,664
	$15,640,202	$12,000,000	$7,701,405	$19,938,797	$1,743,841

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

Year ending September 30,	Principal	Interest	Total
2009	$ 1,953,031	$ 1,222,062	$ 3,175,093
2010	1,924,057	1,091,041	3,015,098
2011	2,064,930	950,163	3,015,093
2012	2,019,421	721,901	2,741,322
2013	2,574,270	714,602	3,288,872
2014-2018	7,806,621	921,611	8,728,232
	$ 18,342,330	$ 5,621,380	$ 23,963,710

The above reflects the amortization of the commercial bank loan over a ten year period, which is the current arrangement with the lender. The loan matures in three years and management believes that due to the RepMar guarantee, the loan will be extended at the end of the initial three year period.

(7) 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 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.

(7) Related Party Transactions, Continued

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. MEC is therefore required to pay gross revenue tax on all revenue with the exception of electricity sales at the rate of 3%. As of September 30, 2008 and 2007, MEC is liable for gross revenue tax to RepMar amounting to $87,393 and $94,257, 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 fuel imported by MEC solely for the purpose of power generation. MEC is, however, required to pay import duty on diesel fuel imported for resale. As of September 30, 2008 and 2007, MEC is liable for import duties to RepMar amounting to $230,752 and $61,961, respectively.

Transactions for the years ended September 30, 2008 and 2007, and the related receivables from and payables to affiliates, are as follows:

	2008			
	Revenues	Expenses	Receivables	Payables
RepMar	$ 3,687,897	$ 1,847,649	$ -	$ 10,969
Majuro Water and Sewer Company, Inc.	380,107	6,691	-	-
Marshall Islands Social Security Administration	59,182	264,509	10,087	32,777
Majuro Resort, Inc.	488,048	7,709	898,661	-
Kwajalein Atoll Joint Utility Resources	3,962,798	-	280,398	-
Other	2,008,333	183,525	289,595	-
	$ 10,586,365	$ 2,310,083	$ 1,478,741	$ 43,746

	2007			
	Revenues	Expenses	Receivables	Payables
RepMar	$ 2,593,010	$ 485,797	$ 482,560	$ 8,061
Majuro Water and Sewer Company, Inc.	300,697	2,692	768,587	17,428
Marshall Islands Social Security Administration	42,511	179,643	6,207	120,482
Majuro Resort, Inc.	391,784	18,254	143,675	-
Kwajalein Atoll Joint Utility Resources	2,840,602	-	-	7,943
Other	1,488,833	134,006	252,192	38,555
	$ 7,657,437	$ 820,392	$ 1,653,221	$ 192,469

(7) Related Party Transactions, Continued

During the years ended September 30, 2008 and 2007, MEC received cash advances from RepMar of $7,058,590 and $1,129,369, respectively, of which $2,340,711 and $905,511, respectively, was applied to certain outstanding utility billings owed by RepMar and affiliates. Repayments of certain cash advances made by MEC to RepMar during the years ended September 30, 2008 and 2007 amounted to $300,000 and $730,000, respectively. As of September 30, 2008 and 2007, advances received from RepMar not yet applied to utility billings amounted to $4,981,548 and $563,669, respectively.

During the years ended September 30, 2008 and 2007, MEC received operating subsidies from RepMar of $355,618 and $874,250, respectively.

As of September 30, 2008 and 2007, MEC maintained a demand deposit account with an affiliated financial institution of $426,292 and $6,644, respectively.

For the years ended September 30, 2008 and 2007, MEC increased allowance for doubtful debts amounting to $-0- and $321,857, respectively, representing allowance for receivable from MWSC.

(8) Commitments and Contingencies

Commitments

On June 22, 2006, MEC entered into a five-year fuel supply contract with SK Networks Co., Ltd. commencing January 2007 through December 2011. Under the fuel supply contract, MEC's minimum purchase obligation shall be 13,000,000 U.S. gallons per year.

On June 21, 2007, MEC entered into an agreement with Luen Thai Fishing Ventures Ltd. (LTFV) for the joint purchase of fuel under a combined single purchase order to MEC's contracted fuel supplier. MEC shall earn a commission per gallon metered at the dispensing terminal located on the fish base dock operated by LTFV.

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. MEC has sustained substantial operating losses during the years ended September 30, 2008 and 2007 of $2,943,881 and $2,895,538, respectively, and has used a substantial amount of working capital in its operations resulting in a working capital deficiency of $4,069,819 at September 30, 2008. Furthermore, at September 30, 2008, total liabilities exceed total assets by $10,978,932. Management acknowledges that it is currently dependent on RepMar for cash advances to fund operations and for its affiliates to pay for actual services rendered in order to maintain MEC as a going concern. Should RepMar and its affiliates choose to discontinue cash advances and payment for services rendered, MEC management may have to consider alternative measures including, among other possibilities, an increase in electricity and fuel rates to maintain MEC as a going concern.

(8) Commitments and Contingencies, Continued

Contingencies, Continued

In view of these matters, realization of a major portion of the assets in the accompanying statement of net assets at September 30, 2008, 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.

(9) 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 usually elects to purchase commercial insurance from independent third parties for the risks of loss to which it is exposed. However, as of September 30, 2008, MEC is self-insured for any losses that could befall its capital assets. Insurance coverage is only obtained for fuel inventory and its fuel delivery operations. Settled claims from these risks have not exceeded commercial insurance coverage for the past three years.

During the year ended September 30, 2007, MEC received insurance proceeds of $3,410,336 for fire damages to its power plant building and engines. Insurance proceeds were netted against estimated repair costs to put back the assets into service. Accrued building and engine repairs expense as of September 30, 2008 and 2007 amounted to $2,415,882 and $3,406,431, respectively.

(10) Subsequent Event

On October 6, 2008, the Nitijela of RepMar enacted Public Law No. 2008-5, which exempted MEC from the payment of import duties on the import of all types of fuel into RepMar, including fuel imported for power generation and for commercial resale.

MARSHALLS ENERGY COMPANY, INC.

Statement of Revenues and Expenses and Changes in Net Deficiency by Source
Year Ended September 30, 2008

	Generation	Distribution	Contracts	Tank Farm	Jaluit	Wotje	Solar	MEC Gas	Admin.	TOTAL
Operating revenues:										
Fuel and gas sales	$ -	$ -	$ -	$12,115,191	$ 45	$ -	$ -	$ 548,279	$ -	$ 12,663,515
Cost of sales	-	-	-	11,734,101	-	-	-	377,099	-	12,111,200
Gross profit on sales	-	-	-	381,090	45	-	-	171,180	-	552,315
Electric and service billings	18,213,201	-	-	-	247,336	188,043	42,341	-	-	18,690,921
Service and Other income	2,573	149,840	9,600	21,631	6,804	60	81,809	667	82,300	355,284
Total electricity sales and other income	18,215,774	149,840	9,600	21,631	254,140	188,103	124,150	667	82,300	19,046,205
Total net operating revenue	18,215,774	149,840	9,600	402,721	254,185	188,103	124,150	171,847	82,300	19,598,520
Operating expenses:										
Fuel and lubes	15,151,311	-	-	-	306,559	-	-	-	-	15,457,870
Salaries, wages and benefits	1,030,492	467,400	-	139,147	189,407	143,516	44,881	44,845	706,653	2,766,341
Repairs and maintenance	928,645	804,055	-	108,086	32,963	4,403	2,842	100,487	57,762	2,039,244
Depreciation and amortization	839,472	61,848	-	28,872	1,308	-	56,124	13,104	68,640	1,069,368
Freight	126,110	62,812	-	-	-	38,494	-	-	3,105	230,521
Office	4,765	2,312	-	2,022	24,449	3,833	-	-	165,913	203,294
Gross revenue tax	33	104	-	339,352	215	-	-	-	1,037	340,741
Insurance	63,316	22,394	-	50,758	5,727	9,137	1,042	2,838	27,714	182,926
Staff training	-	-	-	-	-	-	-	-	57,359	57,359
Laundry and uniforms	15,729	1,436	-	-	238	-	-	-	1,005	18,408
Lease rental	-	-	-	5,250	-	-	-	-	-	5,250
Equipment rental	8,133	4,420	-	1,679	-	-	-	2,847	-	17,079
Travel	912	-	-	-	113	-	-	-	40,459	41,484
Communications	9,721	5,333	-	9,589	319	-	-	816	40,126	65,904
Entertainment	-	-	-	-	-	-	-	-	6	6
Professional fees	-	-	-	17,796	-	-	-	-	3,813	21,609
Advertising	-	-	-	-	-	-	-	-	15,444	15,444
Bank fees	5,058	-	-	-	-	-	-	-	4,540	9,598
Miscellaneous	18,574	1,703	-	972	-	-	-	265	(21,558)	(44)
Total operating expenses	18,202,271	1,433,817	-	703,523	561,298	199,383	104,889	165,202	1,172,018	22,542,401
Operating income (loss)	13,503	(1,283,977)	9,600	(300,803)	(307,113)	(11,280)	19,261	6,645	(1,089,718)	(2,943,881)
Non-operating income (expense):										
Interest expense	(1,503,717)	-	-	-	-	-	-	-	(4,124)	(1,507,841)
	(1,503,717)	-	-	-	-	-	-	-	(4,124)	(1,507,841)
Repmar subsidy	-	-	-	-	161,788	193,830	-	-	-	355,618
Change in net deficiency	$ (1,490,214)	$ (1,283,977)	$ 9,600	$ (300,803)	$ (145,325)	$ 182,550	$ 19,261	$ 6,645	$ (1,093,842)	$ (4,096,104)

See accompanying independent auditors' report.