

MARSHALLS ENERGY COMPANY, INC.

FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT

YEARS ENDED SEPTEMBER 30, 2001 AND 2000

**Deloitte
Touche
Tohmatsu**

INDEPENDENT AUDITORS' REPORT

Board of Directors
Marshalls Energy Company, Inc.:

We have audited the accompanying balance sheets of the Marshalls Energy Company, Inc. (MEC), a component unit of the Republic of the Marshall Islands, as of September 30, 2001 and 2000, and the related statements of (loss) earnings and retained earnings 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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, 2001 and 2000, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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 Increase (Decrease) in Retained Earnings by Source for the year ended September 30, 2001 (page 15) 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 the management of MEC. 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 a report dated November 28, 2001, 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 grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Deloitte & Touche

November 28, 2001

MARSHALLS ENERGY COMPANY, INC.

Balance Sheets
September 30, 2001 and 2000

ASSETS (note 7)

	<u>2001</u>	<u>2000</u>
Utility plant (note 4):		
Electric plant in service	\$ 18,417,459	\$ 17,759,419
Construction work in progress	<u> -</u>	<u> 439,549</u>
Total utility plant	18,417,459	18,198,968
Less accumulated provision for depreciation and amortization	<u>(4,019,620)</u>	<u>(2,981,376)</u>
Net utility plant	<u>14,397,839</u>	<u>15,217,592</u>
Other assets:		
Nonutility property, net	<u> 54,545</u>	<u> 66,063</u>
Current assets:		
Cash and cash equivalents	<u> 663,256</u>	<u> 1,086,699</u>
Accounts receivable:		
Electricity	2,430,302	2,690,561
Affiliates (note 8)	1,115,386	1,369,096
Other	<u> 414,045</u>	<u> 311,313</u>
Total accounts receivable	3,959,733	4,370,970
Less allowance for uncollectible accounts	<u>(1,526,491)</u>	<u>(2,297,200)</u>
Net accounts receivable	<u> 2,433,242</u>	<u> 2,073,770</u>
Materials and supplies (note 3)	<u> 1,344,786</u>	<u> 1,364,383</u>
Prepayments	<u> 27,800</u>	<u> 41,600</u>
Total current assets	<u> 4,469,084</u>	<u> 4,566,452</u>
Total assets	<u>\$ 18,921,468</u>	<u>\$ 19,850,107</u>

See accompanying notes to financial statements.

MARSHALLS ENERGY COMPANY, INC.

Balance Sheets, Continued
September 30, 2001 and 2000

STOCKHOLDER'S EQUITY AND LIABILITIES

	<u>2001</u>	<u>2000</u>
Stockholder's equity:		
Common stock, \$1 par value, 100,000 shares authorized and paid-in, 75,000 shares outstanding	\$ 100,000	\$ 100,000
Contributed capital	781,980	875,468
Retained earnings	<u>2,270,426</u>	<u>3,748,376</u>
	3,152,406	4,723,844
Treasury stock, at cost, 25,000 shares	<u>(25,000)</u>	<u>(25,000)</u>
Total stockholder's equity	<u>3,127,406</u>	<u>4,698,844</u>
Long-term debt:		
RUS mortgage notes less current maturities (note 7)	<u>10,567,717</u>	<u>11,170,259</u>
Current liabilities:		
Short-term borrowings (note 6)	1,200,000	-
Current maturities of long-term debt (note 7)	504,718	284,922
Accounts payable	3,085,894	3,543,904
Payable to affiliates (note 8)	241,627	18,364
Accrued taxes (note 5)	106,975	73,849
Other current and accrued liabilities	<u>87,131</u>	<u>59,965</u>
Total current liabilities	<u>5,226,345</u>	<u>3,981,004</u>
Commitment and contingency (note 9)		
Total stockholder's equity and liabilities	<u>\$ 18,921,468</u>	<u>\$ 19,850,107</u>

See accompanying notes to financial statements.

MARSHALLS ENERGY COMPANY, INC.

Statements of (Loss) Earnings and Retained Earnings
Years Ended September 30, 2001 and 2000

	<u>2001</u>	<u>2000</u>
Operating revenues (note 6)	\$ <u>7,237,341</u>	\$ <u>6,986,742</u>
Operating expenses:		
Cost of power	6,477,095	5,042,095
Distribution operations	1,330,730	1,156,628
Depreciation and amortization	1,006,721	801,693
Administrative and general	925,236	931,631
Taxes	153,639	142,484
Distribution maintenance	88,603	78,087
Consumer accounts	<u>-</u>	<u>248,269</u>
Total operating expenses	<u>9,982,024</u>	<u>8,400,887</u>
Operating deficiency before interest expense	(2,744,683)	(1,414,145)
Interest expense	<u>741,982</u>	<u>528,547</u>
Operating deficiency after interest expense	<u>(3,486,665)</u>	<u>(1,942,692)</u>
Non-operating income (expense):		
Fuel and gas sales	6,122,021	7,323,031
Cost of sales	<u>(4,723,555)</u>	<u>(6,132,297)</u>
Gross profit on sales	1,398,466	1,190,734
Other, net	<u>516,761</u>	<u>826,472</u>
Total non-operating income, net	<u>1,915,227</u>	<u>2,017,206</u>
Net (loss) earnings	(1,571,438)	74,514
Add depreciation on fixed assets acquired by grants externally restricted for capital acquisitions and construction that reduces contributed capital	<u>93,488</u>	<u>93,488</u>
(Decrease) increase in retained earnings	(1,477,950)	168,002
Retained earnings at beginning of year	<u>3,748,376</u>	<u>3,580,374</u>
Retained earnings at end of year	\$ <u>2,270,426</u>	\$ <u>3,748,376</u>

See accompanying notes to financial statements.

MARSHALLS ENERGY COMPANY, INC.

Statements of Cash Flows
Years Ended September 30, 2001 and 2000

	<u>2001</u>	<u>2000</u>
Cash flows from operating activities:		
Net (loss) earnings	\$ (1,571,438)	\$ 74,514
Adjustments to reconcile net (loss) earnings to net cash (used for) provided by operating activities:		
Depreciation and amortization	1,049,762	841,260
Provision for uncollectible accounts receivable	-	248,269
Recovery of bad debts	(743,738)	-
Non-operating interest expense	741,982	528,547
Gain on sale of equipment	-	(2,750)
(Increase) decrease in assets:		
Accounts receivable:		
Electricity	260,259	(374,220)
Affiliates	253,710	(122,823)
Other	(129,703)	(184,971)
Materials and supplies	200,856	(23,624)
Prepayments	13,800	25,342
Increase (decrease) in liabilities:		
Accounts payable	(471,823)	298,974
Payable to affiliates	223,263	(64,365)
Accrued taxes	33,126	42,752
Other current and accrued liabilities	<u>27,166</u>	<u>39,586</u>
Net cash (used for) provided by operating activities	<u>(112,778)</u>	<u>1,326,491</u>
Cash flows from noncapital financing activities:		
Net borrowings under bank credit line agreement (note 6)	1,200,000	-
Interest paid on short-term borrowings	<u>(14,946)</u>	<u>-</u>
Net cash provided by noncapital financing activities	<u>1,185,054</u>	<u>-</u>
Cash flows from capital and related financing activities:		
Proceeds from long-term debt	-	1,937,214
Acquisition and construction of capital assets	(399,750)	(1,326,624)
Principal paid on long-term debt	(382,746)	(326,946)
Interest paid on long-term debt	(713,223)	(694,786)
Proceeds from sale of equipment	<u>-</u>	<u>2,780</u>
Net cash used for capital and related financing activities	<u>(1,495,719)</u>	<u>(408,362)</u>
Net (decrease) increase in cash and cash equivalents	(423,443)	918,129
Cash and cash equivalents at beginning of year	<u>1,086,699</u>	<u>168,570</u>
Cash and cash equivalents at end of year	\$ <u>663,256</u>	\$ <u>1,086,699</u>

See accompanying notes to financial statements.

MARSHALLS ENERGY COMPANY, INC.

Statements of Cash Flows, Continued
 Years Ended September 30, 2001 and 2000

	<u>2001</u>	<u>2000</u>
Supplemental schedule of noncash capital and related financing activities:		
Transfers of completed project to electric plant:		
Electric plant in service	\$ 439,549	\$ 13,007,418
Construction work in progress	<u>(439,549)</u>	<u>(13,007,418)</u>
	\$ <u> -</u>	\$ <u> -</u>
Transfer of electric plant to materials and supplies:		
Electric plant in service	\$ (181,259)	\$ -
Materials and supplies	<u>181,259</u>	<u> -</u>
	\$ <u> -</u>	\$ <u> -</u>

See accompanying notes to financial statements.

MARSHALLS ENERGY COMPANY, INC.

Notes to Financial Statements
September 30, 2001 and 2000

(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 and Jaluit. 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.

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.

MEC's financial statements are incorporated into the general purpose 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.

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.

MARSHALLS ENERGY COMPANY, INC.

Notes to Financial Statements
September 30, 2001 and 2000

(2) Summary of Significant Accounting Policies, Continued

Basis of Accounting

Proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operation of the fund are included in the balance sheets. 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

For purposes of the balance sheets and the statements of cash flows, cash and cash equivalents is defined as cash on hand and cash held in demand accounts. As of September 30, 2001 and 2000, cash and cash equivalents was \$663,256 and \$1,086,699, respectively, and the corresponding bank balance was \$761,615 and \$1,250,098, respectively. Of the bank balance amount as of September 30, 2001 and 2000, \$579,000 and \$1,250,098, respectively, is maintained in one financial institution subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2001 and 2000, bank deposits in the amount of \$100,000 were FDIC insured. MEC does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC coverage are uncollateralized.

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. 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 balance sheets.

Plant and Nonutility Property

Plant and nonutility property are stated at cost. Depreciation of plant and nonutility property and amortization of leasehold land and residences are calculated on the straight-line method based on the estimated useful lives of the respective assets. Costs pertaining to distribution and line supplies are expensed during the year of installation as MEC considers the estimated useful lives of these supplies are less than one year.

MEC capitalizes interest expense in order to recognize all costs associated with construction projects based on MEC's weighted average borrowing rate. During the years ended September 30, 2001 and 2000, \$-0- and \$166,239, respectively, of eligible interest expense was capitalized.

MARSHALLS ENERGY COMPANY, INC.

Notes to Financial Statements
September 30, 2001 and 2000

(2) Summary of Significant Accounting Policies, Continued

Fund Equity

Contributed capital is recorded initially through receipt of capital grants. Depreciation expense for capital assets acquired with capital grants is recorded as a reduction of contributed capital.

Reclassifications

Certain reclassifications have been made to the 2000 financial statements in order to conform with the 2001 presentation.

(3) Materials and Supplies

Materials and supplies at September 30, 2001 and 2000, consists of the following:

	<u>2001</u>	<u>2000</u>
Distribution and power plant supplies	\$ 1,261,104	\$ 1,291,113
Lubricants	63,439	54,813
Fuel	<u>20,243</u>	<u>18,457</u>
	<u>\$ 1,344,786</u>	<u>\$ 1,364,383</u>

(4) Utility Plant

Utility plant at September 30, 2001 and 2000, consists of the following:

	<u>Estimated Useful Lives</u>	<u>2001</u>	<u>2000</u>
Power plant engines	20 years	\$ 14,720,739	\$ 14,417,985
Plant and machinery	3 - 10 years	1,406,943	1,104,576
Vehicles	2 - 4 years	679,691	628,833
Residences	20 years	520,361	520,361
Leasehold improvements	20 years	350,559	350,559
Leasehold land	20 years	330,000	330,000
Fences and seawalls	10 years	272,876	272,876
Furniture and fixtures	3 - 5 years	<u>136,290</u>	<u>134,229</u>
		18,417,459	17,759,419
Less accumulated provision for depreciation and amortization		<u>(4,019,620)</u>	<u>(2,981,376)</u>
Construction work in progress		14,397,839	14,778,043
		<u>-</u>	<u>439,549</u>
		<u>\$ 14,397,839</u>	<u>\$ 15,217,592</u>

MARSHALLS ENERGY COMPANY, INC.

Notes to Financial Statements
September 30, 2001 and 2000

(5) 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, 2001 and 2000, MEC is liable for gross revenue tax to RepMar amounting to \$57,078 and \$70,698, respectively.

Pursuant to the Import Duties Act of 1989, as amended by the Import Duties (Amendment) Act of 1996, 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 subject to certain exemptions. As of September 30, 2001 and 2000, MEC is liable for import duty to RepMar amounting to \$49,897 and \$3,151, respectively.

(6) Short-Term Borrowings

On August 31, 2001, MEC entered into a loan agreement with an affiliated financial institution in the amount of \$1,200,000. The loan bears interest at 12.95% per annum, is payable in monthly installments of \$116,404, including interest, commencing November 1, 2001, and is due September 1, 2002. RepMar has guaranteed this loan payable through an assignment of future payments relating to RepMar's government electric billings.

(7) Notes Payable

	<u>2001</u>	<u>2000</u>
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, 2001 and 2000.	\$ 11,072,435	\$ 11,455,181
Less current installments	<u>504,718</u>	<u>284,922</u>
Long-term debt	<u>\$ 10,567,717</u>	<u>\$ 11,170,259</u>

MARSHALLS ENERGY COMPANY, INC.

Notes to Financial Statements
September 30, 2001 and 2000

(7) Notes Payable, Continued

Future repayment commitments are as follows:

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2002	\$ 504,718	\$ 864,145	\$ 1,368,863
2003	431,240	663,852	1,095,092
2004	458,581	636,517	1,095,098
2005	488,979	606,115	1,095,094
2006	388,124	433,196	821,320
Thereafter	<u>8,800,793</u>	<u>3,694,993</u>	<u>12,495,786</u>
	<u>\$ 11,072,435</u>	<u>\$ 6,898,818</u>	<u>\$ 17,971,253</u>

(8) 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 based on a tariff rate of \$0.11 cents per kilowatt hour for monthly bills less than 500 kilowatt hours, or \$0.13 cents per kilowatt hour for bills greater than 500 kilowatt hours. Effective June 1, 2001, the tariff rate was increased to \$0.12 cents and \$0.16 cents per kilowatt hour, respectively. 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, 2001 and 2000, and the related receivables from and payables to affiliates, are as follows:

	<u>2001</u>			
	<u>Revenues</u>	<u>Expenses</u>	<u>Receivables</u>	<u>Payables</u>
RepMar	\$ 1,001,443	\$ 451,207	\$ 284,909	\$ 168,195
Majuro Water and Sewer Company, Inc.	223,778	2,489	631,939	8
Marshall Islands Social Security Administration	32,896	126,858	5,935	73,136
Majuro Resort, Inc.	374,741	100	30,120	-
Other	<u>703,249</u>	<u>60,285</u>	<u>162,483</u>	<u>288</u>
	<u>\$ 2,336,107</u>	<u>\$ 640,939</u>	<u>\$ 1,115,386</u>	<u>\$ 241,627</u>
	<u>2000</u>			
	<u>Revenues</u>	<u>Expenses</u>	<u>Receivables</u>	<u>Payables</u>
RepMar	\$ 1,061,041	\$ 345,367	\$ 605,861	\$ 10,558
Majuro Water and Sewer Company, Inc.	219,981	5,036	487,240	-
Marshall Islands Social Security Administration	28,405	292,977	5,889	5,035
Majuro Resort, Inc.	209,792	9,051	121,663	-
Other	<u>366,722</u>	<u>51,773</u>	<u>148,443</u>	<u>2,771</u>
	<u>\$ 1,885,941</u>	<u>\$ 704,204</u>	<u>\$ 1,369,096</u>	<u>\$ 18,364</u>

MARSHALLS ENERGY COMPANY, INC.

Notes to Financial Statements
September 30, 2001 and 2000

(8) Related Party Transactions, Continued

As of September 30, 2000, MEC's allowance for uncollectible accounts included certain receivable balances from Majuro Water and Sewer Company, Inc. (MWSC). As of September 30, 2001, management has reassessed the collectibility of these receivable balances from MWSC and determined that the total balance is fully collectible, which has resulted in a recognition of recovery of bad debts of approximately \$450,000, that is included in other income for the year ended September 30, 2001.

On October 20, 2000, the Cabinet of RepMar approved MEC as the contract manager for the construction of a power plant, power distribution and cable facility on Wotje Atoll in the amount of \$2,023,800. The Cabinet further approved the establishment of an escrow account to facilitate the receipt and disbursement of funds relating to this project. During the year ended September 30, 2001, MEC received \$905,950 from RepMar relating to this project, of which \$742,236 has been disbursed. The unexpended amount of \$163,714 as of September 30, 2001 is recorded as a payable to RepMar and included in payable to affiliates.

As of September 30, 2001 and 2000, MEC maintained a demand deposit account with an affiliated financial institution, amounting to \$169,225 and \$-0-, respectively, and has an outstanding loan payable with an affiliated financial institution, amounting to \$1,200,000 and \$-0-, respectively (see note 6).

(9) Commitment and Contingency

Commitment

MEC purchases petroleum products from Mobil Oil Micronesia, Inc. (Mobil) on a consignment basis whereby Mobil continues to hold ownership and title to the product while it is held in storage at the MEC terminal storage tanks. Title and risk on the product remains with Mobil until the product passes the boundary of the MEC terminal. The value of consignment petroleum products as of September 30, 2001 and 2000 is approximately \$1,320,018 and \$417,401, respectively. MEC assumes responsibility for the proper and safe storage/handling of the product while under MEC storage. However, MEC carries insurance coverage on such consignment inventories.

Contingency

MEC has incurred a net loss of \$1,571,438 during the year ended September 30, 2001 and has a working capital deficiency of \$757,261 as of September 30, 2001. These factors, among others, indicate that MEC may be unable to continue as a going concern for a reasonable period of time.

Management of MEC perceives that a decrease in the cost of power generation will result through a decrease in the world market price for petroleum products. Furthermore, 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.

MARSHALLS ENERGY COMPANY, INC.

Notes to Financial Statements
September 30, 2001 and 2000

(10) Risk Management

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

MARSHALLS ENERGY COMPANY, INC.

Schedule of Revenues, Expenses and
Increase (Decrease) in Retained Earnings by Source
Year Ended September 30, 2001
(With comparative information for the year ended September 30, 2000)

	Generation	Distribution	Contracts	Tank			Admin - istration	Totals	
				Farm	Jaluit	MEC-Gas		2001	2000
Operating revenues:									
Fuel and gas sales	\$ -	\$ -	\$ -	\$ 5,775,641	\$ -	\$ 346,380	\$ -	\$ 6,122,021	\$ 7,323,031
Cost of sales	-	-	-	(4,618,078)	-	(105,477)	-	(4,723,555)	(6,132,297)
Gross profit on sales	-	-	-	1,157,563	-	240,903	-	1,398,466	1,190,734
Electric and service billings	7,136,299	11,343	-	-	89,699	-	-	7,237,341	6,986,742
Other income	449,111	43,533	16,600	86,980	48,620	2,340	383,106	1,030,290	1,215,399
Total operating revenues, net	<u>7,585,410</u>	<u>54,876</u>	<u>16,600</u>	<u>1,244,543</u>	<u>138,319</u>	<u>243,243</u>	<u>383,106</u>	<u>9,666,097</u>	<u>9,392,875</u>
Operating expenses:									
Fuel and lubricants	5,035,513	-	-	-	163,579	-	-	5,199,092	3,677,862
Salaries, wages and benefits	695,910	404,814	5,400	40,272	242,066	34,367	392,217	1,815,046	1,761,939
Repairs and supplies	374,461	972,630	-	128,028	36,224	87,433	44,876	1,643,652	1,473,728
Depreciation and amortization	780,576	100,167	-	26,662	19,906	23,175	106,072	1,056,558	841,260
Gross revenue tax	1,008	1,646	498	170,158	831	10,462	2,273	186,876	202,136
Insurance	100,781	31,251	-	24,161	5,008	3,507	9,002	173,710	130,496
Diesel import tax	-	-	-	86,729	-	-	-	86,729	60,806
Office	5,818	2,575	-	1,229	10,353	-	65,788	85,763	92,819
Other personnel costs	38,687	-	-	-	-	-	15,140	53,827	32,854
Communications	8,047	6,732	-	330	14,011	1,049	18,604	48,773	49,093
Travel	13,287	2,459	-	-	-	-	17,387	33,133	46,976
Advertising	-	-	-	-	-	-	26,679	26,679	1,900
Staff training	-	-	-	-	-	-	18,285	18,285	45,632
Laundry and uniforms	10,464	3,437	-	-	122	-	795	14,818	35,020
Professional fees	-	-	-	-	-	-	8,875	8,875	23,133
Entertainment	-	-	-	-	100	-	7,811	7,911	22,423
Bad debts	-	-	-	-	-	-	-	-	248,269
Miscellaneous	7,100	-	-	-	2,600	-	26,126	35,826	43,468
Total operating expenses	<u>7,071,652</u>	<u>1,525,711</u>	<u>5,898</u>	<u>477,569</u>	<u>494,800</u>	<u>159,993</u>	<u>759,930</u>	<u>10,495,553</u>	<u>8,789,814</u>
Earnings (loss) before interest expense	513,758	(1,470,835)	10,702	766,974	(356,481)	83,250	(376,824)	(829,456)	603,061
Interest expense	(726,550)	-	-	-	-	-	(15,432)	(741,982)	(528,547)
Net earnings (loss)	(212,792)	(1,470,835)	10,702	766,974	(356,481)	83,250	(392,256)	(1,571,438)	74,514
Add depreciation on fixed assets acquired by grants externally restricted for capital acquisitions and construction that reduces contributed capital	93,488	-	-	-	-	-	-	93,488	93,488
Increase (decrease) in retained earnings	<u>\$ (119,304)</u>	<u>\$ (1,470,835)</u>	<u>\$ 10,702</u>	<u>\$ 766,974</u>	<u>\$ (356,481)</u>	<u>\$ 83,250</u>	<u>\$ (392,256)</u>	<u>\$ (1,477,950)</u>	<u>\$ 168,002</u>

See accompanying independent auditors' report.