MARSHALLS ENERGY COMPANY, INC.

REPORT ON THE AUDIT OF
FINANCIAL STATEMENTS IN ACCORDANCE
WITH OMB CIRCULAR A-133

YEAR ENDED SEPTEMBER 30, 2003

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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, 2003 and 2002, 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 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, 2003 and 2002, 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.

As described in note 2 to the accompanying financial statements, MEC adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*.

The Management's Discussion and Analysis on pages 3 and 4 is not a required part of the basic financial statements but is supplementary information required by GASB. 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, 2003 (page 16) 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 December 18, 2003, 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 LLP

December 18, 2003

MARSHALLS ENERGY COMPANY, INC.
Management's Discussion and Analysis

This section of the Marshalls Energy Company's (MEC) annual financial report presents our discussion and analysis of MEC's financial performance for the year that ended on September 30, 2003 . Please read it in conjunction with the financial statements, which follow this section. The following table summarizes the financial condition and operations of MEC for fiscal years 2003 and 2002.

	2003	2002
Assets		
Utility plant, net	$ 13,047,044	13,641,708
Current assets	5,300,473	4,593,253
Other assets	69,531	78,627
	$ 18,417,048	$ 18,313,588
Liabilities and Net Assets		
Long-term debt, net	9,781,020	10,234,294
Current portion of long-term debt	458,581	431,240
Other current liabilities	2,377,359	2,444,554
Net assets	5,800,088	5,203,500
	$ 18,417,048	$ 18,313,588
Revenues, Expenses, and Changes in Net Assets		
Utility operations:		
Operating revenues	$ 8,872,780	8,289,970
Operating expenses	11,140,788	9,135,995
Net operating loss from utility operations	(2,268,008)	(846,025)
Nonutility operations:		
Operating revenues	9,614,251	7,960,120
Operating expenses	7,946,979	6,140,018
Net operating income from nonutility operations	1,667,272	1,820,102
Nonoperating income (expense):		
Compact funding	1,866,667	1,866,667
Interest expense	(669,343)	(764,650)
Net nonoperating income (expense)	1,197,324	1,102,017
Increase in net assets	$ 596,588	$ 2,076,094

Financial Highlights

The operating loss from utility operations increased $1,421,983 in FY 2003 compared to FY2002

- Although net operating revenues of $8.8 million were up 7% from FY-02, operating margins were eroded by historically high fuel costs of $7.19 million, up 25% from FY-02.Fuel costs. The increase in revenues is attributed to the first full fiscal year of the tariff increase set in May 2001 for commercial and government customers.

Nonutility revenues increased 22% from FY-02

- Wholesale fuel and gas sales of $9.34 million compared to FY-02's $7.66 million. This revenue source represented 51% of MEC's total revenue but skyrocketing fuel costs also eroded gross margins. The gross profit from these sales at $1.95 million compares to a $2.13 million gross profit in FY-02.

Accounts Receivable increased 21 % from FY- 02

- Accounts Receivable increased to $4,858,589 compared to FY-02's $4,007, 871 an increase of 21%. The largest single factor attributed to the increase is the RepMar account which is $848,120 compared to FY-02's $589,981 an increase of 44%. Management acknowledges that it is dependent on RepMar and its affiliates to pay for actual services rendered. Should RepMar not pay for services rendered MEC will have to consider discontinuing supplying the service and or increasing the rates charged for electricity and fuel.

MARSHALLS ENERGY COMPANY, INC.

Statements of Net Assets
September 30, 2003 and 2002

ASSETS

	2003	2002
Utility plant:		
Electric plant in service	$ 19,104,392	$ 18,675,056
Construction work in progress	-	20,000
Total utility plant	19,104,392	18,695,056
Less accumulated depreciation and amortization	(6,057,348)	(5,053,348)
Net utility plant	13,047,044	13,641,708
Other assets:		
Nonutility property, net	69,531	78,627
Current assets:		
Cash and cash equivalents	713,310	617,345
Accounts receivable:		
Electricity	3,075,538	2,793,137
Affiliates	1,424,890	1,053,766
Other	358,161	160,968
Total accounts receivable	4,858,589	4,007,871
Less allowance for uncollectible accounts	(2,136,475)	(1,856,023)
Net accounts receivable	2,722,114	2,151,848
Materials and supplies	1,834,668	1,784,400
Prepayments	30,381	39,660
Total current assets	5,300,473	4,593,253
Total assets	$ 18,417,048	$ 18,313,588

See accompanying notes to financial statements.

MARSHALLS ENERGY COMPANY, INC.

Statements of Net Assets, Continued
September 30, 2003 and 2002

LIABILITIES AND NET ASSETS

	2003	2002
Net assets:		
Investment in capital assets, net of related debt	$ 2,876,974	$ 3,054,801
Unrestricted	2,923,114	2,148,699
Total net assets	5,800,088	5,203,500
Commitment and contingency		
Long-term debt:		
RUS mortgage notes less current maturities	9,781,020	10,234,294
Current liabilities:		
Current maturities of long-term debt	458,581	431,240
Accounts payable	2,020,733	2,120,750
Payable to affiliates	90,348	171,051
Accrued taxes	175,368	82,536
Other current and accrued liabilities	90,910	70,217
Total current liabilities	2,835,940	2,875,794
Total net assets and liabilities	$ 18,417,048	$ 18,313,588

See accompanying notes to financial statements.

MARSHALLS ENERGY COMPANY, INC.

Statements of Revenues, Expenses and Changes in Net Assets
Years Ended September 30, 2003 and 2002

	2003	2002
Utility operations:		
Operating revenues	$ 8,872,780	$ 8,289,970
Operating expenses:		
Cost of power	7,192,439	5,722,555
Administrative and general	1,231,636	1,033,773
Distribution operations	1,083,620	748,373
Depreciation and amortization	1,020,586	997,333
Consumer accounts	282,463	329,532
Taxes	188,505	160,058
Distribution maintenance	141,539	144,371
Total operating expenses	11,140,788	9,135,995
Operating loss from utility operations	(2,268,008)	(846,025)
Nonutility operations:		
Operating revenues:		
Fuel and gas sales	9,341,838	7,660,469
Other	272,413	299,651
Total operating revenues	9,614,251	7,960,120
Operating expenses:		
Cost of sales	7,384,111	5,530,080
Other	562,868	609,938
Total operating expenses	7,946,979	6,140,018
Operating income from nonutility operations	1,667,272	1,820,102
Operating income (loss)	(600,736)	974,077
Nonoperating income (expense):		
Compact funding	1,866,667	1,866,667
Interest expense	(669,343)	(764,650)
Total nonoperating income (expense), net	1,197,324	1,102,017
Change in net assets	596,588	2,076,094
Net assets at beginning of year	5,203,500	3,127,406
Net assets at end of year	$ 5,800,088	$ 5,203,500

See accompanying notes to financial statements.

MARSHALLS ENERGY COMPANY, INC.

Statements of Cash Flows
Years Ended September 30, 2003 and 2002

	2003	2002
Cash flows from operating activities:		
Cash received from customers	$ 17,361,889	$ 16,135,634
Cash payments to suppliers for goods and services	(15,357,226)	(13,243,530)
Cash payments to employees for services	(1,875,632)	(1,636,314)
Miscellaneous activities, net	(338,505)	(484,220)
Net cash (used for) provided by operating activities	(209,474)	771,570
Cash flows from noncapital financing activities:		
Cash received from Compact Funds	1,866,667	1,866,667
Net repayment under bank credit line agreement	-	(1,200,000)
Interest paid on short-term borrowings	-	(76,455)
Net cash provided by noncapital financing activities	1,866,667	590,212
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets	(476,701)	(312,597)
Proceeds from disposal of capital assets	10,749	-
Principal paid on long-term debt	(425,933)	(406,901)
Interest paid on long-term debt	(669,343)	(688,195)
Net cash used for capital and related financing activities	(1,561,228)	(1,407,693)
Net increase (decrease) in cash and cash equivalents	95,965	(45,911)
Cash and cash equivalents at beginning of year	617,345	663,256
Cash and cash equivalents at end of year	$ 713,310	$ 617,345
Reconciliation of operating income (loss) to net cash (used for) provided by operating activities:		
Operating income (loss)	$ (600,736)	$ 974,077
Adjustments to reconcile change in net assets to net cash (used for) provided by operating activities:		
Depreciation and amortization	1,069,713	1,044,646
Provision for uncollectible accounts receivable	282,463	329,532
(Increase) decrease in assets:		
Accounts receivable:		
Electricity	(284,413)	(362,835)
Affiliates	(371,124)	61,620
Other	(197,193)	253,077
Materials and supplies	(50,268)	(439,614)
Prepayments	9,279	(11,860)
Increase (decrease) in liabilities:		
Accounts payable	(100,017)	(965,144)
Payable to affiliates	(80,703)	(70,576)
Accrued taxes	92,832	(24,439)
Other current and accrued liabilities	20,693	(16,914)
Net cash (used for) provided by operating activities	$ (209,474)	$ 771,570

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 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. These amounts are included in restricted 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 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.

(2) Summary of Significant Accounting Policies, Continued

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

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, 2003 and 2002, cash and cash equivalents are $713,310 and $617,345, respectively, and the corresponding bank balances are $1,663,397 and $1,584,038, respectively. Of the bank balance amount as of September 30, 2003 and 2002, $1,660,806 and $1,468,943, respectively, are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2003 and 2002, bank deposits in the amount of $100,000 and $100,994, respectively, are 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 statements of net assets.

(2) Summary of Significant Accounting Policies, Continued

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. 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
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.

New Accounting Standards

GASB has 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. MEC is required to adopt GASB Statement No. 34, as amended by GASB Statement No. 37, and certain provisions of GASB Statement No. 38 in fiscal year 2003.

To conform to the requirements of GASB 34, the following changes have been made to MEC's financial statements for fiscal years 2003 and 2002:

- Retained earnings have been reclassified into the following net assets categories:
  - Investment in capital assets; capital assets, net of accumulated depreciation and related debt, plus construction or improvement of those assets.
  - 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.
- The statement of cash flows has been presented using the direct method.

(3) Materials and Supplies

Materials and supplies at September 30, 2003 and 2002, consist of the following:

	2003	2002
Distribution and power plant supplies	$ 1,683,194	$ 1,602,911
Lubricants	113,011	162,801
Fuel	38,463	18,688
	$ 1,834,668	$ 1,784,400

(4) Capital Assets

Capital assets activity for the years ended September 30, 2003 and 2002, was as follows:

	2003			
	October 1, 2002	Additions	Retirements	September 30, 2003
Utility Plant:				
Power plant engines	$ 14,720,739	$ -	$ -	$ 14,720,739
Plant and machinery	1,416,381	196,526	-	1,612,907
Vehicles	781,058	71,573	(67,365)	785,266
Leasehold improvements	356,059	214,905	-	570,964
Residences	548,284	-	-	548,284
Fences and seawalls	371,702	-	-	371,702
Leasehold land	330,000	-	-	330,000
Furniture and fixtures	150,833	13,697	-	164,530
Nonutility Plant:				
LPG terminal	174,206	-	-	174,206
	18,849,262	496,701	(67,365)	19,278,598
Less accumulated depreciation	(5,148,927)	(1,069,713)	56,617	(6,162,023)
	13,700,335	(573,012)	(10,748)	13,116,575
Construction work-in-progress	20,000	25,866	(45,866)	-
	$ 13,720,335	$ (547,146)	$ (56,614)	$ 13,116,575

	2002			
	October 1, 2001	Additions	Retirements	September 30, 2002
Utility Plant:				
Power plant engines	$ 14,720,739	$ -	$ -	$ 14,720,739
Plant and machinery	1,406,943	9,438	-	1,416,381
Vehicles	679,691	136,367	(35,000)	781,058
Leasehold improvements	350,559	5,500	-	356,059
Residences	520,361	27,923	-	548,284
Fences and seawalls	272,876	98,826	-	371,702
Leasehold land	330,000	-	-	330,000
Furniture and fixtures	136,290	14,543	-	150,833
Nonutility Plant:				
LPG terminal	174,206	-	-	174,206
	18,591,665	292,597	(35,000)	18,849,262
Less accumulated depreciation	(4,139,281)	(1,044,646)	35,000	(5,148,927)
	14,452,384	(752,049)	-	13,700,335
Construction work-in-progress	-	20,000	-	20,000
	$ 14,452,384	$ (732,049)	$ -	$ 13,720,335

(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, 2003 and 2002, MEC is liable for gross revenue tax to RepMar amounting to \$145,357 and \$60,230, 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, 2003 and 2002, MEC is liable for import duty to RepMar amounting to \$30,011 and \$22,306, respectively.

(6) Notes Payable

	2003	2002
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, 2003 and 2002.	\$ 10,239,601	\$ 10,665,534
Less current installments	458,581	431,240
Long-term debt	\$ 9,781,020	\$ 10,234,294

Future repayment commitments are as follows:

Year ending September 30,	Principal	Interest	Total
2004	$ 458,581	$ 636,517	$ 1,095,098
2005	488,981	606,115	1,095,096
2006	388,124	433,196	821,320
2007	550,388	559,987	1,110,375
2008	724,230	629,359	1,353,589
2009-2013	3,571,347	1,904,131	5,475,478
2014-2018	4,057,950	601,511	4,659,461
	$ 10,239,601	$ 5,370,816	$ 15,610,417

(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 based on a tariff rate of $0.12 cents per kilowatt hour for monthly bills less than 500 kilowatt hours, or $0.16 cents per kilowatt hour for bills greater than 500 kilowatt hours. 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, 2003 and 2002, and the related receivables from and payables to affiliates, are as follows:

	2003			
	Revenues	Expenses	Receivables	Payables
RepMar	$ 1,885,006	$ 490,713	$ 848,120	$ 31,423
Majuro Water and Sewer Company, Inc.	280,069	18,533	247,836	-
Marshall Islands Social Security Administration	34,501	244,213	2,169	58,925
Majuro Resort, Inc.	289,258	8,096	50,302	-
Other	790,278	130,691	276,463	-
	$ 3,279,112	$ 892,246	$ 1,424,890	$ 90,348

	2002			
	Revenues	Expenses	Receivables	Payables
RepMar	$ 1,547,220	$ 487,546	$ 589,981	$ 101,994
Majuro Water and Sewer Company, Inc.	201,249	3,352	171,627	-
Marshall Islands Social Security Administration	34,880	279,128	5,550	69,057
Majuro Resort, Inc.	294,211	3,635	50,465	-
Other	744,347	85,923	236,143	-
	$ 2,821,907	$ 859,584	$ 1,053,766	$ 171,051

(7) Related Party Transactions, Continued

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, 2002, MEC received $1,117,850 from RepMar relating to this project. The unexpended amount of $92,724, payable to RepMar at September 30, 2002, was disbursed during fiscal year 2003.

For the years ended September 30, 2003 and 2002, MEC received Compact Section 214(a) Funding of $1,866,667 each year, passed through RepMar. Management believes that MEC will not continue to receive such funding after fiscal year 2003.

As of September 30, 2003 and 2002, MEC maintained a demand deposit account with an affiliated financial institution, amounting to $2,592 and $115,095, respectively. MEC had a loan payable to an affiliated financial institution amounting to $1,200,000, which was paid in full on July 4, 2002.

(8) 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, 2003 and 2002 is approximately $2,035,781 and $2,283,316, 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

Management of MEC 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.

(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 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 Changes in Net Assets by Source Year Ended September 30, 2003 (With comparative information for the year ended September 30, 2002)

	Generation	Distribution	Contracts	Tank Farm	Jaluit	Wotje	MEC-Gas	Admin - istration	Totals 2003	Totals 2002
Operating revenues:										
Fuel and gas sales	$ -	$ -	$ -	$ 8,918,636	$ -	$ -	$ 423,202	$ -	$ 9,341,838	$ 7,660,469
Cost of sales	-	-	-	(7,284,573)	-	-	(99,538)	-	(7,384,111)	(5,530,080)
Gross profit on sales	-	-	-	1,634,063	-	-	323,664	-	1,957,727	2,130,389
Electric and service billings	8,774,150	9,103	-	-	88,710	817	-	-	8,872,780	8,289,970
Other income	4,690	36,178	22,200	148,187	22,821	1,980	1,538	34,819	272,413	299,651
Total operating revenues, net	8,778,840	45,281	22,200	1,782,250	111,531	2,797	325,202	34,819	11,102,920	10,720,010
Operating expenses:										
Fuel and lubricants	4,902,223	-	-	-	148,989	-	-	-	5,051,212	4,215,743
Salaries, wages and benefits	938,983	448,557	5,400	46,311	239,509	8,531	37,543	505,358	2,230,192	1,815,976
Repairs and supplies	971,225	656,243	-	119,564	52,961	303	32,352	89,360	1,922,008	1,462,609
Depreciation and amortization	810,256	102,076	-	33,642	10,817	-	15,485	97,437	1,069,713	1,044,644
Bad debts	281,949	-	-	-	-	-	-	514	282,463	329,532
Gross revenue tax	-	-	-	-	-	-	-	288,322	288,322	234,949
Insurance	89,241	32,368	-	27,310	4,335	-	2,987	6,893	163,134	155,960
Office	41,189	84,298	-	532	20,041	83	106,023	84,539	336,705	120,792
Diesel import tax	-	-	-	102,577	-	-	-	-	102,577	88,297
Staff training	-	-	-	-	-	-	-	49,387	49,387	75,682
Communications	6,925	5,847	-	362	9,944	-	1,714	32,074	56,866	69,486
Other personnel costs	-	-	-	-	-	-	-	-	-	32,032
Travel	25,748	4,052	-	-	170	372	-	19,216	49,558	27,880
Laundry and uniforms	15,076	1,540	-	140	2,874	-	230	1,525	21,385	22,246
Professional fees	-	-	-	-	-	-	-	3,050	3,050	13,801
Entertainment	-	-	-	-	-	-	-	26,784	26,784	12,892
Advertising	-	-	-	-	-	-	-	10,491	10,491	990
Miscellaneous	13,114	3,374	-	2,473	42	-	-	20,806	39,809	22,422
Total operating expenses	8,095,929	1,338,355	5,400	332,911	489,682	9,289	196,334	1,235,756	11,703,656	9,745,933
Operating income (loss)	682,911	(1,293,074)	16,800	1,449,339	(378,151)	(6,492)	128,868	(1,200,937)	(600,736)	974,077
Nonoperating income (expense):										
Compact funding	1,866,667	-	-	-	-	-	-	-	1,866,667	1,866,667
Interest expense	(669,343)	-	-	-	-	-	-	-	(669,343)	(764,650)
Total nonoperating income (expense), net	1,197,324	-	-	-	-	-	-	-	1,197,324	1,102,017
Change in net assets	$ 1,880,235	$ (1,293,074)	$ 16,800	$ 1,449,339	$ (378,151)	$ (6,492)	$ 128,868	$ (1,200,937)	$ 596,588	$ 2,076,094

See accompanying independent auditors' report.