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August 14, 2013

Mr. David Paul
General Manager
Marshalls Energy Company, Inc.
P.O. Box 1439
Majuro, Marshall Islands 96960

Dear Mr. Paul:

In planning and performing our audit of the financial statements of Marshalls Energy Company (MEC) as of and for the year ended September 30, 2012 (on which we have issued our report dated August 14, 2013), 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, we considered MEC's 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 do not express an opinion on the effectiveness of MEC's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, in connection with our audit, we identified, and included in the attached Appendix I, deficiencies related to MEC's internal control over financial reporting and other matters as of September 30, 2012 that we wish to bring to your attention.

We have also issued a separate report to the Board of Directors, also dated August 14, 2013, 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 definition of a deficiency is also set forth in the attached Appendix I.

A description of the responsibility of management for establishing and maintaining internal control over financial reporting and of the objectives of and inherent limitations of internal control over financial reporting, is set forth in the attached Appendix II and should be read in conjunction with this report.

This report is intended solely for the information and use of the Board of Directors, management, others within the organization, and the Office of the Auditor-General and is not intended to be and should not be used by anyone other than these specified parties.

We will be pleased to discuss the attached comments with you and, if desired, to assist you in implementing any of the suggestions.

We wish to thank the staff and management of MEC for their cooperation and assistance during the course of this engagement.

Very truly yours,

Deloitte + Touche LLP

SECTION I - DEFICIENCIES

We identified, and have included below, certain deficiencies involving MEC's internal control over financial reporting as of September 30, 2012 that we wish to bring to your attention:

(1) Receivables

- Collection of outer island solar electricity billings:

  Outer island solar electricity customers are to be billed at $5 per month; however, bills are not sent to customers. MEC has representatives in the outer islands responsible for collection. Not all customers pay and MEC does not enforce the 30-day disconnection policy. Also, collections from outer island customers are not routinely monitored.

  We recommend that management establish and enforce policies and procedures governing outer island collections. This matter was discussed in our previous letters to management for the audits of fiscal years 2007 through 2011.

- Returned checks receivable:

  At September 31, 2012, MEC recorded $69,320 of returned checks receivable. Of this amount, $57,446 arose in prior years. Historically, no monitoring and reconciliation of the account occurred. In fiscal year 2012, the accountants attempted to monitor and reconcile but there does not appear to be a formal policy governing the monitoring and collection of returned checks.

  We recommend that management establish related policies and procedures. This matter was discussed in our previous letters to management for the audits of fiscal years 2009 through 2011.

(2) Allowance for Doubtful Accounts

MEC does not consistently apply policies and procedures in place with respect to assessing the adequacy of the allowance for doubtful accounts. Audit adjustments were proposed to increase the allowance for doubtful accounts as of September 30, 2012.

We recommend that management establish policies and procedures governing the allowance for doubtful accounts including, but not limited to, reviewing aged accounts receivable reports on a monthly basis, identifying doubtful accounts, and monitoring accounts receivable statistics (e.g. days of sales outstanding, accounts receivable turnover) for significant fluctuations. This matter was discussed in our previous letters to management for the audits of fiscal years 2008 through 2011.

(3) Inventory

- Fuel inventory:

  Inventory quantities as of September 30, 2012 were understated by 399,415 gallons compared to quantities confirmed by fuel supplier. MEC used the fuel prior to obtaining vendor approval.

  We recommend a complete trail of usage and regular reconciliation with the vendor to minimize misstatement of inventory and liabilities. We recommend that approval be obtained prior to use.

(4) Property, Plant and Equipment

- Estimated useful life and depreciable assets

  An asset was not depreciated because useful life had not been estimated. The asset cost $101,107 and was purchased in November 2011.

  We recommend depreciation commence when assets are placed in service.

- Periodic inventories of plant and equipment:

  During fiscal year 2012, MEC conducted a physical count of vehicles; however, a physical count of all other fixed assets was not performed. Based on physical inspection tests, we noted $125,000 of extrapolated costs of recorded assets that may not be located.

  We recommend that management consider performing periodic physical counts and tagging all fixed assets. Furthermore, we recommend that management routinely update and reconcile the fixed asset register. Lack of a physical count of fixed assets was discussed in our previous letters to management for the audits of fiscal years 2007 through 2011.

- Monitoring the outer island fixed asset register:

  A fixed asset register as of September 30, 2012 for outer island residential solar projects was not provided. Also, depreciation was not also recorded. Furthermore, the CWIP accounts for solar projects are not regularly reviewed and reconciled to identify completed projects or to identify invalid items.

  We recommend that management support fixed asset costs, accumulated depreciation, and depreciation expense through a reconciled fixed asset register. We further recommend that management regularly review, reconcile, and evaluate the register for accuracy.

- Evaluation of long-lived assets:

  GASB Statement No. 42, Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries, states that if an event or circumstance indicates that a capital asset may be impaired, but the test of impairment determines that impairment has not occurred, the estimates used in depreciation calculations - remaining estimated useful life and salvage value - should be reevaluated and changed, if necessary. Although our evaluation of MEC's long-lived assets did not indicate that long-lived assets are impaired, we recommend that MEC consider the implication of GASB 42. This matter was discussed in our previous letters to management for the audits of fiscal years 2008 through 2011.

(5) Liabilities

- Import tax payable:

  At September 30, 2012, diesel import tax payable (account number 2120) of $249,787 represented import taxes collected in previous years from a third party for remittance to tax authorities. We were informed that this account has not been reconciled; therefore, we were unable to ascertain whether the third party had been invoiced for and had paid all import taxes due. Furthermore, we were unable to ascertain whether taxes collected were remitted.

  We recommend that management investigate this account, including whether applicable taxes were billed, collected and remitted. This matter was discussed in our previous letters to management for the audits of fiscal years 2009 through 2011.

(5) Liabilities, Continued

- Recorded liabilities:

  At September 30, 2012, account number 2001 in the amount of $68,151 represented withholding taxes collected in previous years. We were informed that this account has not been reconciled; therefore, we were unable to ascertain whether MEC remitted these withholding taxes.

  At September 30, 2012, the composition of account number 2000 in the amount of $110,476 cannot be determined. We were informed that this account has not been reconciled; therefore, we were unable to ascertain its validity.

  At September 30, 2012, a payable to a vendor in the amount of $45,405 is recorded. There were no subsequent payments made to the vendor and balance has been outstanding for over a year. Invoices for the balance could not be provided; therefore, we were unable to ascertain its validity.

  We recommend that management investigate these accounts, including whether applicable taxes were billed, collected and remitted.

(6) Electric Revenue

- Monitor and review line losses:

  Line loss percentage is a function of kilowatt hours generated and billed. Because of the introduction of prepaid electricity in 2011, kilowatt hours billed does not completely monitor and capture prepaid meter user consumption. Thus, line loss percentages may have worsened compared with prior years.

  We recommend that management implement a process to monitor and review line losses.

- Documentation trails:

  Of 75 electricity billings tested, 26 samples dated between October 2011 and April 2012 were not verified against underlying meter readings because raw data is not saved after billing uploading and processing.

  We recommend that management maintain an audit trail of readings.

- Rotation of meter readers:

  MEC has two meter readers and two linemen (in Laura) who assist in monthly meter readings. The meter readers are responsible for the northern end of Majuro (Rita to the airport) and the Laura linemen take care of the southern end (airport to Laura). Meter readers are not rotated.

  For improved controls, we suggest rotating schedules of meter readers.

(6) Electric Revenue, Continued

- Billing to customers:

  MEC's meter reader was not able to read one customer's meter in a specific month because no one was home to allow him in. For months when a meter is not read, a minimum of $12 is charged. The following month, the customer complained about high charges, alleging that readings are erroneous, and did not pay the bill.

  We recommend that management consider billing the average usage for the last 3 months to minimize the opportunity of a recurrence of this matter which contributes to the accumulation of unpaid billings.

(7) Fuel Revenue

- Documentation of negotiated prices:

  Of 75 sample fuel sales, 74 were not agreed to a documented approved sales price.

  We recommend that a policy be formulated and implemented relative to this matter, including the appropriate documentation of sales prices.

- Documentation of fuel receipts:

  Of 75 sample fuel sales, 13 were with bulk delivery receipt (BDR) approved by security personnel after the date fuel was bunkered. Based on the documented signatures, approval occurred after the release of fuel. Security personnel are expected to approve the receipt before the release of fuel.

  We recommend that MEC enforce existing approval policies.

- Completeness of Bulk Delivery Receipts (BDR) and continuity of meter readings

  Customers pay for fuel and obtain a BDR. However, customers use a BDR when fuel is needed; thus, usage and presentment of the document to MEC is not necessarily sequential. However, all numbers in the series need to be accounted for. We reviewed the sequential use of BDRs and noted lapses in sequence are not accounted for. We were unable to trace 2349 and 2350 to the fuel sales log. Per inquiry, these BDRs were not received from the customer because they were misplaced.

  Of 75 samples, one BDR was not provided for examination. Per inquiry, the BDR was misplaced.

  We tested five random days during 2012 and reviewed the BDRs for continuity of meter readings. We noted on one of the five days sampled that a lapse in meter reading equivalent to 15 gallons is unaccounted for. Per inquiry, the BDR may not have been documented.

  We recommend complete accounting of BDR's and daily independent review of meter readings.

(8) Payroll

We noted the following:

- An employee worked eight regular hours but was paid eight overtime hours.
- An employee was paid a rate adjustment that was calculated incorrectly.
- Employee rate changes are not documented and filed or are documented but not approved.

The extrapolated impact of these errors is $31,058 which is presented as an unrecorded adjustment.

We recommend that review of payroll calculations be strengthened. We also recommend that payroll rate changes be documented, approved and filed.

(9) Accrued Reserve for Building and Engine Repairs

The accrued building and engine reserve has a balance of $2,140,822 as of September 30, 2012. MEC obtained a grant from ADB to repair Engine #3. ADB will cover about 60% of the costs while MEC will be responsible for the remainder. Expenditures relating to Engine #3 repairs should be applied against the reserve. Also, the reserve should be decreased by amount of the ADB grant.

We recommend that management estimate the impact of these events on the amount of reserve as of September 30, 2012 and record necessary adjustments.

(10) Expenses

One payment of twenty tested was not evidenced by an actual document travel and another was a reimbursement that was not evidenced by a receipt.

We also noted the following errors in recording transactions:

- Administrative expense of $18 classified as entertainment
- Administrative expense of $50 classified as employee bonus

We recommend that complete and relevant documentary supporting evidence be obtained and filed to support expense payments. We also recommend review prior to recording transactions. Additionally, we recommend dissemination of clear guidance for the correct use of accounts.

(11) Advances from Marshall Islands Marine Resources Authority

Under a memorandum of agreement dated August 3, 2012, Marshall Islands Marine Resources Authority (MIMRA) advanced $2,000,000 to MEC which is interest-free but should be returned by means of funneling future RepMar payments and of its agencies to MIMRA until such time the full amount is repaid. The advance should be repaid in one year. As of September 30, 2012, RepMar paid $1,034,714 to MEC but only $100,000 was remitted to MIMRA.

MEC asserts that the advance has been forgiven and is meant to be applied against RepMar receivables. No signed documentation has been provided evidencing the arrangement.

We recommend that complete and relevant documentary supporting evidence be obtained to support the arrangement.

SECTION II - OTHER MATTERS

Our observations concerning other matters related to operations, compliance with laws and regulations, and best practices involving internal control over financial reporting that we wish to bring to your attention at this time are as follows:

(1) Periodic Preparation and Review of Financial Reports

For fiscal year 2012, MEC closed their records quarterly. Depreciation was recorded only at year-end. We recommend complete recording of transactions and monthly closing of financial records. We also recommend that management develop a documented procedure for financial reporting process including review against budget and other internal metrics.

(2) Information Technology

MEC has not adopted formal policies and procedures governing information technology and data security. Consequently, passwords are not authenticated or enforced in accordance with minimum standards of password length, strength, and lock-out attempts. Backups are not regularly performed and there is no offsite storage for back-ups. Further, back-up restoration is not routinely tested. We recommend that management adopt formal policies and procedures governing information technology and data security. We further noted that one username and password is utilized by the billing department to gain access to and edit electric customer database files. Such edits are not independently approved in writing. This matter was discussed in our previous letters to management for the audits of fiscal years 2008 through 2011.

We further noted that user accounts for NCS are still active and are used approximately two years after implementation of Sage MIP and more than a year after implementation of UTP.

We recommend that user accounts be periodically reviewed and that passwords be routinely subject to change every ninety days. Additionally, appropriate back up routines should be documented and followed. NCS accounts should be deactivated or changed into a read-only access to avoid intended or unintended changes that could compromise the integrity of historical information.

(3) Depreciation Rates

MEC is required to apply RUS-approved depreciation rates on all fixed assets. The list of approved depreciation rates could not be located. We recommend that this list be located and copies provided to accounting staff responsible for recording and depreciating fixed assets. This matter was discussed in our letters to management for the audits of fiscal years 2003 through 2011.

(4) Segregation of Duties

Adjustments to LPG/propane inventory by an individual who is also responsible for custody are not independently reviewed and approved. Furthermore, daily propane stock reports submitted to accounting are not independently verified to substantiate variances in actual and expected readings.

We recommend that management establish adequate controls to mitigate risks associated with the above incompatible functions. This matter was discussed in our previous letters to management for the audits of fiscal years 2009 through 2011.

(5) Retirement Savings Plan

Taxes are currently not being withheld on MEC's matching of employee contributions to the retirement plan. We recommend that management require that applicable taxes be withheld on employer matching of retirement plan contributions and be remitted to taxing authorities. This matter was discussed in our previous letters to management for the audits of fiscal years 2010 and 2011.

(6) Receiving Process

MEC entered into a Grant Agreement with ADB, whereby ADB will fund the purchase of vending machines and materials necessary to repair and improve Engine #3. ADB pays directly to vendors. For two purchases funded by ADB, the Procurement Officer did not stamp on purchase documents that items were received by MEC and dated when received. There is also no clear identification that items received are the invoiced and ordered items.

We recommend that the Procurement Department implement a documented receiving report process, including agreeing nature and quantity of goods received with those ordered, signing off by a preparer and reviewer, and routing copies of documents to the Project Accountant. Documentation should be complete and should be filed timely.

(7) Submission of Annual Certificate

Under the loan agreement with Rural Utilities Service, within 90 days after the close of each calendar year, MEC is required to submit a written statement signed by the General Manager, stating that during such year MEC has fulfilled its obligations under the agreement throughout such year in all material respects or, if there has been a default in the fulfillment of any such obligations, specifying each default know to said person and the nature and status thereof. MEC has not submitted such statement.

We recommend that MEC comply with the reporting requirement.

SECTION III - DEFINITIONS

The definition of a deficiency is as follows:

A *deficiency* in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A deficiency in design exists when (a) a control necessary to meet the control objective is missing or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective would not be met. A deficiency in operation exists when (a) a properly designed control does not operate as designed, or (b) the person performing the control does not possess the necessary authority or competence to perform the control effectively.

APPENDIX II

MANAGEMENT'S RESPONSIBILITY FOR, AND THE OBJECTIVES AND LIMITATIONS OF, INTERNAL CONTROL OVER FINANCIAL REPORTING

The following comments concerning management's responsibility for internal control over financial reporting and the objectives and inherent limitations of internal control over financial reporting are adapted from auditing standards generally accepted in the United States of America.

Management's Responsibility

MEC's management is responsible for the overall accuracy of the financial statements and their conformity with generally accepted accounting principles. In this regard, management is also responsible for establishing and maintaining effective internal control over financial reporting.

Objectives of Internal Control over Financial Reporting

Internal control over financial reporting is a process affected by those charged with governance, management, and other personnel and designed to provide reasonable assurance about the achievement of the entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. Internal control over the safeguarding of assets against unauthorized acquisition, use, or disposition may include controls related to financial reporting and operations objectives. Generally, controls that are relevant to an audit of financial statements are those that pertain to the entity's objective of reliable financial reporting (i.e., the preparation of reliable financial statements that are fairly presented in conformity with generally accepted accounting principles).

Inherent Limitations of Internal Control over Financial Reporting

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.