Deloitte.

Deloitte & Touche LLP
361 South Marine Corps Drive
Tamuning, GU 96913-3973
USA
Tel: (671)646-3884
Fax: (671)649-4932
www.deloitte.com

May 26, 2014

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, 2013 (on which we have issued our report dated May 26, 2014), 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, 2013, that we wish to bring to your attention.

We have also issued a separate report to the Board of Directors, also dated May 26, 2014, 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

APPENDIX I

SECTION I - DEFICIENCIES

We identified, and have included below, certain deficiencies involving MEC's internal control over financial reporting as of September 30, 2013 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, customers are not billed and follow-up on collection does not appear to be occurring. MEC does not enforce the 30-day disconnection policy. 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 2012.

Returned checks receivable:

At September 30, 2013, MEC recorded $61,493 of returned checks receivable. The entire amount was provided with an allowance. Historically, monitoring and reconciliation of the account has not occurred. 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 2012.

(2) Allowance for Doubtful Accounts

MEC does not consistently apply policies and procedures to assess the adequacy of the allowance for doubtful accounts. 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 2012.

(3) Inventory

Fuel inventory:

The September 30, 2013 fuel inventory resulted in a 23,684 gallon difference between the expected balance and the actual count. Furthermore, inventory reconciliation variances appear to exist throughout the year and do not appear to be investigated. We recommend that timely reconciliation and monitoring of fuel inventory variances should occur.

Distribution and Power plant Inventories:

Job Order Requests are not prepared and filed prior to issuance of inventories in the power plant. Additionally, a receiver's signature on the log sheet of inventory issuances is not apparent. Furthermore, inventory files and subledgers maintained by the tank farm, power plant, and distribution personnel are not regularly reconciled with the general ledger. Reconciliation is performed only at year-end, in preparation for the annual audit. We recommend management implement appropriate internal controls over inventory management.

(4) Property, Plant and Equipment

Periodic inventories of plant and equipment:

A physical count of fixed assets was not performed during fiscal year 2013. Fixed assets are not always tagged to facilitate identification. 770 cash power meters aggregating $210,687 were not included in the fixed asset inventory. We recommend that management perform periodic physical counts and tag 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 2012.

Monitoring the outer island fixed asset register:

A fixed asset register as of September 30, 2013 for outer island residential solar projects was not provided. Also, depreciation was not recorded. Furthermore, the CIP accounts for solar projects are not regularly reconciled. 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.

(5) Liabilities

Import tax payable:

At September 30, 2013, diesel import tax payable (GL account 2120) of $249,787 represented import taxes collected in previous years from a third party. We were informed that this account has not been reconciled; therefore, we were unable to ascertain whether the third party was invoiced. Furthermore, we are unable to ascertain whether collected taxes were remitted. We recommend that management investigate and resolve this account balance. This matter was discussed in our previous letters to management for the audits of fiscal years 2009 through 2012.

Recorded liabilities:

At September 30, 2013, $66,244 of withholding taxes collected in previous years were recorded. 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, 2013, the composition of GL account 2000 of $110,476 could not be determined. 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 meters, kilowatt hours billed do not always capture prepaid meter use. Thus, line loss percentages may not provide information comparable with prior years. We recommend that management implement a process to monitor and review line losses.

Billing process:

Of 75 electricity billings tested, three have errors due to incorrect uploading of meter readings. Furthermore, one error was not supported by a rereading. Another customer was not billed for two months. A signed customer collection agreement was not on file. We recommend that management strengthen review of the billing process to timely identify and resolve errors. All collection agreements should be on file.

(6) Electric Revenue, Continued

Customer Master File Update:

One customer's master file changed from a Government to Residential class without appropriate review and approval. Furthermore, the status of several customers was not updated. Some customers were tagged as Active and Billable but had been already transferred to prepaid meters. We recommend management establish appropriate control policies requiring review and approval prior to making changes to master files. In addition, we recommend that customer status be timely updated.

Rotation of meter readers:

Meter readers are not periodically rotated. To improve controls, we suggest rotating meter reader schedules.

(7) Fuel Revenue and Cost of Power

Documentation of negotiated prices:

75 fuel sales tested did not agree to a documented sales price. We recommend that a policy be formulated and implemented relative to this matter, including appropriate documentation of sales prices.

Documentation of fuel receipts:

Of 75 fuel sales tested, seven bulk delivery receipts (BDR) did not reflect an approved signature by security personnel. Security personnel are expected to approve the receipt before fuel release. We recommend that MEC enforce existing approval policies.

Cost of Power:

Monthly fuel usage for power plants appears to indicate differences above acceptable industry variances. We recommend management strengthen controls over monthly power plant fuel usage.

(8) Payroll

Employee rate changes are not documented and filed or are documented but not approved. Furthermore, there is no formal process of updating and modifying payroll master files. The payroll clerk has full access to payroll master files that permits additions and modifications of existing employee information including rates. This allows the entity to be exposed to unauthorized changes. An audit trail documents changes in the master files has not been established and segregation of duties may be documented. We recommend that payroll rate changes be documented, approved and filed. Furthermore, we recommend that management adopt internal control policies over the review and approval process of employee master file changes.

(9) Journal Entries

One manual journal entry was directly posted without appropriate documentation including review and approval. Additionally, JV # 13API0465 was not supported by a signed voucher and related invoices were not provided. We recommend management establish appropriate internal controls over review and approval of journal entries.

(10) Expenses

One expense transaction recorded pertains to unreconciled difference between GL and SL resulting from prior year activities. One travel expense does not have Travel Authorization to attest proper approval of Company-funded travel. Furthermore, the Company does not have formal accounting policy on reporting and liquidation of travel advances and expenses.

One expense sample noted pertains to missing consigned fuel inventories resulting from unreconciled SL and GL balances. It appears that the Company has weak internal control on monitoring and timely reconciliation of reports resulting to unlocated inventories and unidentified reconciling items.

We also noted clearing of prepaid expenses that were already five months after the actual receipt of prepaid items. It appears that there is delay in clearing of prepayment and update of financial information.

We recommend timely reporting and reconciliation of records. We also recommend adopting accounting policy that would encourage timely reporting and liquidation of Company-funded travel advances and expenses.

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

MEC closes its financial statement process on a quarterly basis. Depreciation has been recorded semi-annually. We recommend complete recording of transactions and monthly reconciliation of key financial statement accounts. We also recommend that management develop a documented procedure for the 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 to 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 2012.

(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 2012.

(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 between 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 2012.

(5) Retirement Savings Plan

Taxes are currently not 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 2012.

(6) Receiving Process

MEC entered into a Grant Agreement with RUS, whereby RUS will fund the purchase of equipment and materials necessary to repair and improve Engine #7. Certain related receiving reports were not filed.

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.