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November 2, 2021

Mr. Jack Chong Gum
Chief Executive Officer
Marshalls Energy Company, Inc.
P.O. Box 1439
Majuro, Marshall Islands 96960

Dear Mr. Chong Gum:

In planning and performing our audit of the financial statements of Marshalls Energy Company (MEC) as of and for the year ended September 30, 2020 (on which we have issued our report dated November 2, 2021), 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, 2020, that we wish to bring to your attention.

We have also issued a separate report to the Board of Directors, also dated November 2, 2021, 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, 2020, that we wish to bring to your attention:

<u>(1) Receivables</u>

Allowance for Doubtful Debts Policy:

MEC's current allowance for doubtful debts policy includes assessment of specifically identified accounts and application of certain allowance percentage on remaining receivables depending on the receivable age bracket. This policy has been effective since 2016. We recommend management establish internal control policies and procedures over the doubtful debts policy and revisit the current policy by developing an updated historical analysis of receivables collectability.

Customer Credit Balances:

At September 30, 2020, customer credit receivable balances amounted $301,372, of which $90,998 pertains to long-outstanding collections requiring application to customer debit balances. The remaining $210,374 pertains to over collections from customers, specifically from a local government, which provides electricity allowances to its constituents. Management has been in communication with the local government in order to resolve accumulating credit balances. An audit adjustment was proposed to present amount as deferred revenue. We recommend management establish internal control policies and procedures over the reconciliation of credit balances to properly reflect application to customer accounts. Furthermore, we recommend management correctly present credit balances as deferred revenue.

Collection of Outer Island Solar Electricity Billings:

Outer island solar electricity customers are billed $5 per month and as of September 30, 2020, outstanding balance amounted $1,482,825; however, collection follow-up does not appear to occur. MEC does not enforce the 30-day disconnection policy. We recommend management establish internal control policies and procedures governing outer island solar collections. This matter was discussed in our previous letters to management for the audits of fiscal years 2007 through 2019.

Returned checks receivable:

At September 30, 2020, MEC recorded $65,988 of returned checks receivable with a corresponding allowance for doubtful debts. We recommend management establish internal control policies and procedures over collection of returned checks. This matter was discussed in our previous letters to management for the audits of fiscal years 2009 through 2019.

<u>(2) Inventory</u>

Fuel inventory:

Inventory reconciliation variances appear to exist throughout the year but do not appear to be investigated. While there may be an acceptable industry variance rate, the noted variances exceeded the acceptable or normal rate. We recommend management establish internal control policies and procedures over monitoring, reconciliation, and review of fuel inventory. This matter was discussed in our previous letter to management for the audit of fiscal year 2019.

In addition, fuel dipping sheets appear to be unorganized and some are missing. Further, we noted several errors in the recorded number of gallons (converted based on actual fuel dipping sheets) per Monthly Statistical Fuel Report. Also, there are inconsistencies between the recorded reading per actual fuel dipping sheets and Monthly Statistical Fuel Report. We recommend management establish internal control policies and procedures over inventory management to prevent 1) missing fuel tickets and 2) incorrect conversion of fuel volume, and to monitor usage and contents of the tanks. This matter was discussed in our previous letters to management for the audits of fiscal years 2013 through 2019.

SECTION I – DEFICIENCIES, CONTINUED

(2) Inventory, Continued

Supplies inventory:

There is delay in MEC's tagging of inventories as "Received" in its inventory system, resulting in $790,811 understatement of inventories. Adjustments were proposed to correct the noted misstatements. We recommend management establish internal control policies and procedures over the timely receipt of inventories to the inventory system and adjustment of relevant accounts, such as inventories and payables.

Physical count:

There are six inventory items with physical count different from reported quantity per inventory schedule. Extrapolation of identified inventory misstatements resulted in a potential $58,189 overstatement. We recommend management establish internal control policies and procedures over the monitoring of inventory issuances and properly record in-transit inventories and inventories arriving near year-end. Reconciliation of physical count and correct ending inventory balance should be properly documented.

(3) Property, Plant and Equipment

Updating of fixed asset register and tagging of assets:

Asset tag numbers of three items are not consistent with the numbers in the register and one item is not tagged. We recommend management establish internal control policies and procedures over the update of the fixed asset register reflecting asset tag numbers and continue putting tags on old assets. This matter was discussed in our previous letter to management for the audit of fiscal year 2019.

Monitoring the outer island fixed asset register:

A fixed asset register as of September 30, 2020 for outer island residential solar projects was not provided. We recommend management establish internal control policies and procedures over the reconciliation and update of the fixed asset register for outer island solar projects. This matter was discussed in our previous letters to management for the audits of fiscal years 2013 through 2019.

Periodic inventory and monitoring of assets not in use:

There is one fully depreciated vehicle that is not in use and continues to be recorded in the financial statements. We recommend management establish internal control policies and procedures over the timely updating of the fixed asset register for assets not in good condition, unrepairable and/or not in use.

(4) Electric Revenue

Rotation of meter readers:

Meter readers are not periodically rotated. We recommend management establish internal control policies and procedures over the rotation of meter readers. This matter was discussed in our previous letter to management for the audit of fiscal year 2019.

Monitor and review line losses:

Line losses are a function of kilowatt hours generated and billed. A generation analysis for fiscal year 2020 could not be provided. Thus, line loss percentages could not be calculated. We recommend management establish internal control policies and procedures over the monitoring and review of line losses. This matter was discussed in our previous letter to management for the audit of fiscal year 2019.

SECTION I – DEFICIENCIES, CONTINUED

(4) Electric Revenue, Continued

Meter reading adjustments:

Valid adjustments to meter readings are not documented and do not have evidence of review and approval. We recommend management establish internal control policies and procedures over meter reading adjustments and approval.

Review of unusual usage movements:

For 1 of 29 receivable items tested, erroneous electric revenues were recorded and the reason for such is an incorrect meter tagged in the system. This incorrect meter led to incorrect and larger-than-usual kilowatt usage. Extrapolation of the identified misstatement resulted in a potential $76,444 overstatement. We recommend management establish internal control policies and procedures over the review of unusual movements in customer usage. Furthermore, we recommend management establish a threshold for items to be investigated and monthly procedures to document that a review has taken place.

Monitoring of new postpaid meter connections:

For 1 of 39 postpaid revenue items selected, a portion of the revenue should be reported in FY2019. The reason for the error is late notice to the accounting department of a new meter installation. Extrapolation of the identified misstatement resulted in a potential $42,516 overstatement. We recommend management establish internal control policies and procedures over monitoring new postpaid meter connections.

Differences in Suprima generated reports:

There are unexplained differences in the Suprima system-generated cash power revenue reports. However, we believe that these differences are not material to the financial statements as a whole. We recommend management establish internal control policies and procedures over the review and identification of system-generated variances and determine the ultimate impact on the financial statements.

(5) Other Revenue

Differences in fuel prices charged:

For 4 of 44 fuel revenue items tested, charged prices differ from CEO approved prices. Extrapolation of the identified misstatement resulted in a potential $48,340 understatement. We recommend management establish internal control policies and procedures over fees charged in accordance with approved tariffs.

Unsigned bunker delivery receipt:

For 1 of 44 bunker delivery receipts tested, there is no evidence of security's signature/approval. We recommend management establish internal control policies and procedures over fuel issuances.

Unrecorded deferred revenues:

Three instances of unrecorded deferred revenues in a total amount of $34,575 were identified. We recommend management establish internal control policies and procedures over the reconciliation of collected amounts and actual fuel deliveries.

SECTION I – DEFICIENCIES, CONTINUED

(5) Other Revenue, Continued

Unrecorded lubricant revenues:

Four lubricant sales in an aggregate amount of $39,291 were not recorded due to a lack of internal control procedures over the monitoring and recording of lubricant sales. Currently, with the hiring of new tank farm personnel, management is implementing a check-and-balance system to account for all fuel and lubricant sales. We recommend management establish internal control policies and procedures over monitoring and recording fuel and lubricant sales.

(6) Daily collection receipts

For 13 of 73 daily cash collections tested, deposits occurred on an average of 2 to 5 banking days after receipt. Although this may be acceptable per MEC's policy, we recommend management establish internal control policies and procedures over the requirement for cash collections to be deposited on the next banking day. This matter was discussed in our previous letter to management for the audit of fiscal year 2019.

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) Information Technology

MEC has not adopted formal policies and procedures governing information technology and data security. We recommend management adopt formal policies and procedures governing information technology and data security. This matter was discussed in our previous letters to management for the audits of fiscal years 2008 through 2019.

(2) Depreciation Rates

MEC is required to apply RUS-approved depreciation rates to all capital assets. The list of approved depreciation rates could not be located. We recommend this list be located and copies be 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 2019.

(3) Retirement Savings Plan

Taxes are currently not withheld on MEC's matching of employee contributions to the retirement plan. We recommend management require 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 through 2019.

(4) Adequacy of Documents

Settlement agreements should be retained on file; however, an executed agreement with one customer could not be located. We recommend documentation be on file to support all recorded financial statement transactions. This matter was discussed in our previous letters to management for the audits of fiscal years 2018 and 2019.

(5) Propane issuances

We were unable to test the completeness of Product Delivery Reports (PDR forms) issued due to issuance not being in sequence. We recommend management improve internal controls over approved PDRs. This matter was discussed in our previous letters to management for the audits of fiscal years 2018 and 2019.

SECTION II - OTHER MATTERS, CONTINUED

(6) Board Sitting Fees

During the year ended September 30, 2020, MEC paid sitting fees of $18,438 to Board members and electricity allowances of $33,564 to Board members and management. These fees may constitute wages under the Income Tax Act 1989 and thus be subject to withholding taxes. No withholding taxes were withheld by MEC. We recommend management obtain an interpretation from the Ministry of Finance, Banking and Postal Services Chief of Revenue and Taxation concerning the applicability of withholding taxes on sitting fees paid to Board members. This matter was discussed in our previous letter to management for the audit of fiscal year 2019.

SECTION III - DEFINITION

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.

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.