

June 29, 2016

Mr. Steve Wakefield  
Acting General Manager  
Marshalls Energy Company, Inc.  
P.O. Box 1439  
Majuro, Marshall Islands 96960

Dear Mr. Wakefield:

In planning and performing our audit of the financial statements of Marshalls Energy Company (MEC) as of and for the year ended September 30, 2015 (on which we have issued our report dated June 29, 2016), 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, 2015, that we wish to bring to your attention.

We have also issued a separate report to the Board of Directors, also dated June 29, 2016, 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.

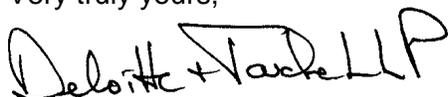
A description of the responsibility of management for establishing and maintaining internal control over financial reporting and of the objectives of and inherent limitations of internal control over financial reporting, is set forth in the attached Appendix II and should be read in conjunction with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



## SECTION I - DEFICIENCIES

We identified, and have included below, certain deficiencies involving MEC's internal control over financial reporting as of September 30, 2015, 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 collection follow-up does not appear to occur. 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 2014.

Returned checks receivable:

At September 30, 2015, MEC recorded \$65,218 of returned checks receivable. The amount was fully reserved for. Historically, account monitoring and reconciliation 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 2014.

### (2) Inventory

Fuel inventory:

Inventory reconciliation variances appear to exist throughout the year but do not appear to be investigated. While there is an acceptable industry variance rate, variances noted exceeded the acceptable or normal rate. We recommend that management strengthen internal control policy over monitoring, reconciliation, and review of fuel inventory.

Distribution and power plant inventories:

MEC transferred all inventories into one storage warehouse during fiscal year 2015. Several variances were noted in inventory as of year-end. Also, inventory files and sub-ledgers maintained by the tank farm, power plant, and distribution personnel are not regularly reconciled with the general ledger. This matter was discussed in our previous letters to management for the audits of fiscal years 2013 and 2014. We recommend management implement appropriate internal controls over inventory management. Furthermore, we recommend that management require that all transferred materials to a new storage warehouse be properly counted and recorded in their inventory system.

**SECTION I – DEFICIENCIES, CONTINUED**

(3) Property, Plant and Equipment

Periodic inventories of plant and equipment:

A physical count of fixed assets was not performed during fiscal year 2015. We recommend 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 2014.

Monitoring the outer island fixed asset register:

A fixed asset register as of September 30, 2015 for outer island residential solar projects was not provided. Also, depreciation was not recorded which resulted in proposed audit adjustments. 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. This matter was discussed in our previous letters to management for the audits of fiscal years 2013 and 2014.

(4) Electric Revenue

Rotation of meter readers:

Meter readers are not periodically rotated. To improve controls, we recommend that meter reader schedules be rotated.

(5) Fuel Revenue

Documentation of negotiated prices:

Of 75 fuel sales tested, 51 did not agree to a documented sales price. Lower fuel prices are to regular customers who purchase fuel in bulk. There is no documentation of negotiated these prices. We recommend that a policy be formulated and implemented relative to this matter, including appropriate documentation of sales prices.

(6) Prepayments

We noted that timely reconciliation of prepayments is not performed. Parts received in prior years were recorded as a current year expense. We recommend that management establish policies and procedures requiring timely recording of transactions and timely reconciliation of prepayments.

## 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

Management has established budgets and targets as measurement tools against actual performance. However, quarterly reports prepared for fiscal year 2015 were not compared and evaluated against budgets. We recommend that management develop a documented procedure for the financial reporting process including review against budget and other internal metrics. Also, we recommend that management require that appropriate personnel perform a detailed review of bank reconciliations to ascertain the integrity of the information. This matter was discussed in our previous letters to management for the audits of fiscal years 2013 and 2014.

### (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 backups. Further, backup 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 2014.

### (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 2014.

### (4) 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 2014.

### (5) Receiving Process

We noted that receiving report related to PO#201411-004 was not in file.

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. This matter was discussed in our previous letters to management for the audits of fiscal years 2013 and 2014.

## SECTION II - OTHER MATTERS, CONTINUED

### (6) Submission of Annual Certificate

Under the loan agreement with Rural Utilities Service, within 90 days of 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 known to said person and the nature and status thereof. MEC has not submitted such statement. We recommend that MEC comply with the reporting requirement. This matter was discussed in our previous letters to management for the audits of fiscal years 2013 and 2014.

### (7) Adequacy of Documents

Certain documentation could not be provided.

- Receiving document and vendor quotations related to Purchase Order #0032562.
- Receiving document and vendor quotations related to Purchase Order #0032935.
- Signed Settlement Agreement with Robert Reimers Enterprises, Inc.

Documentation should be on file in support of all recorded financial statement transactions.

### (8) Bank Reconciliation

We noted that a suspense item dated October 22, 2013 reflected in the October 2013 bank reconciliation was adjusted on June 30, 2015. We recommend that management establish policies and procedures requiring the performance of timely and thorough bank reconciliations and timely clearance of reconciling items.

### (9) Line Losses

For the year ended September 30, 2015, line losses of 14.97 million kWh or 26.31% of total production were incurred, indicating an overall 0.85% decrease from the prior year. Additionally, the total losses appear to be above industry standards. Losses may be caused by oversized transformers, equipment problems, inefficiencies at generation plants or in transmission and distribution, or by theft of service.

This condition is reiterative of conditions identified in our prior year audits of MEC.

We recommend MEC should continue its effort to reduce production and line losses.

## 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.

## **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.