

Management Letter

Marshalls Energy Company, Inc.

(A Component Unit of the Republic of the Marshall Islands)

Year ended September 30, 2022



January 13, 2025

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 the business-type activities of Marshalls Energy Company, Inc. (MEC) as of and for the year ended September 30, 2022, in accordance with auditing standards generally accepted in the United States, and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, we considered its internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of MEC's internal control. Accordingly, we do not express an opinion on the effectiveness of MEC's internal control.

A deficiency in internal control 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 material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented or detected and corrected on a timely basis. A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

During our audit, we noted the following deficiencies in internal control (as described above) and other matters:

Receivables - Allowance for Doubtful Accounts

Comment: MEC's current allowance for doubtful debts policy includes assessment of specifically identified accounts and application of certain allowance percentages on remaining receivables depending on the receivable age bracket. This policy has been effective since 2016.

Recommendation: We recommend management establish internal control policies and procedures requiring assessment of the collectability of accounts receivable. Furthermore, we recommend management establish a revised written policy governing receivable collections and write-offs.

Collection of Outer Island Solar Electricity Billings

Comment: As of September 30, 2022, Outer Island solar receivable balances amounted to \$1,846,366. MEC charges solar electricity customers a flat amount of \$5 per month and does not enforce an established 30-day disconnection policy. A corresponding allowance for doubtful accounts has been established in the amount of \$1,827,223.

Recommendation: We recommend management establish internal control policies and procedures governing outer island solar collections.

Contributed Electric Vehicles (EVs)

Comment: During our review of MEC's asset management and financial records, we identified four EVs acquired by the World Bank funded Sustainable Energy Development Project. Two EVs are under the custody of MEC; however, such were not recorded in MEC's asset register or financial statements. As the acquisition cost of \$89,100 was not considered material to the financial statements, no audit adjustment was proposed.

Recommendation: We recommend management establish procedures to ensure all contributed assets are recorded in MEC's fixed asset register and financial statements at acquisition cost, as per applicable accounting standards.

Bunker Delivery Reports

Comment: During our review of MEC's fuel sales management and documentation processes, we noted that Bunker Delivery Reports (BDRs) extracted from the Microix system are not sequentially numbered. Sequential numbering is a key control measure for tracking and verifying the completeness of transactions and documents.

Recommendation: We recommend management implement sequential numbering by ensuring all BDRs are issued with unique, sequential numbers to establish an effective control mechanism for tracking and reconciliation within the Microix system.

Line Loss

Comment: During our review of MEC's operational performance, we observed that line losses are not being consistently monitored, analyzed, and addressed in a structured manner. Line losses increased in current year as compared to the prior year.

Recommendation: We recommend management implement a robust system for continuous monitoring of line losses by using advanced metering infrastructure and energy management software to track technical and non-technical losses.

Gross Revenue Tax (GRT) Payments

Comment: The Government of the Republic of the Marshall Islands imposes a gross revenue tax (GRT) of 3% on revenues. As per Income Tax Act of 1989, as amended, sales of electricity by public utility companies are exempt from GRT. Accordingly, MEC is exempt from GRT on the sale of electric services. MEC is required to pay GRT on all other revenues. It was observed that MEC has not been paying GRT consistently with enabling legislation. As of September 30, 2022, MEC is liable for current and delinquent GRT of \$1,746,943, which is included as a liability in payables to affiliates.

Recommendation: We recommend management comply with enabling legislation concerning payment of GRT.

Board Sitting Fees

Comment: During the year ended September 30, 2022, MEC paid sitting fees of \$18,600 to Board members. These fees may constitute wages under the Income Tax Act of 1989 and thus may be subject to withholding taxes. It was observed that MEC has not withheld any tax while making this payment.

Recommendation: We recommend management to 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.

Retirement Savings Plan

Condition: During the year ended September 30, 2022, MEC made employer contributions, totaling \$75,549, to employee retirement savings plan. Taxes are not currently withheld and paid on the employer contributions.

Recommendation: 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 employer contributions to employee retirement savings plan.

This communication is intended solely for the information and use of management, the Board of Directors, 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. However, this report is also a matter of public record.

January 13, 2025

At this time, we would like to thank all the staff and management of MEC for their cooperation extended to us during the course of our audit. We would be pleased to discuss the above matters or to respond to any questions, at your convenience.

Sincerely,

Ernst + Young LLP