

May 21, 2009

Mr. William F. Roberts  
General Manager  
Marshalls Energy Company, Inc.  
P.O. Box 1439  
Majuro, Marshall Islands 96960

Dear Mr. Roberts:

In planning and performing our audit of the financial statements of the Marshalls Energy Company (MEC) as of and for the year ended September 30, 2008 (on which we have issued our report dated May 21, 2009), 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. 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, 2008 that we wish to bring to your attention.

We have also issued a separate report to the Board of Directors and management, also dated May 21, 2009, 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.

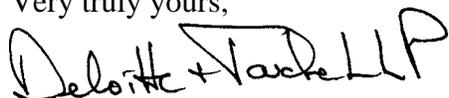
A description of the responsibility of management for establishing and maintaining internal control over financial reporting and of the objectives of and inherent limitations of internal control over financial reporting, is set forth in the attached Appendix II and should be read in conjunction with 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, deficiencies involving MEC's internal control over financial reporting as of September 30, 2008 that we wish to bring to your attention:

### (1) Cash Receipts

During fiscal year 2008, cash receipts and collections from the following locations and dates covered were not received and recorded by MEC:

Wotje solar operations – September 2008  
Namdrik solar operations – August and September 2008

Estimated total collections from the above-mentioned are not considered material. However, we recommend that management establish policies and procedures to ensure that collections from outer islands are fully accounted for. This matter was discussed in our previous letter to management for the audit of financial statements in fiscal year 2007.

### (2) Bank Reconciliation

Bank reconciliations for the Bank of Marshall Islands account are not timely performed. The September 30, 2008, account reconciliation was prepared in December 2008. We recommend that bank reconciliations be performed on a monthly basis.

### (3) Electricity Receivables – Review of Meter Reading Exception Reports

MEC's new billing system generates a meter reading exception report that highlights excessively high or low meter readings. We were informed that such reports were not reviewed during the fiscal year which resulted in overbillings and in various year-end receivable adjustments. We recommend that management implement policies and procedures to document reviews of the meter reading exception report to assist in ensuring that meter readings are accurately processed.

### (4) Allowance for Doubtful Accounts

MEC currently does not have policies and procedures in place with respect to estimating and recording an allowance for doubtful accounts. We recommend that MEC implement appropriate procedures for recording an allowance for doubtful accounts. These procedures may include, but not be limited to, reviewing MEC's accounts receivable aging report on a monthly basis, discussing specific customers' accounts with the credit and collections department to identify accounts for which collection is doubtful, and monitoring accounts receivable statistics (e.g., days sales outstanding, accounts receivable turnover) for significant fluctuation.

### (5) Property, Plant and Equipment

Our tests of property, plant and equipment noted the following:

- a. During fiscal year 2008, MEC conducted a physical count of its vehicles. However, physical counts of all other fixed assets have not been performed.
- b. One vehicle was not registered to MEC and is not insured.

## APPENDIX I, Continued

- c. For two construction in progress amounts tested aggregating \$363,902, salaries paid to employees totaling \$59,023 (check nos. 21882 and 22029) were issued to two MEC officers. The checks were then encashed for distribution. However, the distribution list of employees did not contain acknowledgement by employees evidencing their receipt.

We recommend that management consider performing physical counts of fixed assets, ensure all assets are insured and capitalized expenditures are properly supported. Lack of physical count of all other fixed assets of MEC was discussed in our previous letter to management for the audit of financial statements in fiscal year 2007.

### (6) 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 previous letters to management for the audit of financial statements in fiscal years 2003 through 2007.

### (7) 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.

### (8) Fuel and Gas Sales

Sales to customers should be based on approved and published prices. A price given to customers other than the published rates should be approved by appropriate management. Management approval of prices for the following sales was not adequately documented:

<u>Bunker Receipt/Document #</u>		
27565	27776	28338
27568	27794	28797
27618	27851	28925
27647	27882	29083
27657	27978	29329
27710	28032	29402
27759	28197	
27768	28219	

We recommend that management establish policies and procedures to ensure adequate documentation of overrides of list prices. This matter was discussed in our previous letter to management for the audit of financial statements in fiscal year 2007.

(9) Information System

Our evaluation of MEC's information system indicated that passwords are not authenticated or strictly enforced in accordance with minimum standards of password length, strength and lock out attempts. Further, there is no offsite storage for back-ups and restoration test of back-ups is not performed. We recommend that MEC enforce password authentication and consider performing back-ups on an offsite storage.

(10) Employee Evaluations

We were informed that employee evaluations are performed through verbal discussion with management. We recommend that MEC consider formalizing its employee evaluation process.

**SECTION II — OTHER MATTERS**

We noted no 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.

**SECTION III – DEFINITIONS**

The definition of a deficiency that is established in AU 325, *Communicating Internal Control Related Matters Identified in an Audit*, is as follows:

*A deficiency* 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.