

MARSHALLS ENERGY COMPANY, INC.

**INDEPENDENT AUDITORS' REPORT ON
INTERNAL CONTROL AND ON COMPLIANCE**

YEAR ENDED SEPTEMBER 30, 2004

**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND COMPLIANCE AND OTHER MATTERS
BASED UPON THE AUDIT PERFORMED IN ACCORDANCE
WITH GOVERNMENT AUDITING STANDARDS**

Board of Directors
Marshalls Energy Company, Inc.:

We have audited the financial statements of the Marshalls Energy Company, Inc. (MEC) as of and for the year ended September 30, 2004 and have issued our report thereon dated January 11, 2005. We conducted our audit 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered MEC's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting, which we have reported to management of MEC in a separate letter dated January 11, 2005.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether MEC's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed one instance of noncompliance that is required to be reported under *Government Auditing Standards*, which is described in the accompanying Schedule of Findings as item 2004-1.

This report is intended solely for the information and use of the Board of Directors, management, the Rural Utilities Service, supplemental lenders, the cognizant audit and other federal agencies and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte Touche LLP

January 11, 2005

MARSHALLS ENERGY COMPANY, INC.

Schedule of Findings
Year Ended September 30, 2004

Coverage Ratios

Finding No. 2004-1

Criteria: Section 5.4 of the RUS loan contract requires MEC to establish rates to provide revenue sufficient to meet average coverage ratio requirements as follows:

Operating Times Interest Earned Ratio (OTIER)	=	1.10
Operating Debt Service Coverage (ODSC)	=	1.10

Condition: During the year ended September 30, 2004, MEC achieved the following average coverage ratios:

OTIER	=	(2.25)
ODSC	=	(0.50)

Cause: The cause of the above condition is that utility rates are not sufficient to provide adequate revenues to comply with the prescribed ratio requirements.

Effect: The effect of the above condition is noncompliance with the average coverage ratio requirements as prescribed by Section 5.4 of the RUS loan contract.

Recommendation: We recommend that management review MEC's rates to comply with average coverage ratio requirements.

Prior Year Status: Noncompliance with the average contract ratio requirements as prescribed by Section 5.4 of the RUS loan contract was reported as a finding in the audits of MEC for fiscal years 2000 through 2003.

Auditee Response: Management continues to monitor and evaluate our operations in order to comply with the RUS loan ratios. It must be noted that an electricity rate increase averaging 14.1% has been approved by the Board and became effective from 1st January 2005.

MARSHALLS ENERGY COMPANY, INC.

Unresolved Prior Year Findings
Year Ended September 30, 2004

The status of unresolved prior year findings is disclosed within the Schedule of Findings section of this report (page 3).