

MARSHALLS ENERGY COMPANY, INC.
(A COMPONENT UNIT OF THE REPUBLIC OF
THE MARSHALL ISLANDS)

INDEPENDENT AUDITORS' REPORT ON
INTERNAL CONTROL AND ON COMPLIANCE

YEAR ENDED SEPTEMBER 30, 2008

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN 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, 2008 and have issued our report thereon dated May 21, 2009. 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 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 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 would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A *control 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 misstatements on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiency described in the accompanying Schedule of Findings and Responses (pages 3 through 4) as item 2008-1 to be a significant deficiency in internal control over financial reporting.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that the significant deficiency described above is a material weakness.

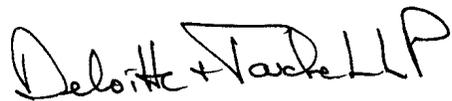
Compliance and Other Matters

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 grant agreements, 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 or other matters that is required to be reported under *Government Auditing Standards* and which is described in the accompanying Schedule of Findings and Responses as item 2008-2.

We noted certain matters that we reported to management of MEC in a separate letter dated May 21, 2009.

MEC's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Responses. We did not audit MEC's response and, accordingly, we express no opinion on it.

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

A handwritten signature in black ink that reads "Deloitte + Tatchell LLP". The signature is written in a cursive, stylized font.

May 21, 2009

MARSHALLS ENERGY COMPANY, INC.

Schedule of Findings and Responses
Year Ended September 30, 2008

Account Reconciliations

Finding No. 2008-1

Criteria: Account subsidiary ledgers are periodically reconciled to the general ledger on a timely basis.

Condition: Account reconciliations are not prepared on a timely basis which resulted in numerous year-end correcting entries for electricity and fuel receivables, inventory, construction-in-progress, import tax payable, import tax expense and related party accounts.

Cause: The cause of the above condition is the lack of periodic reconciliation of subsidiary ledgers.

Effect: The effect of the above condition is potential misstatements of account balances and increased risk of fraud.

Recommendation: We recommend that management perform account reconciliations on a systematic basis throughout the year.

Auditee Response and Corrective Action Plan: Procedures are in place covering reconciliations of subsidiary ledgers. Staff have been instructed to comply with these procedures.

MARSHALLS ENERGY COMPANY, INC.

Schedule of Findings and Responses, Continued
Year Ended September 30, 2008

Coverage Ratios

Finding No. 2008-2

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, 2008, MEC achieved the following average coverage ratios:

OTIER	=	(8.90)
ODSC	=	(3.50)

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 2007.

Auditee Response and Corrective Action Plan: With the approval by Cabinet of the revised tariff pricing template MEC has managed to increase tariffs to the point where all generation costs are now being covered by the electricity tariffs. Tariffs were increased four times in the financial year ended 30th September 2008 representing increases totaling \$0.19 per KWhr or 66%.

MARSHALLS ENERGY COMPANY, INC.

Unresolved Prior Year Findings
Year Ended September 30, 2008

The status of unresolved prior year findings is disclosed within the Schedule of Findings and Responses section of this report (pages 3 through 4).