

December 31, 2021

The Honorable Carson K. Sigrah  
Governor, State of Kosrae  
Federated States of Micronesia

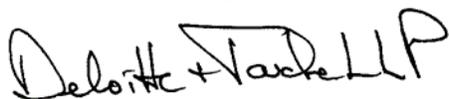
Dear Governor Sigrah:

We have performed an audit of the financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Kosrae (the State) as of and for the year ended September 30, 2020, in accordance with auditing standards generally accepted in the United States of America ("generally accepted auditing standards") and have issued our report thereon dated December 31, 2021.

We have prepared the following comments to assist you in fulfilling your obligation to oversee the financial reporting and disclosure process for which management of the State is responsible.

This report is intended solely for the information and use of the State's management, the Office of the Governor, the Office of the FSM National Public Auditor, federal awarding agencies, and others within the entity and is not intended to be and should not be used by anyone other than these specified parties.

Most respectfully,

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

cc: The Management of the State of Kosrae

## **OUR RESPONSIBILITY UNDER GENERALLY ACCEPTED AUDITING STANDARDS, GENERALLY ACCEPTED GOVERNMENT AUDITING STANDARDS AND THE UNIFORM GUIDANCE**

Our responsibility under (1) generally accepted auditing standards, (2) the standards applicable to financial audits, contained in *Government Auditing Standards*, issued by the Comptroller General of the United States ("generally accepted government auditing standards") (generally accepted auditing standards and generally accepted government auditing standards are collectively referred to herein as the "Auditing Standards") and (3) the audit requirements of Title 2 *U.S. Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (the Uniform Guidance) has been described in our engagement letter dated January 18, 2021. As described in that letter, the objectives of an audit conducted in accordance with the Auditing Standards and the Uniform Guidance are:

- To express an opinion on the fairness of the State's financial statements and the accompanying supplementary information, in relation to the financial statements as a whole, for the year ended September 30, 2020 (the "financial statements"), in accordance with accounting principles generally accepted in the United States of America ("generally accepted accounting principles") in all material respects, and to perform specified procedures on the required supplementary information for the year ended September 30, 2020;
- To express an opinion on whether the supplementary information that accompanies the financial statements, including the Schedule of Expenditures of Federal Awards, is fairly stated, in all material respects, in relation to the financial statements as a whole;
- To report on the State's internal control over financial reporting and on its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters for the year ending September 30, 2020, based on an audit of financial statements performed in accordance with generally accepted government auditing standards; and
- To express an opinion on the State's compliance with requirements applicable to each major program and report on the State's internal control over compliance in accordance with the Uniform Guidance.

Our responsibilities under the Auditing Standards and Uniform Grant Guidance include forming and expressing an opinion about whether the financial statements that have been prepared with the oversight of management and the Office of the Governor are presented fairly, in all material respects, in conformity with generally accepted accounting principles. The audit of the financial statements does not relieve management or the Office of the Governor of their responsibilities.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether caused by fraud or error. In making those risk assessments, we considered internal control over financial reporting relevant to the State's preparation and fair presentation of the financial statements in order to design audit procedures that were appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the State's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the State's internal control over financial reporting. Our consideration of internal control over financial reporting was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses.

We also considered the State's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with the Uniform Guidance. Our audit does not, however, provide a legal determination of the State's compliance with those requirements.

## ACCOUNTING ESTIMATES

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's current judgments. Those judgments are ordinarily based on knowledge and experience about past and current events and on assumptions about future events. Significant accounting estimates reflected in the State's 2020 financial statements include management's estimate of the allowance for uncollectible accounts, which is determined based upon past collection experience and aging of the accounts, and management's estimate of depreciation expense, which is based on estimated useful lives of the respective capital assets. During the year ended September 30, 2020, we are not aware of any significant changes in accounting estimates or in management's judgments relating to such estimates.

## AUDIT ADJUSTMENTS AND UNCORRECTED MISSTATEMENTS

Our audit of the financial statements was designed to obtain reasonable, rather than absolute, assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. As the result of our audit work, we identified matters that resulted in audit adjustments that we believe, either individually or in aggregate, would have a significant effect on the State's financial reporting process. Such adjustments, listed in Appendix A to Attachment I, have been recorded in the accounting records and are reflected in the 2020 financial statements.

In addition, we have attached to this letter, as Appendix B to Attachment I, a summary of uncorrected misstatements aggregated by us during the current engagement and pertaining to the latest period that were determined by management to be immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

## SIGNIFICANT ACCOUNTING POLICIES

The State's significant accounting policies are set forth in Note 1 to the State's 2020 financial statements. During the year ended September 30, 2020, there were no significant changes in previously adopted accounting policies or their application, except for the following pronouncements adopted by the State:

During the year ended September 30, 2020, GASB issued Statement No. 95, *Postponement of the Effective Dates of Certain Authoritative Guidance*, which postpones the effective dates of GASB Statement No. 84, 89, 90, 91, 92 and 93 by one year and GASB Statement No. 87 by 18 months; however, earlier application of the provisions addressed in GASB Statement No. 95 is encouraged and is permitted to the extent specified in each pronouncement as originally issued. In accordance with GASB Statement No. 95, management has elected to postpone implementation of these statements.

In January 2017, GASB issued Statement No. 84, *Fiduciary Activities*. This Statement is to improve guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported. The requirements of this Statement will enhance consistency and comparability by (1) establishing specific criteria for identifying activities that should be reported as fiduciary activities and (2) clarifying whether and how business-type activities should report their fiduciary activities. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. In accordance with GASB Statement No. 95, GASB Statement No. 84 will be effective for fiscal year ending September 30, 2021.

In June 2018, GASB issued Statement No. 89, *Accounting for Interest Cost Incurred Before the End of a Construction Period*. The objectives of this Statement are (1) to enhance the relevance and comparability of information about capital assets and the cost of borrowing for a reporting period and (2) to simplify accounting for interest cost incurred before the end of a construction period. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. In accordance with GASB Statement No. 95, GASB Statement No. 89 will be effective for fiscal year ending September 30, 2022.

**SIGNIFICANT ACCOUNTING POLICIES, CONTINUED**

In March 2018, GASB issued Statement No. 90, *Majority Equity Interests - An Amendment of GASB Statements No. 14 and 61*. The primary objectives of this Statement are to improve the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and to improve the relevance of financial statement information for certain component units. It defines a majority equity interest and specifies that a majority equity interest in a legally separate organization should be reported as an investment if a government's holding of the equity interest meets the definition of an investment. A majority equity interest that meets the definition of an investment should be measured using the equity method, unless it is held by a special-purpose government engaged only in fiduciary activities, a fiduciary fund, or an endowment (including permanent and term endowments) or permanent fund. Those governments and funds should measure the majority equity interest at fair value. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. In accordance with GASB Statement No. 95, GASB Statement No. 90 will be effective for fiscal year September 30, 2021.

In May 2019, GASB issued Statement No. 91, *Conduit Debt Obligations*. The primary objectives of this Statement are to provide a single method of reporting conduit debt obligations by issuers and eliminate diversity in practice associated with (1) commitments extended by issuers, (2) arrangements associated with conduit debt obligations, and (3) related note disclosures. This Statement achieves those objectives by clarifying the existing definition of a conduit debt obligation; establishing that a conduit debt obligation is not a liability of the issuer; establishing standards for accounting and financial reporting of additional commitments and voluntary commitments extended by issuers and arrangements associated with conduit debt obligations; and improving required note disclosures. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. In accordance with GASB Statement No. 95, GASB Statement No. 91 will be effective for fiscal year ending September 30, 2023.

In January 2020, GASB issued statement No. 92, *Omnibus 2020*. The objectives of this Statement are to enhance comparability in accounting and financial reporting and to improve the consistency of authoritative literature by addressing practice issues that have been identified during implementation and application of certain GASB Statements. This Statement addresses a variety of topics and includes specific provisions about the effective date of Statement No. 87, *Leases*, and Implementation Guide No. 2019-3, *Leases*, for interim financial reports, the terminology used to refer to derivative instruments and the applicability of certain requirements of Statement No. 84, *Fiduciary Activities*, to postemployment benefits. The requirements related to the effective date of GASB Statement No. 87 and Implementation Guide 2019-3, reissuance recoveries and terminology used to refer to derivative instruments are effective upon issuance. The remaining requirements of GASB Statement No. 92 is effective for the fiscal year ending September 30, 2022.

In March 2020, GASB issued Statement No. 93, *Replacement of Interbank Offered Rates*. The primary objective of this statement is to address those and other accounting and financial reporting implications of the replacement of an IBOR. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. In accordance with GASB Statement No. 95, GASB Statement No. 93 will be effective for fiscal year ending September 30, 2022.

In March 2020, GASB issued Statement No. 94, *Public-Private and Public-Public Partnerships and Availability Payment Arrangements*. The primary objective of this statement is to improve financial reporting by addressing issues related to public-private and public-public partnership arrangements. This statement also provides guidance for accounting and financial reporting for availability payment arrangements. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. GASB Statement No. 94 will be effective for fiscal year ending September 30, 2023.

## **SIGNIFICANT ACCOUNTING POLICIES, CONTINUED**

In May 2020, GASB issued Statement No. 96, *Subscription-Based Information Technology Arrangements*. This Statement provides guidance on the accounting and financial reporting for subscription-based information technology arrangements (SBITAs) for government end users (governments). This Statement (1) defines a SBITA; (2) establishes that a SBITA results in a right-to-use subscription asset - an intangible asset - and a corresponding subscription liability; (3) provides the capitalization criteria for outlays other than subscription payments, including implementation costs of a SBITA; and (4) requires note disclosures regarding a SBITA. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. GASB Statement No. 96 will be effective for fiscal year ending September 30, 2023.

In June 2020, GASB issued Statement No. 97, *Certain Component Unit Criteria, and Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans - an amendment of GASB Statements No. 14 and No. 84, and a supersession of GASB Statement No. 32*. The primary objectives of this Statement are to (1) increase consistency and comparability related to the reporting of fiduciary component units in circumstances in which a potential component unit does not have a governing board and the primary government performs the duties that a governing board typically would perform; (2) mitigate costs associated with the reporting of certain defined contribution pension plans, defined contribution other postemployment benefit (OPEB) plans, and employee benefit plans other than pension plans or OPEB plans (other employee benefit plans) as fiduciary component units in fiduciary fund financial statements; and (3) enhance the relevance, consistency, and comparability of the accounting and financial reporting for Internal Revenue Code (IRC) Section 457 deferred compensation plans (Section 457 plans) that meet the definition of a pension plan and for benefits provided through those plans. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. GASB Statement No. 97 will be effective for fiscal year ending September 30, 2022.

Management does not believe that the implementation of this statement will have a material effect on the financial statements.

We have evaluated the significant qualitative aspects of the State's accounting practices, including accounting policies, accounting estimates and financial statement disclosures and concluded that the policies are appropriate, adequately disclosed, and consistently applied by management.

### **DISAGREEMENTS WITH MANAGEMENT**

We have not had any disagreements with management related to matters that are material to the State's 2020 financial statements.

### **OUR VIEWS ABOUT SIGNIFICANT MATTERS THAT WERE THE SUBJECT OF CONSULTATION WITH OTHER ACCOUNTANTS**

We are not aware of any consultations that management may have had with other accountants about auditing and accounting matters during 2020.

### **SIGNIFICANT FINDINGS OR ISSUES DISCUSSED, OR SUBJECT OF CORRESPONDENCE, WITH MANAGEMENT PRIOR TO OUR RETENTION**

Throughout the year, routine discussions were held, or were the subject of correspondence, with management regarding the application of accounting principles or auditing standards in connection with transactions that have occurred, transactions that are contemplated, or reassessment of current circumstances. In our judgment, such discussions or correspondence were not held in connection with our retention as auditors.

### **OTHER SIGNIFICANT FINDINGS OR ISSUES ARISING FROM THE AUDIT DISCUSSED, OR SUBJECT OF CORRESPONDENCE WITH MANAGEMENT**

Throughout the year, routine discussions were held, or were the subject of correspondence, with management. In our judgment, such discussions or correspondence did not involve significant findings or issues requiring communication to the Office of the Governor.

## **SIGNIFICANT DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT**

In our judgment, we received the full cooperation of the State's management and staff and had unrestricted access to the State's senior management in the performance of our audit.

## **MANAGEMENT'S REPRESENTATIONS**

We have made specific inquiries of the State's management about the representations embodied in the financial statements. Additionally, we have requested that management provide to us the written representations the State is required to provide to its independent auditors under generally accepted auditing standards. We have attached to this letter, as Attachment I, a copy of the representation letter we obtained from management.

## **EMPHASIS-OF-MATTER PARAGRAPHS**

### *Receivables from the FSM National Government*

As discussed in the Note 3 to the financial statements, the State is in discussion with the FSM National Government to determine the ultimate collectability of certain receivables due from the FSM National Government in consultation with the grantor agency arising from Compact sector grant transactions.

### *COVID-19*

As discussed in the Note 11 to the financial statements, the State determined that the COVID-19 may negatively impact its business, results of operations and net position. The State is unable to reasonably estimate its ultimate financial impact.

Our opinion is not modified with respect to these matters.

## **CONTROL-RELATED MATTERS**

We have issued a separate report to you, also dated December 31, 2021, concerning certain matters involving the State's internal control over financial reporting and on its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters, which was based on the audit performed in accordance with *Government Auditing Standards*. We have also issued a separate report to you, also dated December 31, 2021, concerning the State's compliance with requirements applicable to each major program and on internal control over compliance in accordance with the Uniform Guidance. No significant deficiencies or material weaknesses under standards established by the American Institute of Certified Public Accountants were reported.

We have also identified, and included in Attachment II, deficiencies related to the State's internal control over financial reporting as of September 30, 2020 that we wish to bring to your attention.

The definition of a deficiency is also set forth in Attachment II.

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 Attachment II and should be read in conjunction with this report.



**KOSRAE STATE GOVERNMENT**  
**DEPARTMENT OF ADMINISTRATION AND FINANCE**  
**OFFICE OF THE DIRECTOR**  
**P.O. BOX 878**  
**TOTOL, KOSRAE STATE, FM 96944**

December 31, 2021

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 Division of Planning & Statistics: (691) 370-3163/3797  
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Deloitte & Touche LLP  
 361 South Marine Corps Drive  
 Tamuning GU 96913

We are providing this letter in connection with your audit of the financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Kosrae (the "State"), as of and for the year ended September 30, 2020, which collectively comprise the State's basic financial statements for the purpose of expressing an opinion as to whether the basic financial statements present fairly, in all material respects, the financial position, results of operations or changes in fund balances, of the State in accordance with accounting principles generally accepted in the United States of America (GAAP).

We confirm that we are responsible for the following:

- a. The preparation and fair presentation in the basic financial statements of financial position of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information, in accordance with GAAP.
- b. The design, implementation, and maintenance of internal control:
  - Relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.
  - To prevent and detect fraud.
- c. The review and approval of the financial statements and related notes and acknowledge your role in the preparation of this information. Specifically, we acknowledge that your role in the preparation of the financial statements was a matter of convenience rather than one of necessity. We have reviewed the financial statement preparation assistance provided by you and acknowledge that the financial statements are prepared in accordance with GAAP. Our review was based on the use of the financial statement disclosure checklist for general purpose financial statements obtained from the State Finance Officers Association. Additionally, we agree with the adjusting entries included in Appendix A.

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

We confirm, to the best of our knowledge and belief, the following representations made to you during your audit.

1. The basic financial statements referred to above are fairly presented in accordance with GAAP. In addition:
  - a. The financial statements include all component units as well as joint ventures with an equity interest, and properly disclose all other joint ventures and other related organizations.
  - b. Net position components (net investment in capital assets; restricted; and unrestricted) are properly classified and, if applicable, approved.
  - c. Deposits and investment securities are properly classified in the category of custodial credit risk.
  - d. Capital assets, including infrastructure assets, are properly capitalized, reported, and, if applicable, depreciated.
  - e. Required supplementary information is measured and presented within prescribed guidelines.
  - f. Applicable laws and regulations are followed in adopting, approving, and amending budgets.
  - g. The State's policy regarding whether to first apply restricted or unrestricted resources when an expense is incurred for purposes for which both restricted and unrestricted net position is available and appropriately disclosed and that net position is properly recognized under the policy.
  - h. The financial statements properly classify all funds and activities, including special and extraordinary items.
  - i. All funds that meet the quantitative criteria in the Government Accounting Standards Board (GASB) Codification of Government Accounting and Financial Reporting Standards (GASB Codification) Section 2200.159 for presentation as major are identified and presented as such and all other funds that are presented as major are particularly important to financial statement users.
  - j. Expenses have been appropriately classified in or allocated to functions and programs in the statement of activities, and allocations have been made on a reasonable basis.
  - k. Revenues are appropriately classified in the statement of activities within program revenues, general revenues, contributions to term or permanent endowments, or contributions to permanent fund principal.
  - l. The State has followed GASB Codification Section 1800.178 regarding which resources (restricted, committed, assigned, or unassigned) are considered to be spent for expenditures to determine the fund balance classifications for financial reporting purposes.
  - m. Interfund, internal, and intra-entity activity and balances have been appropriately classified and reported.
  - n. Fund balance restrictions, commitments, and assignments are properly classified and, if applicable, approved.
2. The State has provided to you all relevant information and access as agreed in the terms of the audit engagement letter.

3. The State has made available to you:
  - a. All financial records and related data for all financial transactions of the State and for all funds administered by the State. The records, books, and accounts, as provided to you, record the financial and fiscal operations of all funds administered by the State and provide the audit trail to be used in a review of accountability. Information presented in financial reports is supported by the books and records from which the financial statements have been prepared.
  - b. Contracts and grant agreements (including amendments, if any) and any other correspondence that has taken place with federal agencies.
4. There has been no:
  - a. Action taken by State management that contravenes the provisions of federal laws and Federated States of Micronesia laws and regulations, or of contracts and grants applicable to the State.
  - b. Communication from other regulatory agencies concerning noncompliance with or deficiencies in financial reporting practices or other matters that could have a material effect on the financial statements, which have been provided to you.
5. We believe the effects of any uncorrected financial statement misstatements aggregated by you during the current audit engagement and pertaining to the latest period in the current year are immaterial, both individually and in the aggregate, to the financial statements taken as a whole. A summary of such uncorrected misstatements has been attached as Appendix B.
6. The State has not performed a formal risk assessment, including the assessment of the risk that the financial statements may be materially misstated as a result of fraud. However, management has made available to you their understanding about the risks of fraud in the State and do not believe that the financial statements are materially misstated as a result of fraud.
7. We have no knowledge of any fraud or suspected fraud affecting the State involving:
  - a. Management.
  - b. Employees who have significant roles in the State's internal control.
  - c. Others, where the fraud could have a material effect on the financial statements.
8. We have no knowledge of any allegations of fraud or suspected fraud affecting the State's financial statements communicated by employees, former employees, analysts, regulators, or others.
9. There are no unasserted claims or assessments that we are aware of or that legal counsel has advised us are probable of assertion and must be disclosed in accordance with GASB Codification of Governmental Accounting and Financial Reporting Standards ("GASB Codification") Section C50, *Claims and Judgments*, except as disclosed in Note 10 to the financial statements.
10. Significant assumptions used by us in making accounting estimates are reasonable.
11. We are responsible for the preparation of the Schedule of Expenditures of Federal Awards in accordance with the requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* ("OMB Uniform Guidance"). We have identified and disclosed all of the State's government programs and related activities subject to the OMB Uniform Guidance compliance audit. In addition, we have accurately completed the appropriate sections of the data collection form.

12. We are responsible for compliance with local, state, and federal laws, rules, and regulations, including compliance with the requirements of OMB Uniform Guidance, and the provisions of grants and contracts relating to the State's operations. We are responsible for understanding and complying with the requirements of the federal statutes, regulations, and the terms and conditions of federal awards related to each of the State's federal programs. We are responsible for establishing and maintaining the components of internal control relating to our activities in order to achieve the objectives of providing reliable financial reports, effective and efficient operations, and compliance with laws and regulations. We are responsible for maintaining accounting and administrative control over revenues, obligations, expenditures, assets, and liabilities.
13. We are responsible for establishing and maintaining, and have established and maintained, effective internal control over compliance for federal programs that provides reasonable assurance that we are managing federal awards in compliance with federal statutes, regulations, and the terms and conditions of the federal awards that could have a material effect on its federal programs.
14. We have disclosed to you all deficiencies in the design or operation of internal control over financial reporting identified as part of our evaluation, including separately disclosing to you all such deficiencies that are significant deficiencies or material weaknesses in internal control over financial reporting.
15. No events have occurred subsequent to September 30, 2020, that require consideration as adjustments to or disclosures in the schedule of federal awards and related notes or that existed at the end of the reporting period that affect noncompliance during the reporting period.
16. We have disclosed all known noncompliance with direct and material compliance requirements occurring subsequent to September 30, 2020.
17. No changes in internal control over compliance or other factors that might significantly affect internal control over financial reporting, including any corrective actions taken by the State with regard to significant deficiencies and material weaknesses in internal control over compliance, have occurred subsequent to September 30, 2020.
18. Federal awards expenditures have been charged in accordance with applicable cost principles.
19. The Reporting Package submitted to the Federal Audit Clearinghouse (FAC) as defined by the OMB Uniform Guidance section 2CFR200.512(3)(c) does not contain protected personally identifiable information.
20. We have disclosed all contracts or other agreements with service organizations.
21. We have disclosed to you all communications from service organizations relating to noncompliance with the requirements of federal statutes, regulations, and terms and conditions of federal awards at those organizations.
22. We have:
  - a. Identified and disclosed to you the requirements of federal statutes, regulations, and the terms and conditions of federal awards that are considered to have a direct and material effect on each major program under audit.
  - b. Complied, in all material respects, with the direct and material compliance requirements identified above in connection with federal awards.
  - c. Identified and disclosed interpretations of any compliance requirements that have varying interpretations.

- d. Made available all federal awards (including amendments, if any) and any other correspondence relevant to federal programs and related activities that have taken place with federal agencies or pass-through entities. Management has made available all documentation related to compliance with the direct and material compliance requirements, including information related to federal program financial reports and claims for advances and reimbursements. Federal financial reports and claims for advances and reimbursements are supported by the books and records from which the financial statements have been prepared and are prepared on a basis consistent with that presented in the Schedule of Expenditures of Federal Awards. The copies of federal program financial reports provided are true copies of the reports submitted, or electronically transmitted, to the federal agency or pass-through Entity, as applicable.
  - e. Identified and disclosed all amounts questioned and all known noncompliance with the direct and material compliance requirements of federal awards, including the results of other audits, program reviews, or any communications from federal awarding agencies and pass-through entities concerning possible noncompliance related to the objectives of the audit.
  - f. Identified previous financial audits, attestation engagements, performance audits, or other studies related to the objectives of the audit and the corrective actions taken to address significant findings and recommendations, including the status of follow-up on prior audit findings (and information about all management decisions) by federal awarding agencies and pass-through entities.
  - g. Provided to you our views on the reported findings, conclusions, and recommendations for your report. We are responsible for follow-up on all prior-year(s) findings. We have prepared a summary schedule of prior-year findings reporting the status of our efforts in implementation of the prior-year's corrective action plan. The summary schedule of prior audit findings includes all findings required to be included in accordance with OMB Uniform Guidance.
23. We are responsible for taking corrective action plan on audit findings and have developed a corrective action plan that meets the requirements of OMB Uniform Guidance. We have included in the corrective action plan for current-year findings, the name of the person in our organization responsible for implementation of the actions, the best actions to be taken, and the estimate of a completion date. We have taken timely and appropriate steps to remedy fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse that you report.
24. Management has identified and disclosed to you all laws and regulations that have a direct and material effect on the determination of financial statement amounts.
25. We believe that we have properly identified, reported, and classified each component unit of the State and each organization that meets the criteria established in GASB Codification Section 2100, *Defining the Financial Reporting Entity*.

Except where otherwise stated below, matters less than \$80,600 collectively for the governmental activities, \$13,200 collectively for the General Fund, \$50,200 collectively for the Grants Assistance Fund, \$35,800 collectively for the Compact Trust Fund, and \$7,400 collectively for the aggregate remaining fund information are not considered to be exceptions that require disclosure for the purpose of the following representations. These amounts are not necessarily indicative of amounts that would require adjustment to, or disclosure in, the basic financial statements.

- 26. Except as listed in Appendix B, there are no transactions that have not been properly recorded and reflected in the financial statements.
- 27. The State has no plans or intentions that may affect the carrying value or classification of assets and liabilities.

28. Regarding related parties:
  - a. We have disclosed to you the identity of the State's related parties and all the related-party relationships and transactions of which we are aware.
  - b. To the extent applicable, related parties and all related-party relationships and transactions, including sales, purchases, loans, transfers, leasing arrangements, and guarantees (written or oral) have been appropriately identified, properly accounted for, and disclosed in the financial statements.
29. In preparing the financial statements in accordance with GAAP, management uses estimates. All estimates have been disclosed in the financial statements for which known information available prior to the issuance of the financial statements indicates that both of the following criteria are met:
  - a. It is reasonably possible that the estimate of the effect on the financial statements of a condition, situation, or set of circumstances that existed at the date of the financial statements will change in the near term due to one or more future confirming events.
  - b. The effect of the change would be material to the financial statements.
30. Risks associated with concentrations, based on information known to management, that meet all of the following criteria have been disclosed in the financial statements:
  - a. The concentration exists at the date of the financial statements.
  - b. The concentration makes the State vulnerable to the risk of a near-term severe impact.
  - c. It is at least reasonably possible that the events that could cause the severe impact will occur in the near term.
31. There are no:
  - a. Instances of identified or suspected noncompliance with laws, regulations, or provisions of contracts or grant agreements whose effects should be considered when preparing the financial statements, or other instances that warrant the attention of those charged with governance.
  - b. Known actual or possible litigation and claims whose effects should be considered when preparing the financial statements and that have not been disclosed to you and accounted for and disclosed in accordance with GAAP.
  - c. Known actual or likely instances of abuse that have occurred that could be quantitatively or qualitatively material to the financial statements.
  - d. Other liabilities or gain or loss contingencies that are required to be accrued or disclosed by GASB Codification Section C50, *Claims and Judgments*, except as discussed in Note 10 to the financial statements.
32. The State has satisfactory title to all owned assets, and there are no liens or encumbrances on such assets, nor has any asset been pledged as collateral, except as discussed in Notes 1 and 6 to the financial statements.
33. The State has complied with aspects of contractual agreements that may affect the financial statements.
34. No department or agency of the State has reported a material instance of noncompliance to us.

35. The State has identified all derivative instruments as defined by GASB Codification Section D40, *Derivative Instruments*, and appropriately recorded and disclosed such derivatives in accordance with GASB Codification Section D40.
36. No events have occurred after September 30, 2020, but before December 31, 2021, the date the financial statements were available to be issued that require consideration as adjustments to or disclosures in the financial statements.
37. Regarding required supplementary information:
  - a. We confirm that we are responsible for the required supplementary information.
  - b. The required supplementary information is measured and presented in accordance with GASB Codification Section 2200, *Comprehensive Annual Financial Report*.
  - c. The methods of measurement and presentation of the supplementary information have not changed from those used in the prior period.
38. Regarding supplementary information:
  - a. We are responsible for the preparation and fair presentation of the supplementary information in accordance with GASB Codification Section 2200, *Comprehensive Annual Financial Report*.
  - b. We believe the supplementary information, including its form and content, is fairly presented in accordance with GASB Codification Section 2200, *Comprehensive Annual Financial Report*.
  - c. The methods of measurement and presentation of the supplementary information have not changed from those used in the prior period.
39. Receivables recorded in the financial statements represent valid claims against debtors for sales or other charges arising on or before September 30, 2020 and have been appropriately reduced to their estimated net realizable value.
40. The State's significant accounting policies are set forth in Note 1 to the State's 2020 financial statements. During the year ended September 30, 2020, there were no significant changes in previously adopted accounting policies or their application, except for the following pronouncements adopted by the State:
41. During the year ended September 30, 2020, GASB issued Statement No. 95, *Postponement of the Effective Dates of Certain Authoritative Guidance*, which postpones the effective dates of GASB Statement No. 84, 89, 90, 91, 92 and 93 by one year and GASB Statement No. 87 by 18 months; however, earlier application of the provisions addressed in GASB Statement No. 95 is encouraged and is permitted to the extent specified in each pronouncement as originally issued. In accordance with GASB Statement No. 95, management has elected to postpone implementation of these statements.
42. In January 2017, GASB issued Statement No. 84, *Fiduciary Activities*. This Statement is to improve guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported. The requirements of this Statement will enhance consistency and comparability by (1) establishing specific criteria for identifying activities that should be reported as fiduciary activities and (2) clarifying whether and how business-type activities should report their fiduciary activities. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. In accordance with GASB Statement No. 95, GASB Statement No. 84 will be effective for fiscal year ending September 30, 2021.

43. In June 2018, GASB issued Statement No. 89, *Accounting for Interest Cost Incurred Before the End of a Construction Period*. The objectives of this Statement are (1) to enhance the relevance and comparability of information about capital assets and the cost of borrowing for a reporting period and (2) to simplify accounting for interest cost incurred before the end of a construction period. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. In accordance with GASB Statement No. 95, GASB Statement No. 89 will be effective for fiscal year ending September 30, 2022.
44. In March 2018, GASB issued Statement No. 90, *Majority Equity Interests - An Amendment of GASB Statements No. 14 and 61*. The primary objectives of this Statement are to improve the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and to improve the relevance of financial statement information for certain component units. It defines a majority equity interest and specifies that a majority equity interest in a legally separate organization should be reported as an investment if a government's holding of the equity interest meets the definition of an investment. A majority equity interest that meets the definition of an investment should be measured using the equity method, unless it is held by a special-purpose government engaged only in fiduciary activities, a fiduciary fund, or an endowment (including permanent and term endowments) or permanent fund. Those governments and funds should measure the majority equity interest at fair value. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. In accordance with GASB Statement No. 95, GASB Statement No. 90 will be effective for fiscal year September 30, 2021.
45. In May 2019, GASB issued Statement No. 91, *Conduit Debt Obligations*. The primary objectives of this Statement are to provide a single method of reporting conduit debt obligations by issuers and eliminate diversity in practice associated with (1) commitments extended by issuers, (2) arrangements associated with conduit debt obligations, and (3) related note disclosures. This Statement achieves those objectives by clarifying the existing definition of a conduit debt obligation; establishing that a conduit debt obligation is not a liability of the issuer; establishing standards for accounting and financial reporting of additional commitments and voluntary commitments extended by issuers and arrangements associated with conduit debt obligations; and improving required note disclosures. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. In accordance with GASB Statement No. 95, GASB Statement No. 91 will be effective for fiscal year ending September 30, 2023.
46. In January 2020, GASB issued statement No. 92, *Omnibus 2020*. The objectives of this Statement are to enhance comparability in accounting and financial reporting and to improve the consistency of authoritative literature by addressing practice issues that have been identified during implementation and application of certain GASB Statements. This Statement addresses a variety of topics and includes specific provisions about the effective date of Statement No. 87, *Leases*, and Implementation Guide No. 2019-3, *Leases*, for interim financial reports, the terminology used to refer to derivative instruments and the applicability of certain requirements of Statement No. 84, *Fiduciary Activities*, to postemployment benefits. The requirements related to the effective date of GASB Statement No. 87 and Implementation Guide 2019-3, reissuance recoveries and terminology used to refer to derivative instruments are effective upon issuance. The remaining requirements of GASB Statement No. 92 is effective for the fiscal year ending September 30, 2022.
47. In March 2020, GASB issued Statement No. 93, *Replacement of Interbank Offered Rates*. The primary objective of this statement is to address those and other accounting and financial reporting implications of the replacement of an IBOR. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. In accordance with GASB Statement No. 95, GASB Statement No. 93 will be effective for fiscal year ending September 30, 2022.

48. In March 2020, GASB issued Statement No. 94, *Public-Private and Public-Public Partnerships and Availability Payment Arrangements*. The primary objective of this statement is to improve financial reporting by addressing issues related to public-private and public-public partnership arrangements. This statement also provides guidance for accounting and financial reporting for availability payment arrangements. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. GASB Statement No. 94 will be effective for fiscal year ending September 30, 2023.
49. In May 2020, GASB issued Statement No. 96, *Subscription-Based Information Technology Arrangements*. This Statement provides guidance on the accounting and financial reporting for subscription-based information technology arrangements (SBITAs) for government end users (governments). This Statement (1) defines a SBITA; (2) establishes that a SBITA results in a right-to-use subscription asset - an intangible asset - and a corresponding subscription liability; (3) provides the capitalization criteria for outlays other than subscription payments, including implementation costs of a SBITA; and (4) requires note disclosures regarding a SBITA. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. GASB Statement No. 96 will be effective for fiscal year ending September 30, 2023.
50. In June 2020, GASB issued Statement No. 97, *Certain Component Unit Criteria, and Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans - an amendment of GASB Statements No. 14 and No. 84, and a supersession of GASB Statement No. 32*. The primary objectives of this Statement are to (1) increase consistency and comparability related to the reporting of fiduciary component units in circumstances in which a potential component unit does not have a governing board and the primary government performs the duties that a governing board typically would perform; (2) mitigate costs associated with the reporting of certain defined contribution pension plans, defined contribution other postemployment benefit (OPEB) plans, and employee benefit plans other than pension plans or OPEB plans (other employee benefit plans) as fiduciary component units in fiduciary fund financial statements; and (3) enhance the relevance, consistency, and comparability of the accounting and financial reporting for Internal Revenue Code (IRC) Section 457 deferred compensation plans (Section 457 plans) that meet the definition of a pension plan and for benefits provided through those plans. Management does not believe that this statement, upon implementation, will have a material effect on the financial statements. GASB Statement No. 97 will be effective for fiscal year ending September 30, 2022.
51. Management of the State believes that it is in compliance with all significant limitations and restrictions of the Asian Development Bank loan covenants as of September 30, 2020.
52. Arrangements with financial institutions involving compensating balances or other arrangements involving restrictions on cash balances, line of credit, or similar arrangements have been properly disclosed in the financial statements.
53. Financial instruments with significant individual or group concentration of credit risk have been appropriately identified, properly recorded, and disclosed in the financial statements.
54. Management is in discussion with the FSM National Government to determine the ultimate collectability of certain receivables due from the FSM National Government in consultation with federal grantor agencies arising from Compact sector grant transactions. Management believes that the recorded balances are correct.
55. The State is exposed to various risks of loss related to torts; theft of damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. It is the policy of the primary government not to purchase commercial insurance for the risks of loss to which it is exposed. Instead, the State management believes it is more economical to manage its risks internally. In the event of claim settlements and judgments, the State reports all of its risk management activities in its General Fund. Claims expenditures and liabilities are reported when it is probable that a loss has

occurred and the amount of that loss can be reasonably estimated. These losses include an estimate of claims that have been incurred but not reported. No losses have occurred as a result of these risks in any of the past three fiscal years.

56. We have appropriately identified and properly recorded and disclosed in the financial statements, where applicable, all interfund transactions, including repayment terms.
57. No evidence of fraud, possible irregularities, or dishonesty in fiscal operations of programs administered by the State has been discovered.
58. No events have occurred after September 30, 2020 but before December 31, 2021, the date of the financial statements were available to be issued that require consideration as adjustments to, or disclosures in, the financial statements.

Very truly yours,

A handwritten signature in black ink, appearing to read 'Rensley Sigrah', is written over a horizontal line.

Rensley Sigrah  
Director of Administration and Finance

Kosrae State Government  
September 30, 2020  
Schedule of Adjustments (Corrected misstatements)

## APPENDIX A

## Journal Entries - AJE

**General Fund**

GL Code	Name	Debit	Credit
	<b>1 CAJE To record adjustment</b>		
01-1999-00-00-00000-99	Due to from Treasury Fund	250,000.00	
01-7910-01-03-00199-00	Operating Transfers In		250,000.00
99-1999-00-00-00000-23	Due to from	250,000.00	
99-1999-00-00-00000-01	Due to from		250,000.00
01-8812-10-29-01095-00	Bad Debt Expense	150,000.00	
01-1999-00-00-00000-99	Due to from Treasury Fund		150,000.00
99-1999-00-00-00000-01	Due to from	150,000.00	
99-1999-00-00-00000-25	Due to from		150,000.00
		<u>800,000.00</u>	<u>800,000.00</u>

To record CAJE relating to completed projects in Fund 23 and to record bad debt expense for CFSM receivable

	<b>2 CAJE To record CAJE</b>		
01-1999-00-00-00000-99	Due to from Treasury Fund	150,000.00	
01-7910-01-03-00199-00	Operating Transfers In		150,000.00
99-1999-00-00-00000-01	Due to from		150,000.00
99-1999-00-00-00000-23	Due to from	150,000.00	
		<u>300,000.00</u>	<u>300,000.00</u>

To record CAJE JV20260

General Fund - RJE

	<b>1 RJE To record CRJE - 2264.3 and (Posted)</b>		
01-2250-00-00-00000-00	Advances to Suppliers	408,778.05	
99-1046-00-00-00000-00	Sweep BOG		408,778.05
		<u>408,778.05</u>	<u>408,778.05</u>

To record JV20167 and JV20166

**Grant Assistance Fund**

GL Code	Name	Debit	Credit
	<b>1 CAJE To record client adjustment relating to completed</b>		
23-8910-10-29-01095-00	Transfer out	250,000.00	
23-1999-00-00-00000-99	Due to from Treasury Fund		250,000.00
		<u>250,000.00</u>	<u>250,000.00</u>

To record CAJE JV20227

	<b>2 CAJE To record CAJE</b>		
23-8910-10-29-01095-00	Transfer out	150,000.00	
23-1999-00-00-00000-99	Due to from Treasury Fund		150,000.00
		<u>150,000.00</u>	<u>150,000.00</u>

To record CAJE JV202260

Kosrae State Government  
September 30, 2020  
Schedule of Adjustments (Corrected misstatements)

APPENDIX A

Journal Entries - AJE

Non Major Fund  
GL Code

Name	Debit	Credit
<b>1 CAJE To record CAJE</b>		
Due to from Treasury Fund	150,000.00	
Allow D/A AR PY		150,000.00
	<u>150,000.00</u>	<u>150,000.00</u>
To record CAJE to transfer bad debt to GF		

Kosrae State Government  
September 30, 2020  
Schedule of Uncorrected Misstatements

## APPENDIX B - UNCORRECTED ADJUSTMENTS

Misstatement Description	Type of Mistatement	Balance Sheet			Income Statement
		Assets Dr (Cr)	Liabilities Dr (Cr)	Net Position Dr (Cr)	Revenue Expenses Dr (Cr)
<b><i>General Fund</i></b>					
<b>PAJE no. 1</b>					
1. To correct investment per confirmation	Factual	(38,626)			38,626
<b>PAJE no. 2</b>					
2. To reconcile BOG sweep account	Factual	(6,159)			6,159
<b>PAJE no. 3</b>					
3. To recognize unallocated diff in bank reconciliation	Factual	(6,996)			6,996
<b><i>Grant Assistance Fund</i></b>					
<b>PAJE no. 1</b>					
1. To reconcile GL balance - bank reconciliation	Factual	(28,181)			28,181
<b>PAJE no. 2</b>					
2. To reconcile GL balance - unearned	Factual		21,250		(21,250)
		<b>(79,962)</b>	<b>21,250</b>	<b>0</b>	<b>58,712</b>

**SECTION I – DEFICIENCIES**

We identified the following deficiencies involving the State’s internal control over financial reporting as of September 30, 2020:

1. Bank reconciliation – General Fund

Comment: The September 30, 2020 bank reconciliation (for one bank account) included unrecorded transactions totaling net amount of \$443,000, thus, resulted into audit adjustment.

Recommendation: Management should perform timely review of bank reconciliation and make necessary adjustments.

2. Receivables from CFSM

Comment: At September 30, 2020, net receivables from CFSM of \$714,325 continue to increase with little to no subsequent collection. During the year, the management provided an allowance of \$150,000.

Recommendation: Management should assess the collectability and pursue collection of outstanding receivables.

3. Fund Balance – Grant Assistance Fund

Comment: At September 30, 2020, the net grant assistance fund balance, after client adjustments, amounted to \$216,918, which represents completed projects from previous years. During the year ended September 30, 2020, the management provided an adjustment to recognize a transfer-out from grant assistance fund to general fund and to cover the unassigned fund deficit of general fund of \$400,000.

Recommendation: Management should assess the validity of fund balance.

**SECTION II – DEFINITION**

The definition of a deficiency 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 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 is not always 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 qualifications to perform the control effectively.