

June 26, 2007

Honorable Robert Weilbacher
Governor, State of Kosrae
Federated States of Micronesia:

In planning and performing our audit of the general purpose financial statements of the State of Kosrae Government (the State) for the year ended September 30, 2006, on which we have issued our report dated June 26, 2007, we developed the following recommendations concerning certain matters related to its internal control. Our recommendations are summarized below.

Finding 2006-1 – Cash

Criteria:

1. Bank reconciling items should be investigated in a timely manner.
2. Cash transactions should be recorded in a timely manner and be recorded to the proper account.

Condition:

1. Unidentified reconciling items from fiscal year 2002 and 2003 totaling \$2,182 remain in the payroll bank reconciliation. (Fund Account 66-122)
2. A \$1,000 withdrawal from the Early Retirement Time Certificate of Deposit account was not recorded in a timely manner. (Fund Account 59-138)
3. \$4,538 of additional monies deposited into the Shrew Gifford Savings account were not recorded in a timely manner. (Fund Account 96-131)
4. \$3,267 was withdrawn from the MTN Time Certificate of Deposit account and was not recorded in a timely manner. (Fund Account 60-136)
5. A deposit for \$8,600 to the MSHP Self Help Program savings account was not recorded in a timely manner. (Fund Account 33-142)
6. A \$7,600 withdrawal from the MSHP Self Help Program savings account was improperly recorded against the Housing Revolving Fund. (Fund Accounts 33-142 and 82-142)

Cause: Untimely investigation of reconciling items and untimely recording of cash transactions.

Effect: A loss in cash and a misstatement of cash, income and expense may be present.

Recommendation: We recommend that the State ensure that bank reconciling items are investigated in a timely manner. It is also important that the State ensure that cash transactions, such as deposits and withdrawals, are recorded in a timely manner and are recorded in appropriate accounts to avoid misstatements of cash, income and expenditures.

Finding 2006-2 – Inventory

Criteria: Inventory should be supported with underlying details.

Condition:

1. No support was provided for inventory recorded in the General fund totaling \$11,757.
2. No support was provided for inventory recorded in the Agriculture revolving fund totaling \$8,825.

Cause: There appears to be a lack of adequate internal control over ensuring that inventory is updated on a timely basis.

Effect: Inventory may be misstated.

Recommendation: We recommend that the State ensure that inventory is reconciled on a timely basis. If the above balances are incorrect, the State should expense nonvalid inventory balances accordingly.

Finding 2006-3 – Scholarship

Criteria: Scholarship disbursements should be paid directly to the Financial Aid Office of the institution of higher education where the applicant is in attendance, or in the case of a loan for transportation cost, the State may issue the check to cover such costs to the student directly.

Condition: Under accounts payable voucher number 600195201 and check number 19653, an amount of \$4,000 was paid for fall 2005 semester fees. The check was made payable only to the student.

Cause: There appears to be a lack of control over ensuring that scholarship checks are disbursed in compliance with the criteria.

Effect: Fraudulent activities may result from such noncompliance.

Recommendation: We recommend that the State strengthen its internal control by complying with the Student Scholarship, Grant and Loan Regulations for issuance of disbursements.

Finding 2006-3 – Continuing Appropriations

Criteria: Entries for continuing appropriations should be periodically reviewed for validity.

Condition: Of 14 samples tested, one sample indicated the existence of a double entry for the same allotment advice of \$7,790. (471210-dhs001).

Cause: The root cause of the weakness is a lack of periodic review and reconciliation.

Effect: There is a potential misstatement of the continuing appropriations balance.

Recommendation: We recommend that the State periodically review and reconcile budgetary records.

Honorable Robert Weilbacher
Governor, State of Kosrae
Federated States of Micronesia
June 26, 2007

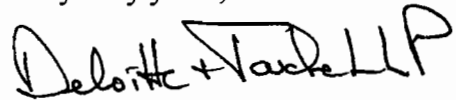
Page 3

* * * * *

We have communicated certain matters noted during our audit of the financial statements of the State of Kosrae for the year ended September 30, 2006, which we considered to be reportable conditions, in our report dated June 26, 2007.

This report is intended for the information and use of management of the State and others within the organization.

Very truly yours,

The signature is handwritten in black ink. It appears to read "Deloitte + Touche LLP" in a stylized, cursive script. The "Deloitte" part is written in a more formal, blocky style, while the "+ Touche LLP" part is more fluid and cursive.