

June 15, 2009

The Board of Directors
Chuuk Public Utility Corporation:

In planning and performing our audit of the financial statements of the Chuuk Public Utility Corporation (CPUC), as of and for the year ended September 30, 2008 (on which we have issued our report dated June 15, 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 CPUC'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 CPUC's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of CPUC'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 CPUC'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 management, also dated June 15, 2009, on our consideration of CPUC'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.

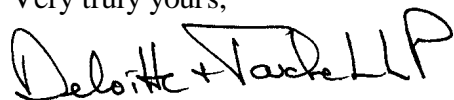
The definition of a deficiency is also set forth in the attached Appendix I.

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 and others within the organization, 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.

Very truly yours,



SECTION I – CONTROL DEFICIENCIES

We identified, and have included below, control deficiencies involving CPUC's internal control over financial reporting as of September 30, 2008 that we wish to bring to your attention:

Bank Reconciliations

Comment: CPUC should perform monthly reconciliations of its bank accounts. Management could not explain a \$5,396 unknown balance in the September 30, 2008 bank reconciliation.

Recommendation: We recommend that reconciliations be performed on a monthly basis and differences be researched and cleared.

Fixed Assets

Comment: The fixed asset register should detail assets owned. CPUC has not performed a physical count of its fixed assets for the past several years.

Recommendation: We recommend that management perform a verification of its assets and reconcile such against the fixed asset register.

Construction-in-Progress

Comment: Project completion dates should be followed. The Pole Hardening Project is still in progress and has passed its extended completion deadline of October 11, 2006. No additional extension was obtained.

Recommendation: Management should submit and obtain a project extension.

Construction-in-Progress

Comment: Construction in progress (CIP) during the year should be capitalized upon completion. Certain projects have been recorded as CIP for a long period of time and management could not advise whether the projects were ever completed.

Recommendation: Management should closely monitor construction projects and capitalize and begin depreciating projects upon completion.

Other Accounts Payable

Comment: A detail schedule is maintained to support the other accounts payable account. No documents, such as vendor invoices, could be provided to support \$153,983 of recorded payables.

Recommendation: We recommend that details of accounts payable be maintained and be reconciled to the general ledger control account.

Long Overdue Account

Comment: CPUC should review the account receivable subsidiary ledger and follow up on accounts that are over ninety days past due. Numerous receivable balances are over ninety days past due, including several more than one year old. In addition, delinquent accounts over ninety days are not subject to timely follow up.

Recommendation: We recommend the following:

- To avoid future collection problems, management should emphasize the importance of timely follow-up on outstanding invoices by implementing a system of customer contact when receivable balances become greater than thirty days old.
- That a policy be established whereby a listing of all accounts with balances ninety days and older are submitted to management to review for collection, increase collection efforts wherever possible and write off all uncollectible receivable balances.

Cash Collection Report

Comment: Cash receipts are maintained and attached to the Cash Consolidated Report. For two of seventy-six samples tested, the Cash Consolidated Report balance did not agree with the validated deposit slip.

Recommendation: We recommend that cash receipts be maintained and differences be timely investigated.

Production Fuel Transactions

Comment: Production Fuel Transactions should be supported by invoices and cashier check/check/payment slips. These documents should be maintained on file and be available for examination. We noted the following conditions:

1. For fourteen of eighty-five samples tested, no invoices could be provided.
2. For seven of eighty-five samples tested, no cashier checks/checks/payment slips could be provided.
3. The direct deposit payment in 8/6/08 for invoice #1569 reflects a \$20 variance when compared with the invoice.

Recommendation: CPUC should strengthen its controls and require that invoices and cashier checks/checks/payment slips be maintained on file.

Proper Recordkeeping of Documents

Comment: Documents such as vendor invoices, lease agreements and cancelled checks should be maintained and safeguarded to substantiate activities undertaken. We noted that no invoices or source documents were attached to the following transaction:

Proper Recordkeeping of Documents, Continued

<u>Check Number</u>	<u>Check Date</u>	<u>Check Amount</u>
1031	12/30/2008	\$5,000

Recommendation: CPUC should strengthen controls to ensure the safekeeping of supporting documents.

Operating Expense Transactions

Comment: Documents such as vendor invoices, lease agreements and cancelled checks should be maintained and safeguarded to substantiate activities undertaken during the period.

We noted the following conditions:

1. Documents, such as invoices or lease agreements, were not provided for the following transactions:

<u>Check Number</u>	<u>Check Date</u>	<u>Check Amount</u>
JE-J0052	02/28/08	\$1,518
JE-J0107	10/31/07	\$1,041

2. For rental housing expense, G/L reference: JE-J0168, Account #: 54017-ADM-A, the amount: was \$158,867.75

- a.) The lease agreement for Yourie Gouland could not be provided. Note that the rental expense is \$11,000 in 2008

Recommendation: CPUC should strengthen its controls to ensure the safekeeping of its documents.

Revenue Recording – Sales Power

Comment: CPUC should record revenue when services have been rendered and billed to customers. We noted the following conditions:

1. For 12 of 43 samples tested, a variance exists between the Read Entry Worksheet and the Monthly Live Bill Register
2. For 11 of 12 months tested, the billing summary sheet for Commercial power sales does not agree with the general ledger balance.
3. For 4 of 4 months tested, the billing summary sheet for Residential power sales does not agree with the general ledger balance.
4. For 5 of 7 months tested, the billing summary sheet for Government power sales does not agree with the general ledger.
5. For 7 of 43 samples tested, rates were applied improperly.

Revenue Recording – Sales Power, Continued

6. The entity does not have a system of formal approvals for rate changes.

Recommendations: We recommend that (1) meter readings are accurately posted to the billing system, (2) monthly billing summaries agree with general ledger balances, (3) applicable rates are applied, (4) a formal approval procedure is established for rate changes and, (5) supporting documents are kept and are maintained on file.

Revenue Recording – Cash Power

Comment: CPUC should record revenue when services are rendered and are billed to customers. We noted the following conditions:

1. For 1 of 52 samples tested, a variance exists between the daily commercial collections posted to the general ledger and the daily collection summary report.
2. The deposit slip for cash receipt #149124, dated 12/24/07, cannot be located.
3. For 6 of 12 months, daily cash sales collections do not agree with daily collection summaries.
4. The daily cash sales collection report and deposit slips supporting all 12/20/07 transactions could not be located.

Recommendations: We recommend that (1) documents are kept and maintained on file (2) daily commercial collections posted to the general ledger agree with daily collection summary reports and, (3) daily cash collections agree with daily collection summaries.

Recording of Transactions in Proper Period

Comment: Numerous transactions totaling \$97,718 were not recorded in the correct accounting period.

Recommendation: We recommend that liabilities be recognized upon receipt of goods or services.

Payroll Transactions

Comment: Payroll transactions should be supported by employee personnel action forms, timesheets, and other underlying documentation to validate calculations and recording. Furthermore, payroll documents should be maintained on file and be available for examination. We noted the following conditions:

1. For three of twenty-six samples tested, actual pay rates were not correctly applied and this resulted in a miscalculation of salary.
2. For one of twenty-six samples tested, there was no supervisor's signature on the personal leave form.
3. For one of twenty-six samples tested, a copy of the payroll check could not be located.

Recommendation: CPUC should verify that employee pay rates are correctly applied and should require that other underlying documentation is maintained on file.

Cash Collected Used for Operation

Comment: In numerous instances, daily cash collections were used to fund small purchases such as gasoline, tin roofing and prepaid cell cards. This practice increases the risk of misappropriation of cash and makes errors difficult to verify.

Recommendation: We recommend that daily cash collections be deposited intact. In addition, all payments should be made by check.

SECTION III – DEFINITION

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

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 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 properly designed control does not operate as designed, or when the person performing the control does not possess the necessary authority or qualifications 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

CPUC'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.