

April 23, 2010

To the Board of Directors of
Kosrae Utilities Authority:

In planning and performing our audit of the financial statements of the Kosrae Utilities Authority (KUA), a component unit of the State of Kosrae as of and for the year ended September 30, 2009, in accordance with auditing standards generally accepted in the United States of America and have issued our report thereon dated April 23, 2010.

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 KUA is responsible.

OUR RESPONSIBILITY UNDER GENERALLY ACCEPTED AUDITING STANDARDS AND GENERALLY ACCEPTED GOVERNMENT AUDITING STANDARDS

Our responsibility under auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, have been described in our engagement letter dated September 30, 2009. As described in that letter, the objective of a financial statement audit conducted in accordance with the aforementioned standards is:

- To express an opinion on the fairness of the presentation of KUA's basic financial statements and to disclaim an opinion on the required supplementary information for the year ended September 30, 2009 in conformity with accounting principles generally accepted in the United States of America ("generally accepted accounting principles"), in all material respects; and
- To report on KUA'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 ended September 30, 2009 based on an audit of financial statements performed in accordance with the standards applicable to financial audits contained in *Government Auditing Standards*.

Our responsibilities under generally accepted auditing standards include forming and expressing an opinion about whether the financial statements that have been prepared with the oversight of management and the Board of Directors 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 Board of Directors of their responsibilities.

We considered KUA'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 KUA's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of KUA's internal control over financial reporting. Our consideration of internal control over financial reporting would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses.

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 normally based on knowledge and experience about past and current events and on assumptions about future events. Significant accounting estimates reflected in KUA's 2009 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; management's estimate of the allowance for inventory obsolescence, which is determined based upon expected inventory turnover and inventory aging; 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, 2009, 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

As the result of our audit work, we identified matters that resulted in audit adjustments that we believe, either individually or in the aggregate, would have a significant effect on KUA's financial reporting process. Such adjustments, listed in Appendix I, have been recorded in the accounting records and are reflected in the 2009 financial statements.

In addition, we have attached to this letter, as Appendix II, a summary of uncorrected misstatements aggregated by us during the current engagement and pertaining to the latest period presented 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

KUA's significant accounting policies are set forth in Note 2 to KUA's 2009 financial statements. During the year ended September 30, 2009, there were no significant changes in previously adopted accounting policies or their application, except for the following pronouncements adopted by the KUA:

- Governmental Accounting Standards Board (GASB) Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other than Pension Plans*, which establishes uniform financial reporting for other postemployment benefit plans by state and local governments.
- GASB Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfer of Assets and Future Revenues*, which establishes criteria that governments will use to ascertain whether certain transactions should be regarded as a sale or a collateralized borrowing, and includes a provision that stipulates that governments should not revalue assets that are transferred between financial reporting entity components.
- GASB Statement No. 50, *Pension Disclosures an amendment of GASB Statements No. 25 and 27*, which more closely aligns the financial reporting requirements for pensions with those for other post-employment benefits.

The implementation of these pronouncements did not have a material effect on the financial statements of KUA.

OTHER INFORMATION IN THE ANNUAL REPORTS

When audited financial statements are included in documents containing other information such as KUA's 2009 Annual Report, we will read such other information and consider whether it, or the manner of its presentation, is materially inconsistent with the information, or the manner of its presentation, in the financial statements audited by us. We will read the other information in KUA's 2009 Annual Report and will inquire as to the methods of measurement and presentation of such information. If we note a material inconsistency or if we obtain any knowledge of a material misstatement of fact in the other information, we will discuss this matter with management and, if appropriate, with the Board.

DISAGREEMENTS WITH MANAGEMENT

We have not had any disagreements with management related to matters that are material to KUA’s 2009 financial statements.

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 2009.

MANAGEMENT’S REPRESENTATIONS

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

MAJOR ISSUES DISCUSSED WITH MANAGEMENT PRIOR TO OUR INITIAL ENGAGEMENT OR 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.

SIGNIFICANT DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT

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

CONTROL-RELATED MATTERS

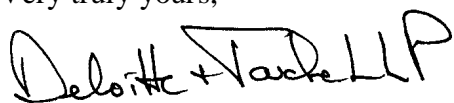
We have issued a separate report to you, dated April 23, 2010, wherein no matters involving KUA’s internal control over financial reporting were considered to be significant deficiencies under standards established by the American Institute of Certified Public Accountants, and on its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters were reported.

* * * * *

This report is intended solely for the information and use of the Board of Directors, management, and others within KUA and is not intended to be and should not be used by anyone other than these specified parties.

We wish to thank the staff and management of KUA for their cooperation and assistance during the course of this engagement.

Very truly yours,



Description of Misstatement	Summary of Corrected Misstatements								TOTAL
	Assets		Liabilities		Equity		Income		
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	
AJE <1>									0
(Dr) Bad debts							2,745		2,745
(Cr) Allowance		2,745							(2,745)
									0
AJE <2>									0
(Dr) Allowance	41,334								41,334
(Cr) Misc. Revenue								41,334	(41,334)
									0
AJE <3>									0
(Dr) USDA grant							175,000		175,000
(Cr) Deferred revenue				175,000					(175,000)
									0
AJE <4>									0
(Dr) Provision for stock obsolescence							45,099		45,099
(Cr) Allowance		45,099							(45,099)
									0
AJE <5>									0
(Dr) AR - Residential	3,150								3,150
(Dr) AR - KSG	697								697
(Dr) AR - Non KSG	333								333
(Dr) AR - Industrial	599								599
(Dr) AR - Commercial	610								610
(Cr) Accounts payable - other				5,390					(5,390)
									0
RJE <1>									0
(Dr) Allowance for doubtful accounts	7,272								7,272
(Cr) Allowance for advances		7,272							(7,272)
									0
RJE <2>									0
(Dr) Current portion of long-term debts									(95,245)
(Cr) Long-term debts				95,245					95,245
									0
RJE <3>									0
(Dr) Allowance for doubtful accounts	67,468								67,468
(Cr) Allowance for doubtful accounts - others		67,468							(67,468)
									0
RJE <4>									0
(Dr) Allowance for doubtful accounts	7,785								7,785
(Cr) Allowance for AR - FSM Govt		7,785							(7,785)
									0
RJE <5>									0
(Dr) USDA Funded Project							28,785		28,785
(Cr) Capital contributions								28,785	(28,785)
									0
RJE <6>									0
(Dr) OMIP grants - 7th year							12,688		12,688
(Dr) OMIP grants - 9th year							20,858		20,858
(Cr) Capital contribution								33,546	(33,546)
									0
Total Misstatements Adjusted	129,249	130,369	95,245	275,635	0	0	285,175	103,665	0

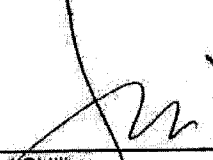
The above corrected misstatements and reclassifications do not represent fraud or illegal acts.

Fred Skilling
General Manager

Kosrae Utilities Authority
 September 30, 2009
 Appendix A - Uncorrected Misstatements

	Assets Dr (Cr)	Liabilities Dr (Cr)	Equity Dr (Cr)	Income Dr (Cr)
Current Year Known Misstatements				
PAJE <1>				
(Dr) Expense				25,346
(Dr) Accumulated Depreciation	78,664			
(Cr) Fixed Assets	(104,010)			
PAJE <2>				
(Dr) Fuel expense				5,286
(Cr) Other expense				(5,286)
Total Known Misstatements	(25,346)	0	0	25,346

The above uncorrected misstatements do not represent fraud or illegal acts.



Fred Skilling
 General Manager



KOSRAE UTILITIES AUTHORITY

P.O. Box KUA
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April 23, 2010

Deloitte & Touche
P.O. Box 753
Kolonias, Pohnpei 96941

We are providing this letter in connection with your audits of the statements of net assets of Kosrae Utilities Authority (the Authority), a component unit of the State of Kosrae, as of September 30, 2009 and 2008 and the related statements of revenues, expenses and changes in net assets and of cash flows for the years then ended, for the purpose of expressing an opinion as to whether the financial statements present fairly, in all material respects, the financial position, results of operations, and cash flows of the Corporation in conformity with accounting principles generally accepted in the United States of America (GAAP). We confirm that we are responsible for the following:

- a. The fair presentation in the financial statements of the Authority's net assets, and the related statements of revenues, expenses and changes in net assets, and cash flows in conformity with GAAP.
- b. The fair presentation of the required supplementary information, including Management's Discussion and Analysis, accompanying the financial statements.
- c. The design and implementation of programs and controls to prevent and detect fraud.
- d. Establishing and maintaining effective internal control over financial reporting.
- e. Compliance with local and federal laws, rules and regulations, including compliance with the requirements of grants and contracts relating to the Authority's operations. 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.
- f. Maintaining accounting and administrative control over revenues, obligations, expenditures, assets, and liabilities.
- g. 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 stand-alone business-type activities obtained from the Government Finance Officers Association.

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 audits.

1. The financial statements referred to above are fairly presented in conformity with GAAP. In addition:
 - a. Net asset components (invested in capital assets net of related debt, restricted and unrestricted) are properly classified and approved.
 - b. Revenues and expenses are appropriately classified in the statements of revenues, expenses and changes in net assets within operating and non-operating revenues and expenses.
 - c. Deposits and investments are properly classified in category of custodial credit risk.
 - d. Capital assets are properly capitalized, reported and depreciated.
 - e. Required supplementary information is measured and presented within prescribed guidelines.
 - f. Costs to federal awards have been charged in accordance with applicable cost principles.
2. The Authority has made available to you all:
 - a. Financial records and related data for all financial transactions of the Authority. The records, books, and accounts, as provided to you, record the financial and fiscal operations of the Authority 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. Minutes of the meetings of the Board of Directors or summaries of actions of recent meetings for which minutes have not yet been prepared.
3. There have been no:
 - a. Action taken by the Authority's management that contravenes the provisions of federal and Federated States of Micronesia (FSM) laws and regulations or of contracts and grants applicable to the Authority and for all funds administered by the Authority.
 - 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.
4. We believe the effects of any uncorrected financial statement misstatements aggregated by you during the current audit engagement and pertaining to the latest period presented 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 A.

5. We have no knowledge of any fraud or suspected fraud affecting the Authority involving (a) management, (b) employees who have significant roles in internal control over financial reporting, or (c) others if the fraud could have a material effect on the financial statements.
6. We have no knowledge of any allegations of fraud or suspected fraud affecting the Authority received in communications from employees, former employees, analysts, regulators, or others.
7. There are no unasserted claims or assessments that legal counsel has advised us are probable of assertion and must be disclosed in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 450, *Contingencies* (formerly FASB Statement No. 5, *Accounting for Contingencies*).
8. We are responsible for compliance with local and state laws, rules and regulations, including compliance with the provisions of grants and contracts relating to the Authority's operations. 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. The Authority is responsible for maintaining accounting and administrative control over revenues, obligations, expenditures, assets, and liabilities.
9. There are no reportable conditions, including significant deficiencies and material weaknesses, in the design or operation of internal control that could adversely affect the Authority's ability to initiate, record, process, and report financial information.
10. 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.
11. The Authority 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 Authority and do not believe that the financial statements are materially misstated as a result of fraud.

Except where otherwise stated below, matters less than \$11,400 collectively are not considered to be exceptions that require disclosure for the purpose of the following representations. This amount is not necessarily indicative of amounts that would require adjustment to or disclosure in the financial statements.

12. There are no transactions that have been improperly recorded in the accounting records underlying the financial statements except for those listed in Appendix A.
13. The Authority has no plans or intentions that may affect the carrying value or classification of assets and liabilities.
14. The following, to the extent applicable, have been appropriately identified and properly recorded and disclosed in the financial statements:
 - a. Arrangements with financial institutions involving compensating balances or other arrangements involving restrictions on cash balances and line-of-credit or similar arrangements.

- b. Related-party transactions and associated amounts receivable or payable, including sales, purchases, loans, transfers, leasing arrangements, and guarantees (written or oral).
 - c. Guarantees, whether written or oral, under which the Authority is contingently liable.
15. In preparing the financial statements in conformity 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 at least 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.

We are not aware of any estimates at September 30, 2009 that may change and that the effect of the change would be material to the financial statements.

16. 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 enterprise vulnerable to the risk of a near-term severe impact; and
 - c. It is at least reasonably possible that the events that could cause the severe impact will occur in the near term.
17. There are no:
- a. Violations or possible violations of laws or regulations whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency.
 - b. Other liabilities or gain or loss contingencies that are required to be accrued or disclosed by FASB ASC 450, *Contingencies* (formerly FASB Statement No. 5, *Accounting for Contingencies*) other than that disclosed in the financial statements.
18. The Authority 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 disclosed in the financial statements.
19. The Authority has complied with all aspects of contractual agreements that would have an effect on the financial statements in the event of noncompliance.
20. No events have occurred subsequent to September 30, 2009 to the dates of our signatures below that require consideration as adjustments to or disclosures in the financial statements.

21. We have disclosed to you that no change in the Authority's internal control over financial reporting has occurred during the Authority's most recent fiscal year that has materially affected, or is reasonably likely to materially affect, the Authority's internal control over financial reporting.
22. Receivables recorded in the financial statements represent valid claims against debtors for sales or other charges arising on or before the balance-sheet date and have been appropriately reduced to their estimated net realizable value.
23. Provision has been made to reduce excess or obsolete inventories to their estimated net realizable value. All inventories are the property of the Authority and do not include any items consigned to it or any items billed to customers.
24. We believe that all expenditures that have been deferred to future periods are recoverable.
25. No corporation or agency of the Federal Government, the Kosrae State Government, or the FSM National Government has reported a material instance of noncompliance to us; however, we are aware of \$109,706 of cumulative questioned costs reported for the Authority and we do not believe that resolution of this matter will involve a material liability and therefore, no provision for this matter has been reported in the financial statements.
26. There have been no actions taken by management, which contravene the provisions of local laws or regulations or of contracts applicable to the Authority.
27. We have no intention of terminating our retirement plan or taking any other action that could result in an effective termination or reportable event for the plan. We are not aware of any occurrences that could result in the termination of our retirement plan to which we contribute. We are of the opinion that the plan does not represent an asset or liability of the Authority.
28. We do not plan to make frequent amendments to our pension or other postretirement benefit plans.
29. The Authority is responsible for determining and maintaining the adequacy of the allowance for doubtful accounts receivable, as well as estimates used to determine such amounts. Management believes the allowances are adequate to absorb currently estimated bad debts in the account balances.
30. We have identified to you all awards provided by federal agencies in the form of grants, contracts, loans, loan guarantees, property, cooperative agreements, interest subsidies, insurance, or direct appropriations.
31. The Authority has obligated, expended, received, and used public funds of the Authority in accordance with the purpose for which such funds have been appropriated or otherwise authorized by federal law. Such obligation, expenditure, receipt, or use of public funds was in accordance with any limitations, conditions, or mandatory directions imposed by federal law.
32. Money or similar assets handled by the Authority on behalf of the Federal Government have been properly and legally administered and the accounting and recordkeeping related thereto is proper, accurate, and in accordance with law.

33. No evidence of fraud or dishonesty in fiscal operations of programs administered by the Authority has been discovered.

34. During fiscal year 2009, the Authority implemented the following pronouncements:

- GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, which establishes standards for the measurement, recognition, and display of other postemployment benefits expense/expenditures and related liabilities, note disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employers.
- GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, which provides guidance and consistency under which a governmental entity would be required to report a liability related to pollution remediation.
- GASB Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*, which improves the quality of financial reporting by requiring endowments to report their land and other real estate investments at fair value, creating consistency in reporting among similar entities that exist to invest resources for the purpose of generating income.
- GASB Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, which improves financial reporting by contributing to the GASB's efforts to codify all GAAP for state and local governments so that they derive from a single source.
- GASB Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*, which incorporates accounting and financial reporting guidance previously only contained in the American Institute of Certified Public Accountants (AICPA) auditing literature into the GASB's accounting and financial reporting literature for state and local governments, and addresses three issues from the AICPA's literature - related party transactions, going concern considerations, and subsequent events.

The implementation of these pronouncements did not have a material effect on the financial statements of the Authority.

35. In June 2007, GASB issued statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, which addresses whether and when intangible assets should be considered capital assets for financial reporting purposes. The provisions of this statement are effective for periods beginning after June 15, 2009. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Authority.

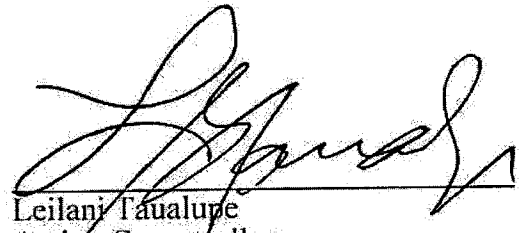
36. In June 2008, GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, which is intended to improve how state and local governments report information about derivative instruments - financial arrangements used by governments to manage specific risks or make investments - in their financial statements. The provisions of this statement are effective for periods beginning after June 15, 2009. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Authority.

37. In December 2008, GASB issued Technical Bulletin No. 2008-1, *Determining the Annual Required Contribution Adjustment for Postemployment Benefits*, which clarifies the requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, for calculating the annual required contribution (ARC) adjustment. The provisions of this statement are effective for periods beginning after December 15, 2008. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Authority.
38. In March 2009, GASB issued Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, which enhances the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. The provisions of this statement are effective for periods beginning after June 15, 2010. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Authority.
39. The Authority does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk. The Authority has not experienced any losses on such accounts and management believes it is not exposed to any significant credit risk on its deposits.
40. The Authority has not received written communication from its lenders regarding any loan covenant noncompliance and believes that it is in compliance with all applicable covenants.



 Fred Skilling
 General Manager

5/26/10
 Date



 Leilani Fualupe
 Acting Comptroller

5/26/10
 Date