

February 12, 2011

Mr. Namio Nanpei  
General Manager  
FSM Coconut Development Authority

Dear Members of the Board:

In planning and performing our audit of the financial statements of the Federated States of Micronesia (FSM) Coconut Development Authority (the Authority), a component unit of the FSM National Government, as of and for the year ended September 30, 2010 (on which we have issued our report dated February 12, 2011), 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 the Authority'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 the Authority's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Authority'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 the Authority's internal control over financial reporting and other matters as of September 30, 2010 that we wish to bring to your attention.

We have also issued a separate report to the Board of Directors, also dated February 12, 2011, on our consideration of the Authority'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.

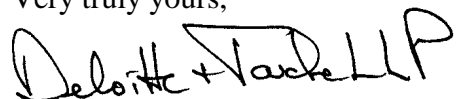
A description of the responsibility of management for establishing and maintaining internal control over financial reporting and of the objectives of and inherent limitations of internal control over financial reporting, is set forth in the attached Appendix II and should be read in conjunction with 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.

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

Very truly yours,



**SECTION I – CONTROL DEFICIENCIES**

We identified, and have included below, control deficiencies involving the Authority's internal control over financial reporting as of September 30, 2010 that we wish to bring to your attention:

**File Maintenance**

Comment: Certain transaction documents are maintained at the FSM National Government Finance Office and copies are not available at the Authority.

Recommendation: We recommend that all transaction documents be maintained at the Authority.

**Billings**

Comment: The Authority does not prepare customer billings. It does not appear that a control is in place to collect trade receivables in a timely manner.

Recommendation: We recommend that the Authority prepare and send invoices to customers to minimize potential bad debts. We also recommend that the Authority review its credit policies.

**Issuance of Inventory**

Comment: It does not appear that issuance of raw and packaging materials to the Food Division is monitored. Details of such issuances are not documented.

Recommendations: We recommend that issuances of raw and packaging materials to the Food Division be documented in detail (i.e., date, cost, quantity and etc.).

**Fixed Asset Register**

Comment: The fixed asset register has certain items that may no longer be in existence.

Recommendation: We recommend that the Authority perform a periodic verification of fixed assets and use that inventory as a basis to update the register.

**Labor Costs**

Comment: Contractor hours are expensed as incurred instead of being capitalized as part of inventory.

Recommendation: We recommend that labor hours associated with inventory be capitalized.

**Entertainment Expense**

Comment: The Authority provides lunch to contractual employees and such costs were recorded as entertainment expense. The amount for fiscal year 2010 is \$1,856.

Recommendation: We recommend that the Authority reconsider the appropriateness of providing lunches to contractual employees.

**Contract Forms**

Comment: Lease agreements are not complete. The leases lack mailing addresses, periods of the agreement and other pertinent data.

Recommendation: We recommend that the Authority review contracts/agreement for their completeness.

**Audit Adjustments**

Comment: Numerous adjustments were proposed in the audit process after the final trial balance was submitted. This condition indicates that a more thorough review of the general ledger is required.

Recommendation: We recommend that general ledger reviews be timely performed.

**SECTION II – OTHER MATTERS**

We noted no matters related to operations, compliance with laws and regulations, and best practices involving internal control over financial reporting that we wish to bring to your attention.

**SECTION III – DEFINITION**

The definition of a deficiency that is established in AU 325, *Communicating Internal Control Related Matters Identified in an Audit*, 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 would not be 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 competence 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**

The Authority’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.