

February 28, 2011

The Board of Directors
Kosrae Utilities Authority

Dear Members of the Board:

We have performed an audit of the financial statements of Kosrae Utilities Authority (KUA), a component unit of the State of Kosrae, as of and for the year ended September 30, 2010, in accordance with auditing standards generally accepted in the United States of America and have issued our report thereon dated February 28, 2011.

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, 2010. 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, 2010 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, 2010 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 by management with the oversight of the Board 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 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.

MANAGEMENT JUDGMENTS AND 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 2010 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, 2010, 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 2010 financial statements.

In addition, we have attached to this letter, as Appendix II, a summary of uncorrected misstatement aggregated by us during the current engagement and pertaining to the latest period presented that was 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 2010 financial statements. During the year ended September 30, 2010, there were no significant changes in previously adopted accounting policies or their application, except for the following pronouncements adopted by KUA:

- GASB 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.
- GASB 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.
- GASB 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.
- GASB Statement No. 58, *Accounting and Financial Reporting for Chapter 9 Bankruptcies*, which provides guidance for governments that have petitioned for protection from creditors by filing for bankruptcy under Chapter 9 of the United States Bankruptcy Code, and establishes requirements for recognizing and measuring the effects of the bankruptcy process on assets and liabilities, and for classifying changes in those items and related costs.

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

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 has not evaluated the effect that the implementation of this statement will have on the financial statements of KUA.

In December 2009, GASB issued Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, which amends Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, and addresses issues related to measurement of OPEB obligations by certain employers participating in agent multiple-employer OPEB plans. The provisions of Statement 57 related to the use and reporting of the alternative measurement method are effective immediately. The provisions related to the frequency and timing of measurements are effective for actuarial valuations first used to report funded status information in OPEB plan financial statements for periods beginning after June 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of KUA.

In June 2010, GASB issued Statement No. 59, *Financial Instruments Omnibus*, which updates and improves existing standards regarding financial reporting of certain financial instruments and external investment pools. The provisions of this statement are effective for periods beginning after June 15, 2010. Management has not evaluated the effect that the implementation of this statement will have on the financial statements of KUA.

CRITICAL ACCOUNTING POLICIES AND PRACTICES

Critical accounting policies are those that are both most important to the portrayal of KUA's financial condition and results and require management's most difficult, subjective, or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. KUA has not identified any critical accounting policies or practices.

ALTERNATE ACCOUNTING TREATMENTS

We had no discussions with management regarding alternative accounting treatments within generally accepted accounting principles for policies and practices related to material items, including recognition, measurement, and disclosure considerations related to the accounting for specific transactions as well as general accounting policies, related to the year ended September 30, 2010.

OTHER INFORMATION IN THE ANNUAL REPORTS

When audited financial statements are included in documents containing other information such as KUA's 2010 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 2010 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 2010 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 2010.

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

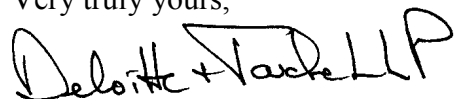
We have issued a separate report to you, dated February 28, 2011, wherein no matters involving KUA's internal control over financial reporting were considered to be significant deficiencies under standards established by the American Institute of Certified Public Accountants, and on its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters were reported.

We have communicated to management, in a separate letter also dated February 28, 2011, control deficiencies that we identified during our audit.

This report is intended solely for the information and use of the Board of Directors, management, and others within the organization, and the Office of the FSM National Public Auditor 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.

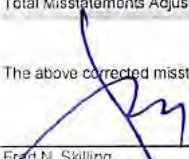
Very truly yours,

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

SUMMARY OF CORRECTED MISSTATEMENTS

Description of Misstatement	Assets		Liabilities		Equity		Income		TOTAL
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	
AJE <1>									
(Dr) 15030 Allowance for inventory obsolescence	4,426.37								4,426.37
(Cr) 40014 Recovery of bad debts / inventory obsolescence							4,426.37		-4,426.37
AJE <2>									
(Dr) 12030 Allowance - AR	1,878.27								1,878.27
(Cr) 12032 Allowance - AR Other		232.19							-232.19
(Cr) 13011 Allowance - TA		914.57							-914.57
(Cr) 40014 Recovery of bad debts / inventory obsolescence							731.51		731.51
RJE <1>									
(Dr) 23002 Long-term debt				98,338.63					98,338.63
(Cr) 22002 Current portion of long-term debt				98,338.63					-98,338.63
RJE <2>									
(Dr) 20003 Deferred revenue				175,000.00					175,000.00
(Cr) 20002 Accounts payable - other				175,000.00					-175,000.00
Total Misstatements Adjusted	6,304.64	1,146.76	273,338.63	273,338.63	0.00	0.00	0.00	5,157.88	0.00

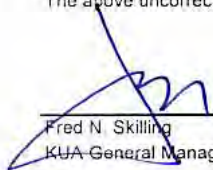
The above corrected misstatements do not represent fraud or illegal acts. Rather, such represent misstatements.


 Fred N. Skilling
 KCA General Manager

SUMMARY OF UNCORRECTED MISSTATEMENT

	Assets		Liabilities		Equity		Income		TOTAL
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	
PAJE <1>									0
(Dr) Accumulated depreciation	83,065								83,065
(Dr) Supplies expense					28,005				28,005
(Cr) Fixed assets		111,070							-111,070
	83,065	111,070	0	0	28,005	0	0	0	0

The above uncorrected misstatement does not represent fraud or illegal acts. Rather, such represent misstatement.


 Fred N. Skilling
 KUA General Manager



State of Kosrae
Federated States of Micronesia

APPENDIX III

KOSRAE UTILITIES AUTHORITY

P.O. Box KUA
Kosrae, FM 96944

TEL: (691) 370-3799/3344
FAX: (691) 370-3798

February 28, 2011

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

Gentlemen:

We are providing this letter in connection with your audits of the statements of net assets of the Kosrae Utilities Authority (KUA), a component unit of the State of Kosrae, as of September 30, 2010 and 2009, and the related statements of revenues, expenses and changes in net assets and of cash flows for the years then ended, which collectively comprise KUA'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, and cash flows of KUA in conformity with accounting principles generally accepted in the United States of America. We confirm that we are responsible for the following:

- a. The fair presentation in the basic financial statements of financial position, results of operations, and cash flows, in conformity with accounting principles generally accepted in the United States of America (GAAP).
- b. The fair presentation of the required supplementary information, including the Management's Discussion and Analysis, accompanying the basic financial statements that is presented for the purpose of additional analysis of the basic 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. The review and approval of the financial statements, accompanying schedules 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 stand-alone business-type activities checklist by 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 basic 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, if applicable, approved.
 - b. Deposits and investment securities are properly classified in the category of custodial credit risk.
 - c. 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.
 - 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. Costs to federal awards have been charged in accordance with applicable cost principles.
2. KUA has made available to you all:
 - a. Financial records and related data.
 - b. Minutes of meetings of the Board of Directors or summaries of actions of recent meetings for which have not yet been prepared:

<u>Name</u>	<u>Date</u>
Regular Meeting	April 1, 2010
Regular Meeting	May 6, 2010
Regular Meeting	August 20, 2010
Regular Meeting	August 23, 2010
Regular Meeting	August 25, 2010
Regular Meeting	September 30, 2010

3. There have been no: (1) action taken by KUA management that contravenes the provisions of Federated States of Micronesia (FSM) laws and State laws and regulations, or of contracts and grants applicable to KUA; and (2) communications from 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. KUA 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 its understanding about the risks of fraud in KUA and does not believe that the financial statements are materially misstated as a result of fraud.

6. We have no knowledge of any fraud or suspected fraud affecting KUA involving:
 - a. Management.
 - b. Employees who have significant roles in internal control over financial reporting.
 - c. Others if the fraud could have a material effect on the financial statements.
7. We have no knowledge of any allegations of fraud or suspected fraud affecting KUA received in communications from employees, former employees, analysts, regulators, or others.
8. 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) Topic No. 450 Contingencies (formerly FASB Statement No. 5, *Accounting for Contingencies*).
9. We are responsible for compliance with State and FSM laws, rules and regulations, including compliance with provisions of grants and contracts relating to KUA'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. KUA is responsible for maintaining accounting and administrative control over revenues, obligations, expenditures, assets, and liabilities.
10. 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.
11. No changes in internal control over financial reporting or other factors that might significantly affect internal control over financial reporting, including any corrective actions taken by management with regard to significant deficiencies and material weaknesses, have occurred subsequent to September 30, 2010.
12. We have resolved all significant deficiencies and material weaknesses identified and communicated to the Board of Directors during the previous audit of internal control over financial reporting.
13. 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.

Except where otherwise stated below, matters less than \$8,400 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.

14. Except as listed in Appendix A, there are no transactions that have not been properly recorded in the accounting records underlying the financial statements.
15. KUA has no plans or intentions that may affect the carrying value or classification of assets and liabilities.

16. The following, to the extent applicable, have been appropriately identified, properly recorded, and disclosed in the financial statements:
 - a. Related party transactions and associated amounts receivable or payable, including sales, purchases, loans, transfers, leasing arrangements, and guarantees (written or oral).
 - b. Guarantees, whether written or oral, under which KUA is contingently liable.
17. 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.
18. 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.
 - c. It is at least reasonably possible that the events that could cause the severe impact will occur in the near term.
19. 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 ASC Topic No. 450 *Contingencies*.
20. KUA 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.
21. KUA has complied with all aspects of contractual agreements that would have an effect on the financial statements in the event of noncompliance.
22. No events have occurred after September 30, 2010, but before February 28, 2011, the date the financial statements were available to be issued that require consideration as adjustments to, or disclosures in the financial statements.
23. No department or agency of the Federal Government, the FSM National Government or the State of Kosrae has reported a material instance of noncompliance to us; however, we are aware of \$109,706 of cumulative questioned costs reported by KUA 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.

24. With regard to the fair value measurements and disclosures of certain assets, we believe that:
- a. The measurement methods, including the related assumptions, used in determining fair value were appropriate, consistent with market participant assumptions where available without undue cost and effort, and were consistently applied in accordance with GAAP.
 - b. The completeness and adequacy of the disclosures related to fair values are in conformity with GAAP.
 - c. No events have occurred subsequent to September 30, 2010 that require adjustment to the fair value measurements and disclosures included in the financial statements.
25. 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.
26. Financial instruments with significant individual or group concentration of credit risk have been appropriately identified, properly recorded, and disclosed in the financial statements.
27. During fiscal year 2010, KUA implemented the following pronouncements:
- GASB 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.
 - GASB 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.
 - GASB 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.
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The implementation of these pronouncements did not have a material effect on the financial statements.

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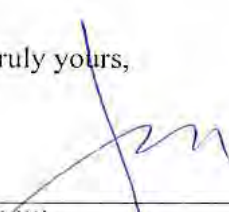
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In June 2010, GASB issued Statement No. 59, *Financial Instruments Omnibus*, which updates and improves existing standards regarding financial reporting of certain financial instruments and external investment pools. The provisions of this statement are effective for periods beginning after June 15, 2010. Management has not evaluated the effect that the implementation of this statement will have on the financial statements of KUA.

28. 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.
29. 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.
30. KUA has obligated, expended, received, and used public funds of KUA 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.
31. Money or similar assets handled by KUA on behalf of the Federal Government have been properly and legally administered and the accounting and record keeping related thereto is proper, accurate, and in accordance with law.
32. No evidence of fraud or dishonesty in fiscal operations of programs administered by KUA has been discovered.
33. Provision has been made to reduce excess or obsolete inventories to their estimated net realizable value. All inventories are the property of KUA and do not include any items consigned to it.
34. We believe that all expenditures that have been deferred to future periods are recoverable.
35. 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 any of the plans. 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 KUA.
36. We do not plan to make frequent amendments to our pension or other postemployment benefit plans.

37. We represent to you that, subsequent to September 30, 2010, there were no changes in internal control or other factors that might significantly affect internal control, including any corrective action taken by management with regard to reportable conditions (including material weaknesses).
38. No evidence of fraud or dishonesty in fiscal operations of programs administered by KUA has been discovered.
39. All additions to KUA's property accounts consist of replacements or additions that are properly capitalizable.
40. There were no items of physical property contained in the property accounts of KUA that were either (a) abandoned or (b) out of service and not regarded as either (i) standby property or equipment or (ii) property held for use only temporarily out of service, as that term is commonly understood in the public utility business.
41. KUA 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. KUA has not experienced any losses on such accounts and management believes it is not exposed to any significant credit risk on its deposits.
42. KUA has not received written communication from its lenders regarding any loan covenant noncompliance and believes that it is in compliance with all applicable covenants.


Very truly yours,



Fred Skilling
General Manager

3/9/11

Date



Robert Gillana
Comptroller

3/9/11

Date