

June 6, 2012

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, 2011, in accordance with auditing standards generally accepted in the United States of America (“generally accepted auditing standards”) and have issued our report thereon dated June 6, 2012.

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 generally accepted auditing standards and 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, 2011. 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, 2011 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, 2011 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 2011 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, 2011, we are not aware of any significant changes in accounting estimates or in management's judgments relating to such estimates.

AUDIT ADJUSTMENTS

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 2011 financial statements.

SIGNIFICANT ACCOUNTING POLICIES

KUA's significant accounting policies are set forth in Note 2 to KUA's 2011 financial statements. During the year ended September 30, 2011, there were no significant changes in previously adopted accounting policies or their application, except for the following pronouncements adopted by KUA:

- GASB 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.
- GASB Statement No. 59, *Financial Instruments Omnibus*, which updates and improves existing standards regarding financial reporting of certain financial instruments and external investment pools.

The implementation of these pronouncements did not have a material effect 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.

In December 2010, GASB issued Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, which addresses how to account for and report service concession arrangements (SCAs), a type of public-private or public-public partnership that state and local governments are increasingly entering into.

In December 2010, GASB issued Statement No. 61, *The Financial Reporting Entity: Omnibus*, which is designed to improve financial reporting for governmental entities by amending the requirements of Statements No. 14, *The Financial Reporting Entity*, and No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, to better meet user needs and address reporting entity issues that have come to light since those Statements were issued in 1991 and 1999, respectively.

In December 2010, GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which is intended to enhance the usefulness of its Codification by incorporating guidance that previously could only be found in certain Financial Accounting Standards Board (FASB) and American Institute of Certified Public Accountants (AICPA) pronouncements.

In July 2011, GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which establishes guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position.

In July 2011, GASB issued Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions* (an amendment of GASB Statement No. 53), which will improve financial reporting by state and local governments by clarifying the circumstances in which hedge accounting continues to be applied when a swap counterparty, or a swap counterparty's credit support provider, is replaced.

Management does not believe that the implementation of these statements will have a material effect 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, 2011.

OTHER INFORMATION IN THE ANNUAL REPORTS

When audited financial statements are included in documents containing other information such as KUA's 2011 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 2011 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 2011 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 2011.

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 II, 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

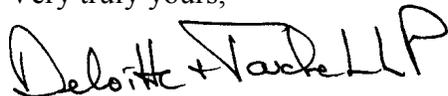
We have issued a separate report to you, dated June 6, 2012, wherein no matters involving KUA's internal control over financial reporting were considered to be significant deficiencies under standards established by the American Institute of Certified Public Accountants, and on its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters were reported.

We have communicated to management, in a separate letter also dated June 6, 2012, control deficiencies that we identified during our audit.

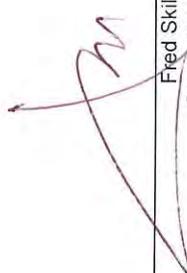
This report is intended solely for the information and use of the Board of Directors, management, and others within the organization, and the Office of the FSM National Public Auditor and is not intended to be and should not be used by anyone other than these specified parties.

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

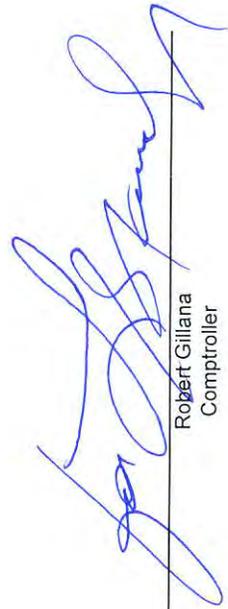
Very truly yours,

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

Description of Misstatement	Indicate if Known or Likely	Account Balance	Assets	Liabilities	Equity	Income	Appendix A TOTAL
Misstatement							
Current-Period Misstatements							
AJE <1> To record the receipt of the Japan grant.	Known	(DR) Long-term deposit				252,800	252,800
	Known	(CR) Sub-grant from Japan through FSMNG	252,800				(252,800)
Total Misstatements			252,800			252,800	Appendix A TOTAL



 Fred Skilling
 General Manager



 Robert Gillana
 Comptroller



State of Kosrae
Federated States of Micronesia

KOSRAE UTILITIES AUTHORITY

P.O. Box KUA
Kosrae, FM 96944

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

June 6, 2012

Deloitte & Touche LLP
361 S Marine Corps Dr
Tamuning GU 96913-3911

We are providing this letter in connection with your audits of the statements of net assets of Kosrae Utilities Authority (KUA), a component unit of the State of Kosrae, as of September 30, 2011 and 2010 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 Company 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 basic financial statements of financial position, results of operations, and cash flows in conformity with GAAP;
- b. The fair presentation of the required supplementary information, including Management's Discussion and Analysis, accompanying the basic financial statements;
- c. The design, implementation, and maintenance of programs and controls to prevent and detect fraud;
- d. Establishing and maintaining effective internal control over financial reporting; and
- e. 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 financial statements was a matter of convenience rather than 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. Additionally, we concur with the adjusting entry included in Appendix A.

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.

APPENDIX II, CONTINUED

1. The basic financial statements referred to above are fairly presented in conformity with GAAP. In addition:
 - a. Net assets components (invested in capital assets, net of related debt; restricted and unrestricted) are properly classified and, if applicable, approved;
 - b. Expenses have been appropriately classified in or allocated to functions and programs in the statements of activities, and allocations have been made on a reasonable basis;
 - c. Revenues are appropriately classified in the statement of activities;
 - d. Deposits and investments are properly classified in category of custodial credit risk;
 - e. Capital assets, including infrastructure assets, are properly capitalized and reported, and, if applicable, depreciated;
 - f. Required supplementary information is measured and presented in prescribed guidelines; and
 - g. Applicable laws and regulation are followed in adopting, approving and amending budgets.
2. KUA has provided to you all relevant information and access as agreed in the terms of the audit engagement letter, including:
 - a. Contracts and grant agreements (including amendments, if any);
 - b. Financial records and related data for all financial transaction of the Company. The records, books and accounts, as provided to you, record the financial and fiscal operations of the Company 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; and
 - c. Resolutions and minutes of the meetings of the Board of Directors or summaries of actions of recent meetings for which minutes have not yet been prepared. Board meetings were held on the following dates:

▪ November 4, 2010	▪ June 7, 2011
▪ November 8, 2010	▪ August 5, 2011
▪ December 21, 2010	▪ August 18, 2011
▪ January 28, 2011	▪ August 24, 2011
▪ April 4, 2011	▪ September 15, 2011
▪ April 18, 2011	▪ October 7, 2011
▪ May 2, 2011	▪ November 14, 2011
▪ May 12, 2011	▪ January 3, 2012
3. There have been no:
 - a. Actions taken by KUA's management that contravenes the provisions of federal laws and FSM laws and regulations; and
 - b. 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. 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 their understanding about the risks of fraud in KUA and do not believe that the financial statements are materially misstated as a result of fraud.
5. We have no knowledge of any fraud or suspected fraud affecting KUA involving:
 - a. Management
 - b. Employees who have significant roles in KUA's internal control over financial reporting
 - 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 KUA received in communications from employees, former employees, 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. Significant assumptions used by us in making accounting estimates are reasonable.
9. During fiscal year 2011, KUA implemented the following pronouncements:
 - GASB 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.
 - GASB 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.
 - GASB Statement No. 59, Financial Instruments Omnibus, which updates and improves existing standards regarding financial reporting of certain financial instruments and external investment pools.

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

In December 2010, GASB issued Statement No. 60, Accounting and Financial Reporting for Service Concession Arrangements, which addresses how to account for and report service concession arrangements (SCAs), a type of public-private or public-public partnership. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of KUA.

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In December 2010, GASB issued Statement No. 62, Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements, which is intended to enhance the usefulness of its Codification by incorporating guidance that previously could only be found in certain Financial Accounting Standards Board (FASB) and American Institute of Certified Public Accountants (AICPA) pronouncements. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of KUA.

In July 2011, GASB issued Statement No. 63, Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position, which establishes guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position. The provisions of this statement are effective for periods beginning after December 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of KUA.

In July 2011, GASB issued Statement No. 64, Derivative Instruments: Application of Hedge Accounting Termination Provisions (an amendment of GASB Statement No. 53), which will improve financial reporting by state and local governments by clarifying the circumstances in which hedge accounting continues to be applied when a swap counterparty, or a swap counterparty’s credit support provider, is replaced. The provisions of this statement are effective 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.

10. There are no reportable conditions including significant deficiencies and material weaknesses, in the design or operation of internal control that could adversely affect KUA’s ability to initiate, record, process, and report financial information.
11. There are no control deficiencies in the design or operation of internal control over financial reporting that could adversely affect KUA’s ability to initiate, record, process, and report financial information.
12. We are aware of our requirements to disclose to you any change in KUA’s internal control over financial reporting that occurred during KUA’s most recent fiscal year that has materially affected, or is reasonably likely to materially affect, KUA’s internal control over financial reporting and we advise you that no such changes have occurred.
13. Management has identified and disclosed to you all laws and regulations that have direct and material effect on the determination of financial statement amounts.

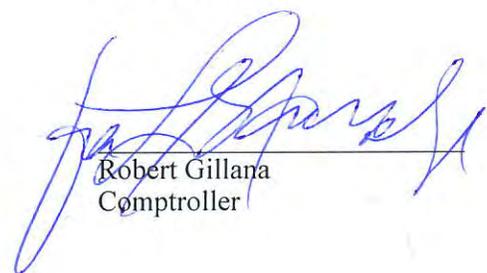
Except where otherwise stated below, immaterial matters less than \$13,000 collectively are not considered to be exceptions that require disclosure for the purpose of the following representations. This amount is not necessarily indicative of amounts that would require adjustment to, or disclosure in, the financial statements.

14. 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); and
 - b. Guarantees, whether written or oral, under which KUA is contingently liable.
 - c. Arrangements with financial institutions involving compensating balances or other arrangements involving restrictions on cash balances and line-of-credit or similar arrangements.
 - d. Financial instruments with significant or group concentration of credit risk.
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; and

- 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*).
- 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 notes to the financial statements.
- 21. 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.
- 22. 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 or any items billed to customers.
- 23. We believe that all expenditures that have been deferred to future periods are recoverable.
- 24. With regard to the fair value measurements and disclosures of certain assets, liabilities, and specific components of equity, such as:
 - 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 accounting principles generally accepted in the United States of America.
 - c. No events have occurred after September 30, 2011, but before June 6, 2012, the date the financial statements were available to be issued that require adjustment to the fair value measurements and disclosures included in the financial statements.
- 25. KUA purchases commercial insurance to cover its potential risks of loss from fire on its building and the contents and full coverage on property damages. It is substantially self-insured for all other risks. Management is of the opinion that no material losses have been sustained as a result of this practice.
- 26. KUA has complied with all aspects of contractual agreements that may have an effect on the financial statements in the event of noncompliance.
- 27. No department or agency of KUA has reported a material instance of noncompliance to us.
- 28. No events have occurred after September 30, 2011, but before June 6, 2012, the date the financial statements were available to be issued that require consideration as adjustments to, or disclosures in, the financial statements except as disclosed in Note 10 to the financial statements.



Fred Skilling
General Manager



Robert Gillana
Comptroller