

KOSRAE PORT AUTHORITY
(A COMPONENT UNIT OF THE STATE OF KOSRAE)

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED SEPTEMBER 30, 2012 AND 2011

KOSRAE PORT AUTHORITY
(A COMPONENT UNIT OF THE STATE OF KOSRAE)

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Years Ended September 30, 2012 and 2011

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INDEPENDENT AUDITORS' REPORT

Board of Directors
Kosrae Port Authority:

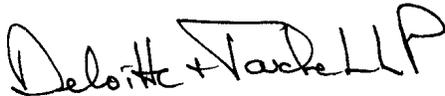
We have audited the accompanying statements of net assets of the Kosrae Port Authority (the Authority), a component unit of the State of Kosrae, as of September 30, 2012 and 2011, and the related statements of revenues, expenses and changes in net assets and of cash flows for the years then ended. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of 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 express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Kosrae Port Authority as of September 30, 2012 and 2011, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 27, 2013, 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 purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 3 through 4 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

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

June 27, 2013

KOSRAE PORT AUTHORITY
(A COMPONENT UNIT OF THE STATE OF KOSRAE)

Management's Discussion and Analysis
Years Ended September 30, 2012 and 2011

This analysis prepared by Kosrae Port Authority (Authority) offers readers of the Authority's financial statements a narrative overview of its activities for fiscal year ended September 30, 2012. This analysis is required by the Government Accounting Standards Board (GASB), which provide guidelines on what must be included and excluded from the analysis.

The Statement of Net Assets and Statement of Revenues, Expenses and Changes in Net Assets provides an indication of the Authority's financial condition. The Authority's net assets reflect the difference between assets and liabilities. An increase in net assets over time typically indicates an improvement in the Authority's financial condition.

The following summarizes the financial position and results of operations of Kosrae Port Authority for the fiscal years 2012, 2011 and 2010.

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Assets:			
Current assets	\$ 32,302	\$ 43,270	\$ 55,140
Property and equipment, net	<u>16,944,452</u>	<u>17,806,447</u>	<u>18,668,442</u>
Total assets	<u>\$ 16,976,754</u>	<u>\$ 17,849,717</u>	<u>\$ 18,723,582</u>
Liabilities and Net Assets:			
Current liabilities	\$ <u>89,526</u>	\$ <u>96,818</u>	\$ <u>114,964</u>
Net Assets:			
Invested in capital assets	16,944,452	17,806,447	18,668,442
Unrestricted	<u>(57,224)</u>	<u>(53,548)</u>	<u>(59,824)</u>
Total net assets	<u>16,887,228</u>	<u>17,752,899</u>	<u>18,608,618</u>
Total liabilities and net assets	<u>\$ 16,976,754</u>	<u>\$ 17,849,717</u>	<u>\$ 18,723,582</u>
Revenues, Expenses and Changes in Net Assets			
Operating revenues	\$ 181,171	\$ 188,987	\$ 161,805
Operating expenses	<u>(1,046,842)</u>	<u>(1,044,706)</u>	<u>(1,045,521)</u>
Net operating loss	<u>(865,671)</u>	<u>(855,719)</u>	<u>(883,716)</u>
Capital contribution	<u>-</u>	<u>-</u>	<u>7,725,577</u>
Change in net assets	(865,671)	(855,719)	6,841,861
Net assets at beginning of the year	<u>17,752,899</u>	<u>18,608,618</u>	<u>11,766,757</u>
Net assets at the end of the year	<u>\$ 16,887,228</u>	<u>\$ 17,752,899</u>	<u>\$ 18,608,618</u>

KOSRAE PORT AUTHORITY
(A COMPONENT UNIT OF THE STATE OF KOSRAE)

Management's Discussion and Analysis, Continued
Years Ended September 30, 2012 and 2011

Financial Highlights

The Authority's total assets as of September 30, 2012 are comprised of the net amount of its cash, accounts receivable, and property and equipment net of accumulated depreciation. The property and equipment were transferred from the Kosrae State Government in July 2008. In fiscal year 2010, the Authority received a significant capital contribution of \$7,725,577 for various airport improvement projects which were jointly funded by the US Federal Aviation Administration and the FSM National Government. The reduction of capital assets in fiscal year 2012 is due to depreciation expense for the year. For additional information with respect to capital assets, please see Note 4 to the financial statements.

Current liabilities comprise accounts payable, accrued liabilities and others, and the due to primary government of \$72,174 which was mentioned in the last audit report. There has not been any formal discussion or negotiation on how to settle this debt. The Authority would like to eventually settle for a write-off based on a verbal agreement during the Transfer Negotiation made in July 2008 with the previous Administration.

Operating revenues are mainly from airport landing fees, sea port charges and departure fees. Fiscal year 2012 revenues registered a decrease of 13% compared to fiscal year 2011. A \$17,038 recovery of bad debts for the year; however, was recognized.

Depreciation expense comprised 82% of total operating expenses while salaries and benefits registered 10%. Other expenses such as utilities, fuel, communications, travel, and others totaling \$80,546 consisted 8% of the total operating expenses. There are no significant changes from amounts recorded in 2011.

Management's Discussion and Analysis for the year ended September 30, 2011 is set forth in the Authority's report on the audit of financial statements, which is dated June 5, 2012. That Discussion and Analysis explains the major factors impacting the 2011 financial statements and can be viewed at the Office of the Public Auditor's website at www.fsmopa.fm.

Economic factors and Next Year's Budget

The Kosrae Port Authority continuously experiences economic and financial challenges as it relies heavily on revenues realized from both airport and seaport operations. Airport revenues were affected because of the reduction in the flight schedule of the only carrier flying in Kosrae State. The expenditures, on the other hand are expected to increase, particularly utilities due to the usage of donated facilities.

Management realizes the problem and has looked to the Port tariff restructuring as means of increasing revenues. In addition, leases will be reviewed as to reasonableness for possible increases as well.

Contacting the Authority's Financial Management

This financial report is designed to provide our customers, creditors, and other interested parties a general overview of Kosrae Port Authority's finances. If you have questions about this report or need additional financial information, contact the Office of the General Manager at P. O. Box 960, Tofol, Kosrae FM 96944.

KOSRAE PORT AUTHORITY
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Statements of Net Assets
September 30, 2012 and 2011

<u>ASSETS</u>	<u>2012</u>	<u>2011</u>
Current assets:		
Cash	\$ 6,809	\$ 27,175
Accounts receivable, net	22,343	12,945
Other assets	<u>3,150</u>	<u>3,150</u>
Total current assets	32,302	43,270
Property and equipment, net	<u>16,944,452</u>	<u>17,806,447</u>
	<u>\$ 16,976,754</u>	<u>\$ 17,849,717</u>
<u>LIABILITIES AND NET ASSETS</u>		
Current liabilities:		
Accounts payable	\$ 7,248	\$ 13,895
Accrued liabilities and others	10,104	10,749
Due to primary government	<u>72,174</u>	<u>72,174</u>
Total liabilities	<u>89,526</u>	<u>96,818</u>
Contingencies		
Net assets:		
Invested in capital assets	16,944,452	17,806,447
Unrestricted	<u>(57,224)</u>	<u>(53,548)</u>
Total net assets	<u>16,887,228</u>	<u>17,752,899</u>
	<u>\$ 16,976,754</u>	<u>\$ 17,849,717</u>

See accompanying notes to financial statements.

KOSRAE PORT AUTHORITY
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Statements of Revenues, Expenses, and Changes in Net Assets
Years Ended September 30, 2012 and 2011

	2012	2011
Operating revenues:		
Charges for service	\$ 164,133	\$ 188,987
Recovery of bad debts	17,038	-
Total operating revenues	181,171	188,987
Operating expenses:		
Depreciation and amortization	861,995	861,995
Salaries and benefits	104,301	113,739
Utilities	45,456	40,843
Travel	13,648	7,640
Fuel	9,544	8,778
Supplies and materials	4,016	823
Communication	3,125	2,312
Representation and entertainment	1,741	740
Repairs	1,278	-
Bank service charges	341	161
Taxes	-	2,099
Freight and handling	-	1,061
Miscellaneous and others	1,397	4,515
Total operating expenses	1,046,842	1,044,706
Loss from operations and change in net assets	(865,671)	(855,719)
Net assets at beginning of year	17,752,899	18,608,618
Net assets at end of year	\$ 16,887,228	\$ 17,752,899

See accompanying notes to financial statements.

KOSRAE PORT AUTHORITY
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Statements of Cash Flows
Years Ended September 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Cash flows from operating activities:		
Cash received from customers	\$ 171,773	\$ 161,687
Cash paid to suppliers for goods and services	(87,193)	(71,401)
Cash paid to employees	(104,946)	(113,516)
	<u>(20,366)</u>	<u>(23,230)</u>
Net cash used in operating activities		
Net change in cash	(20,366)	(23,230)
Cash at beginning of year	<u>27,175</u>	<u>50,405</u>
Cash at end of year	\$ <u><u>6,809</u></u>	\$ <u><u>27,175</u></u>
Reconciliation of loss from operations to net cash used in operating activities:		
Loss from operations	\$ (865,671)	\$ (855,719)
Adjustments to reconcile loss from operations to net cash used in operating activities:		
Depreciation and amortization	861,995	861,995
(Increase) decrease in assets:		
Accounts receivable	(9,398)	(8,210)
Other	-	(3,150)
Increase (decrease) in liabilities:		
Accounts payable	(6,647)	721
Accrued liabilities and others	(645)	(18,867)
	<u>(20,366)</u>	<u>(23,230)</u>
Net cash used in operating activities	\$ <u><u>(20,366)</u></u>	\$ <u><u>(23,230)</u></u>

See accompanying notes to financial statements.

KOSRAE PORT AUTHORITY
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Notes to Financial Statements
September 30, 2012 and 2011

(1) Reporting Entity

The Kosrae Port Authority (the Authority), a component unit of the Kosrae State Government, was established by Kosrae State Public Law 7-91. The primary purpose of the Authority is to oversee the use and maintenance of Kosrae State's sea and air ports. The Authority began operating as a separate entity in fiscal year 2008, although the accounting for the Authority was not transferred from the Kosrae State Department of Administration and Finance until July 1, 2008.

The Authority is governed by a five-member Board of Directors. The Board is composed of four directors appointed by the Governor with the advice and consent of the Legislature, and, ex-officio, the Director of the Department of Transportation and Infrastructure. An appointed director serves for a term of four years, subject to reappointment, and until his successor has been appointed and qualifies. The Governor appoints two directors to two-year terms and two directors to four-year term.

The Authority's financial statements are incorporated into the financial statements of the Kosrae State Government as a component unit.

(2) Summary of Significant Accounting Policies

The accounting policies of the Authority conform to accounting principles generally accepted in the United States of America as applicable to governmental entities, specifically proprietary funds. Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, requires that proprietary activities apply all applicable GASB pronouncements as well as Statements and Interpretations issued by the Financial Accounting Standards Board (FASB), Accounting Principle Board Opinions and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989. The Authority has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, which was subsequently amended by GASB Statement No. 37, *Basic Financial Statements - Management's Discussion and Analysis - for State and Local Governments: Omnibus*, and modified by GASB Statement No. 38, *Certain Financial Statement Note Disclosures*, establish financial reporting standards for governmental entities which require that management's discussion and analysis of the financial activities be included with the basic financial statements and notes and modifies certain other financial statement disclosure requirements.

To conform to the requirements of GASB Statement No. 34, the Authority's equity is presented in the following net asset categories:

- Invested in capital assets, net of related debt: capital assets, net of accumulated depreciation, plus construction or improvement of those assets, less related debt.
- Unrestricted; net assets that are not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action of management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

KOSRAE PORT AUTHORITY
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Notes to Financial Statements
September 30, 2012 and 2011

(2) Summary of Significant Accounting Policies, Continued

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Basis of Accounting

Proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operation of the fund are included in the statements of net assets. Proprietary fund operating statements present increases and decreases in net total assets. The accrual basis of accounting is utilized by proprietary funds. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

The Authority's revenues are derived primarily from providing various services to major shipping and airline customers under an approved tariff rate schedule and are reported as operating revenues. Capital, grants, financing or investing related transactions are reported as non-operating revenues. Revenue is recognized on the accrual basis and is recorded upon billing when services have been completed. All expenses related to operating the Authority are reported as operating expenses. Interest income or federal program revenues are the primary components of non-operating expenses and revenues.

Cash

Custodial credit risk is the risk that in the event of a bank failure, the Authority's deposits may not be returned to it. Such deposits are not covered by depository insurance and are either uncollateralized or collateralized with securities held by the pledging financial institution or held by the pledging financial institution but not in the depositor-government's name. The Authority does not have a deposit policy for custodial credit risk.

As of September 30, 2012 and 2011, the cash balance was \$6,809 and \$27,175, respectively, and the corresponding bank balances were \$7,208 and \$26,176, respectively, which are maintained in financial institutions subject to Federal Deposit Insurance Authority (FDIC) insurance. As of September 30, 2012 and 2011, bank deposits were fully FDIC insured.

Receivables

The Authority's accounts receivable are mostly with businesses and individuals based in Kosrae State that relate to space rentals, landing fees, port and handling charges, and other fees. The allowance for uncollectible accounts is stated at an amount which management believes will be adequate to absorb possible losses on accounts receivable that may become uncollectible based on evaluations of the collectibility of these accounts and prior collection experience. The allowance is established through a provision for bad debts charged to expense. Bad debts are written off against the allowance on the specific identification method.

KOSRAE PORT AUTHORITY
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Notes to Financial Statements
September 30, 2012 and 2011

(2) Summary of Significant Accounting Policies, Continued

Property and Equipment

Property and equipment are stated at cost or at estimated appraised values as of the transfer date, less accumulated depreciation. Depreciation is based on the straight-line method over the estimated useful lives of the respective assets. The Authority utilizes a capitalization threshold of \$100,000, which was set by Kosrae State upon transfer of these assets to the Authority. No subsequent additions have occurred since the date of transfer.

Taxes

Corporate profits are not subject to income tax in the Federated States of Micronesia. The Government of the Federated States of Micronesia imposes a gross receipts tax of 3% on revenues. The Authority is specifically exempt from this tax.

New Accounting Standards

During fiscal year 2012, the Authority implemented the following pronouncements:

- 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 the frequency and timing of measurements for actuarial valuations first used to report funded status information in OPEB plan financial statements. The implementation of this pronouncement did not have a material effect on the accompanying financial statements.
- GASB 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 implementation of this pronouncement did not have a material effect on the accompanying financial statements.

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. 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 the Authority.

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. The provisions of this statement are effective for periods beginning after June 15, 2012. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Authority.

KOSRAE PORT AUTHORITY
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Notes to Financial Statements
September 30, 2012 and 2011

(1) Summary of Significant Accounting Policies, Continued

New Accounting Standards, Continued

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 the Authority.

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 has not yet determined the effect of implementation of this statement on the financial statements of the Authority.

In April 2012, GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*, which clarifies the appropriate reporting of deferred outflows of resources and deferred inflows of resources to ensure consistency in financial reporting. The provisions of this statement are effective for periods beginning after December 15, 2012. Management has not yet determined the effect of implementation of this statement on the financial statements of the Authority.

In April 2012, GASB issued Statement No. 66, *Technical Corrections - 2012*, which enhances the usefulness of financial reports by resolving conflicting accounting and financial reporting guidance that could diminish the consistency of financial reporting. The provisions of this statement are effective for periods beginning after December 15, 2012. Management has not yet determined the effect of implementation of this statement on the financial statements of the Authority.

In June 2012, GASB issued Statement No. 67, *Financial Reporting for Pension Plans*, which revises existing guidance for the financial reports of most pension plans, and Statement No. 68, *Accounting and Financial Reporting for Pensions*, which revises and establishes new financial reporting requirements for most governments that provide their employees with pension benefits. The provisions in Statement 67 are effective for financial statements for periods beginning after June 15, 2013. The provisions in Statement 68 are effective for fiscal years beginning after June 15, 2014. Management has not yet determined the effect of implementation of these statements on the financial statements of the Authority.

(3) Accounts Receivable

The detail of accounts receivable, net of for uncollectible accounts, at September 30, 2012 and 2011, is as follows:

	<u>2012</u>	<u>2011</u>
Accounts receivable	\$ 73,146	\$ 63,748
Less allowance for uncollectible accounts	(50,803)	(50,803)
	\$ <u>22,343</u>	\$ <u>12,945</u>

KOSRAE PORT AUTHORITY
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Notes to Financial Statements
September 30, 2012 and 2011

(4) Property and Equipment

Capital asset activity for the years ended September 30, 2012 and 2011, was as follows:

	<u>Estimated Useful Lives</u>	<u>Balance at October 1, 2011</u>	<u>Transfers and Additions</u>	<u>Transfers and Deletions</u>	<u>Balance at September 30, 2012</u>
Depreciable:					
Buildings and improvements	10 to 50 years	\$ 8,618,737	\$ -	\$ -	\$ 8,618,737
Machinery and equipment	5 years	924,968	-	-	924,968
Infrastructure	10 to 80 years	<u>37,972,012</u>	<u>-</u>	<u>-</u>	<u>37,972,012</u>
		47,515,717	-	-	47,515,717
Less accumulated depreciation		<u>(29,709,270)</u>	<u>(861,995)</u>	<u>-</u>	<u>(30,571,265)</u>
Property and equipment, net		\$ <u>17,806,447</u>	\$ <u>(861,995)</u>	\$ <u>-</u>	\$ <u>16,944,452</u>
	<u>Estimated Useful Lives</u>	<u>Balance at October 1, 2010</u>	<u>Transfers and Additions</u>	<u>Transfers and Deletions</u>	<u>Balance at September 30, 2011</u>
Depreciable:					
Buildings and improvements	10 to 50 years	\$ 8,618,737	\$ -	\$ -	\$ 8,618,737
Machinery and equipment	5 years	924,968	-	-	924,968
Infrastructure	10 to 80 years	<u>37,972,012</u>	<u>-</u>	<u>-</u>	<u>37,972,012</u>
		47,515,717	-	-	47,515,717
Less accumulated depreciation		<u>(28,847,275)</u>	<u>(861,995)</u>	<u>-</u>	<u>(29,709,270)</u>
Property and equipment, net		\$ <u>18,668,442</u>	\$ <u>(861,995)</u>	\$ <u>-</u>	\$ <u>17,806,447</u>

(5) Risk Management

The Authority purchases insurance to cover life insurance risks. However, the Authority does not purchase insurance to cover risks associated with its buildings and other fixed assets. Management is of the opinion that no material losses have been sustained as a result of this practice since the inception of its operations in July 2008.

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

The Board of Directors
Kosrae Port Authority:

We have audited the financial statements of the Kosrae Port Authority (the Authority) as of and for the year ended September 30, 2012, and have issued our report thereon dated June 27, 2013. We conducted our audit 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Authority's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, 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.

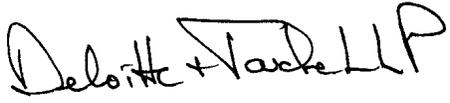
A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance and other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of management and the Board of Directors of the Kosrae Port Authority and is not intended to be and should not be used by anyone other than these specified parties.

Handwritten signature of Deloitte + Stach LLP in black ink.

June 27, 2013

KOSRAE PORT AUTHORITY

Summary Schedule of Prior Audit Findings
Years Ended September 30, 2012 and 2011

There are no unresolved prior audit findings as of September 30, 2012.