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June 17, 2014

Board of Directors
Kosrae Port Authority

Dear Members of the Board:

In planning and performing our audit of the financial statements of Kosrae Port Authority (the Authority) as of and for the year ended September 30, 2013 (on which we have issued our report dated June 17, 2014), in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, we considered the Authority's internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting. However, in connection with our audit, we identified, and included in the attached Appendix I, deficiencies related to the Authority's internal control over financial reporting and other matters as of September 30, 2013 that we wish to bring to your attention.

We have also issued a separate report to the Board of Directors, also dated June 17, 2014, on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters.

The definition of a deficiency is also set forth in the attached Appendix I.

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

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

We will be pleased to discuss the attached comments with you and, if desired, to assist you in implementing any of the suggestions.

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

Very truly yours,

Deloitte & Touche LLP

SECTION I – DEFICIENCIES

We developed the following recommendations concerning deficiencies in internal control over financial reporting that we wish to bring to your attention.

Lack of Controls over Departure Fees

Condition: There were significant discrepancies between passenger manifests and the number of receipts collected. Departure fees are susceptible to fraud as fees are collected in cash. A risk exists that funds are collected and the passenger is reported as not having boarded or is exempt. There are no controls designed or implemented to check receipts against passenger manifests for completeness, to recount cash collected and to agree against receipts collected, and to agree cash collected to the amount deposited. Additionally, there are a number of missing fiscal year 2013 receipts.

Recommendation: We recommend that:

- passengers per airline manifests and receipts collected should be reconciled and discrepancies should be documented (e.g. explanation of the # of passengers who did not board the plane or were exempt);
- receipts should be matched to cash collections;
- cash collected should be matched to the deposit slip;
- the sequential number of receipts should be verified;
- the collector and the general manager or the individual checking the collector's work should sign as preparer and reviewer for audit trail purposes.

Schedule of Accounts Receivable (Carried forward from prior years)

Condition: The Authority does not maintain updated customer files and is not able to provide a breakdown of the year-end receivable balance per customer. The Authority does not regularly reconcile its receivables with customers and does not perform timely follow-up on billings. Further, no control is in place to analyze collectability of accounts receivable and to document that the allowance is sufficient.

Recommendation: The Authority should update and maintain customer files and perform regular receivable reconciliations with customers. Further, the Authority should perform periodic collectability analyses.

Board Meeting Minutes

Condition: The Authority does not always prepare Board of Director minutes. This condition could result in incomplete meeting records.

Recommendation: The Authority should maintain a written record of all Board of Director meetings.

Record Keeping

Condition: There are instances of missing cash receipts, invoices, departure fee tickets and flight manifests. In addition, the Authority does not maintain files in an orderly manner. This condition could result in inaccurate or incomplete accounting records.

Recommendation: The Authority should maintain all cash receipts, invoices and transaction files in an orderly manner.

Lack of Accounting Software

Condition: The Authority has not started using a comprehensive accounting software and has yet to rebuild its accounting records. Currently, revenue records are maintained manually, and check registers are maintained in EXCEL.

Recommendation: We recommend that management expedite the purchase of accounting software and rebuild its accounting records. The software should be installed on an office computer, and backups should be performed regularly and should be kept off-site.

Lack of Payroll Files

Condition: Timesheets and timecards are not always on file. For several payments, payroll was not calculated based on the underlying employment contract. Furthermore, timesheets were not signed as evidence of management review and approval.

Recommendation: Management should verify that all employee contracts are on file, and retain and safeguard all payroll documents. The Authority should implement procedures to formally approve timesheets prior to payment and to periodically verify payroll calculations.

Social Security and Withholding Tax

Condition: Several returns were not submitted to the tax authorities by the due date. Furthermore, there were missing tax returns and related cash receipts.

Recommendation: We recommend that management timely remit taxes. Management should maintain all tax documents on file.

Old Contracts

Condition: Existing contracts for the rental of 1) airline offices, the manager's office, airline ticket counter and baggage make up area, and 2) the Air Cargo building expired in 2010 and 2007, respectively.

Recommendation: Management and the Board are currently negotiating with United Airlines to update these contracts. Management should keep all contracts current and renew them prior to expiration.

Due to Primary Government

Condition: The Authority has an amount due to the primary government which has been outstanding since 2008.

Recommendation: We recommend that the Authority attempt to devise a plan to reduce the amount owed, by formally requesting a write-off of the amount due, or setting aside funds to pay off the amount.

Custody of Cash

Condition: Cash is stored in unsecured locations.

Recommendation: KPA should utilize a safe or night depository when deposits cannot be made on the day of collection.

Monitoring of Expenses of Subsidies

Condition: Payments made using government subsidies are not monitored. For some subsidies, spending appears to exceed the allotted amount.

Recommendation: KPA should monitor expenses funded by subsidies.

SECTION II – DEFINITIONS

The definition of a deficiency is as follows:

A *deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A deficiency in design exists when (a) a control necessary to meet the control objective is missing or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective would not be met. A deficiency in operation exists when (a) a properly designed control does not operate as designed, or (b) the person performing the control does not possess the necessary authority or competence to perform the control effectively.

MANAGEMENT'S RESPONSIBILITY FOR, AND THE OBJECTIVES AND LIMITATIONS OF, INTERNAL CONTROL OVER FINANCIAL REPORTING

The following comments concerning management's responsibility for internal control over financial reporting and the objectives and inherent limitations of internal control over financial reporting are adapted from auditing standards generally accepted in the United States of America.

Management's Responsibility

The Authority's management is responsible for the overall accuracy of the financial statements and their conformity with generally accepted accounting principles. In this regard, management is also responsible for establishing and maintaining effective internal control over financial reporting.

Objectives of Internal Control over Financial Reporting

Internal control over financial reporting is a process affected by those charged with governance, management, and other personnel and designed to provide reasonable assurance about the achievement of the entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. Internal control over the safeguarding of assets against unauthorized acquisition, use, or disposition may include controls related to financial reporting and operations objectives. Generally, controls that are relevant to an audit of financial statements are those that pertain to the entity's objective of reliable financial reporting (i.e., the preparation of reliable financial statements that are fairly presented in conformity with generally accepted accounting principles).

Inherent Limitations of Internal Control over Financial Reporting

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.