

June 30, 2009

Honorable Emmanuel Mori  
President  
Federated States of Micronesia:

Dear President Mori:

We have performed an audit of the financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Federated States of Micronesia (FSM) National Government as of and for the year ended September 30, 2008, in accordance with auditing standards generally accepted in the United States of America and have issued our report thereon dated June 30, 2009.

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 the FSM 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 and standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, has been described in our engagement letter dated July 15, 2008. 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 each opinion unit in the FSM's basic financial statements and the accompanying supplementary information, and to disclaim an opinion on the required supplementary information for the year ended September 30, 2008 in conformity with accounting principles generally accepted in the United States of America ("generally accepted accounting principles"), in all material respects;
- To express an opinion on whether the supplementary information that accompanies the basic financial statements is presented fairly, in all material respects, in relation to the basic financial statements taken as a whole;
- To report on the FSM'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, 2008 based on an audit of financial statements performed in accordance with the standards applicable to financial audits contained in *Government Auditing Standards*; and
- To report on the FSM's compliance with requirements applicable to each major program and on internal control over compliance in accordance with the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement (OMB Circular A-133)*.

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 Office of the President 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 Office of the President of their responsibilities.

We considered the FSM'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 FSM's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the FSM'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.

We also considered the FSM's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133. Our audit does not, however, provide a legal determination of the FSM's compliance with those requirements.

## **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 ordinarily based on knowledge and experience about past and current events and on assumptions about future events. Significant accounting estimates reflected in the FSM's 2008 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, 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, 2008, we are not aware of any significant changes in accounting estimates or in management's judgments relating to such estimates.

## **UNCORRECTED MISSTATEMENTS**

Our audit of the financial statements was designed to obtain reasonable, rather than absolute, assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. We have attached to this letter, as Appendix II, a summary of uncorrected misstatements aggregated by us during the current engagement and pertaining to the latest period presented that were determined by management to be immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

## **MATERIAL CORRECTED MISSTATEMENTS**

Material misstatements were brought to the attention of management as a result of our audit procedures and were corrected by management during the current period. We have attached to this letter, as Appendix I, a summary of misstatements corrected by management.

## **SIGNIFICANT ACCOUNTING POLICIES**

The FSM's significant accounting policies are set forth in Note 1 to the FSM's 2008 financial statements. During the year ended September 30, 2008, there were no significant changes in previously adopted accounting policies or their application.

## **DISAGREEMENTS WITH MANAGEMENT**

We have not had any disagreements with management related to matters that are material to the FSM's 2008 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 2008.

## **SIGNIFICANT ISSUES DISCUSSED, OR SUBJECT OF CORRESPONDENCE, 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.

## **OTHER SIGNIFICANT ISSUES DISCUSSED, OR SUBJECT OF CORRESPONDENCE, WITH MANAGEMENT**

Throughout the year, routine discussions were held, or were the subject of correspondence, with management. In our judgment, such discussions or correspondence did not involve significant issues requiring communication to the Office of the President.

## **SIGNIFICANT DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT**

In our judgment, we received the full cooperation of the FSM's management and staff and had unrestricted access to the FSM's senior management in the performance of our audit.

## **MANAGEMENT'S REPRESENTATIONS**

We have made specific inquiries of the FSM's management about the representations embodied in the financial statements. Additionally, we have requested that management provide to us the written representations the FSM 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.

## **CONTROL-RELATED MATTERS**

We have issued a separate report to you, also dated June 30, 2009, containing certain matters involving the FSM's internal control over financial reporting that we consider to be material weaknesses or 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. We have also issued a separate report to you, also dated June 30, 2009, containing certain matters involving the FSM's compliance with requirements applicable to each major program and on internal control over compliance in accordance with OMB Circular A-133. Although we have included management's written responses to our comments contained in those reports, such responses have not been subjected to the auditing procedures applied in our audit of the basic financial statements and, accordingly, we do not express an opinion or provide any form of assurance on the appropriateness of the responses or the effectiveness of any corrective actions described therein.

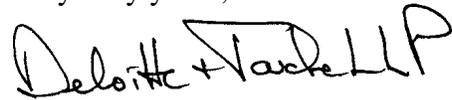
Honorable Emmanuel Mori  
President  
Federated States of Micronesia  
June 30, 2009

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

Very truly yours,

A handwritten signature in black ink that reads "Deloitte + Touche LLP". The signature is written in a cursive, stylized font. The word "Deloitte" is on the left, followed by a plus sign, and "Touche LLP" is on the right. The "T" in "Touche" is particularly large and loops back over the "o".

Journal Entries - A/E		General Fund	
		September 30, 2008	
#	Name	Debit	Credit
	<b>1 GF - caje To record loan receivable - FSM PetroCorp</b>		
01-4110-FB	Unreserved Fund Balance	524,350.00	-
01-4130-FB	R/B Restricted Capital Assets	-	524,350.00
01-03190	Micronesia Petroleum Corp	524,350.00	-
01-2338-AS	Loan Receivable - FSM PetroCorp	1,048,700.00	1,048,700.00
	To correct recording of \$524k payment to BOG to open reserve account for FSM Petro Corp per PL15-18 and to record related asset for the FSM PetroCorp Loan.L		
	L		
	L		
	<b>2 GF - caje To correct recording of revenue.</b>		
01-1999-AS	Due to Treasury Fund	1,326.00	571,861.84
01-7810-RE	Interest Income	159,741.02	-
01-7890-RE	Realized Gain On Equities	410,794.82	-
01-7895-RE	Unrealized Earnings	571,861.84	571,861.84
	To move to GF investment loss on ER.		
	<b>3 GF - caje To record reconciling items CFSM YAP.</b>		
01 - 8910	Transfer out - DT	14,000.00	-
01-1999-AS	Due to Treasury Fund	-	14,000.00
01-1999-AS	Due to Treasury Fund	14,000.00	-
25-3635-LI	Fed D/D Payable Yap	-	1,044.53
25-3635-LI	Fed D/D Payable Yap	-	14,000.00
25-3635-LI	Fed D/D Payable Yap	-	16,084.18
25-4110-FB	Unreserved Fund Balance	634,000.00	634,000.00
25-4120-FB	R/R Restricted Coit Approp	625.02	-
01-00215	St Judiciary S	279.58	-
01-02095	Joint Law Enfc	25.25	-
25-45024	Garvey Village	25.25	-

Journal Entries - AJE		General Fund September 30, 2008	
#	Name	Debit	Credit
25-45036	Amun Village C	50.03	-
25-45041	Consumable Goo	15,104.31	-
25-45059	OI Infrastructure Development	1,044.53	-
		678,128.72	678,128.72
	To record YAP state exp per recon (JVE0837) including YAP expense to be recorded in fund 51.L		
	To reduce CFSM continuing appropriation, to reduce GF encumbrance.L		
	4 GF - Caja To correct recording of payment.		108,247.78
01 - 8910	Transfer out - DT	108,247.78	-
25-42420	CHK Hlth Care	108,247.78	108,247.78
	To correct recording of payment to vendor erroneously recorded as transfer out <JVE0837>.		
	5 GF - caja To correct disaster fund.		200,000.00
01 - 8910	Transfer out - DT	200,000.00	200,000.00
01-03139	Disaster Emerg	200,000.00	200,000.00
	To correct recording of emergency grant.		
	6 GF - caja To record federal payable to KSG.		-
01-3112-LI	A/P Other not on Subledger	96,395.51	96,395.51
99-1999-AS-20	DUE TO	96,395.51	96,395.51
	To record federal payable to KSG (federal recon).		
	7 GF - caja To record gain/loss on ex rates for fy08.		1,500.96
01-7999-RE	Other Miscellaneous	-	3,850.79
01-00515	Embassy China	12,884.81	-
01-00516	Embassy Suva F	9,972.27	-
01-00517	Embassy Tokyo	-	-



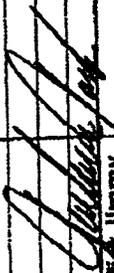
Journal Entries - AJE		General Fund	
		September 30, 2008	
#	Name	Debit	Credit
01-4110-FB	Unreserved Fund Balance	15,000.00	-
01-4110-FB	Unreserved Fund Balance	159,190.00	-
01-4110-FB	Unreserved Fund Balance	2,259.00	-
01-4110-FB	Unreserved Fund Balance	726,754.00	-
01-4130-FB	R/B Restricted Capital Assets	549,796.00	-
01-7999-RE	Other Miscellaneous	-	75,356.17
01-7999-RE	Other Miscellaneous	-	159,190.00
01-01095	Non-recurring	-	15,000.00
01-01095	Non-recurring	549,796.00	2,259.00
01-01095	Non-recurring	-	651,397.83
01-01095	Non-recurring	15,000.00	-
99-1022-AS	CIB Embassy Beijing	-	15,000.00
99-1022-AS	CIB Embassy Beijing	2,905,996.00	2,805,996.00
	11 AJE To correct fund balance beginning	78,822.00	-
01-4110-FB	Unreserved Fund Balance	4,869,316.00	-
01-4110-FB	Unreserved Fund Balance	-	4,948,138.00
01-7910-RE	Operating Transfers In	4,948,138.00	4,948,138.00
	To correct beginning balance in relation to Fund 51 and Fund 07 (PY CIP funds).		
	12 AJE To record additional allowance on MLFC.		1,223,382.00
01-1999-AS	Due to Treasury Fund	1,223,382.00	-
01-01095	Non-recurring	1,223,382.00	1,223,382.00
	To record allowance on MLFC. JVE0651.		
	13 GF-CAAJE To record reversal of GF revenue		90,808.00
01-3299-LI	Unidentified Deposits	90,808.00	-
01-7999-RE	Other Miscellaneous	90,808.00	90,808.00



Journal Entries - AJE		Federal Fund	
#	Name	Debit	Credit
	1 CAJE To record payable to KSG.		
20 - 1999 - 00	Due to Treasury Fund	96,395.51	-
20 - 3633 - 00	Fed D/D Payable KOS	-	96,395.51
	To record federal payable to KSG (Federal recon).		
	2 CAJE To record federal payable and advance to YSG.		
20 - 1410 - 00	A/R Federal Grants	471,074.76	-
20 - 1410 - 00	A/R Federal Grants	1,508,057.90	-
20 - 1999 - 00	Due to Treasury Fund	89,158.56	-
20 - 3635 - 00	Fed D/D Payable Yap	-	471,074.76
20 - 3635 - 00	Fed D/D Payable Yap	-	1,542,115.85
20 - 3635 - 00	Fed D/D Payable Yap	-	1,508,057.90
20 - 3635 - 00	Fed D/D Payable Yap	-	89,158.56
20 - 2285 - 00	Advance to yap	1,542,115.85	-
		3,608,465.07	3,608,465.07
	3 CAJE To record retainage payable for fy08		
20 - 1410 - 00	A/R Federal Grants	305,332.02	-
20 - 1410 - 00	A/R Federal Grants	-	1,266,648.41
20 - 3711 - 00	Retainage Payable	-	305,332.02
20 - 3711 - 00	Retainage Payable	1,266,648.41	-
Dup4422 - 20	Federal Grants	-	305,332.02
Dup4422 - 20	Federal Grants	1,266,648.41	-
20 - 8310 - 80	Gen Contractual Services - Retainage	305,332.02	-
20 - 8310 - 80	Gen Contractual Services - Retainage	-	1,266,648.41
		3,143,956.86	3,143,956.86
	To revise retainage payable recorded. - JVE0843.		
	4 AJE To record CIP fund beginning (PY Fund 49)		

Journal Entries - AJE		Federal Fund	
#	Name	Debit	Credit
07 - 4110 - FB	Unreserved Fund Balance	-	78,822.00
07 - 8910 - EX	Transfer out	78,822.00	-
	To correct recording of fund balance beginning.	78,822.00	78,822.00

The above adjustments are not due to fraud or illegal acts. Rather, we believe that the above constitute misstatement. In connection with the Corrected Audit Adjustments listed above, we have reviewed and approve them on the basis of information we have provided to you.

  
 Juliet Jimmy  
 Assistant Secretary for National Treasury

Date: 10/20/09

Journal Entries - RJE		Federal Fund
#	Name	Debit      Credit
	1 RJE To reclass advances of YAP.	
20 - 3636 - 00	Fed D/D Payable Yap	1,542,115.85      -
20-3637-DTT	Due to US Govt (federal advances)	-      1,542,115.85
	To reclass advances of YAP on FEMA projects.	1,542,115.85      1,542,115.85
<p>The above adjustments are not due to fraud or illegal acts. Rather, we believe that the above constitute misstatement. In connection with the Corrected Audit Reclassification Adjustments listed above, we have reviewed and approve them on the basis of information we have provided to you.</p>		
		Date
Julie A. Jimenez		2/10/2017
Assistant Secretary for National Treasury		







Journal Entries - AJE		ADB fund	
#	Name	Debit	Credit
	1 CAJE 1 To adjust principal payments LN1459.		
91-1018-AS	Imprest ADB BSS BoG	-	1,264.65
91-1018-AS	Imprest ADB BSS BoG	1,888.00	-
91-2302-AS	BSS Loan Receivab CHK	-	7,526.00
91-2302-AS	BSS Loan Receivab CHK	1,264.65	-
91-2302-AS	BSS Loan Receivab CHK	-	5,220.60
91-2302-AS	BSS Loan Receivab CHK	11,273.25	-
91-2303-AS	BSS Loan Receivable KOS	-	1,021.00
91-2303-AS	BSS Loan Receivable KOS	5,220.60	-
91-2303-AS	BSS Loan Receivable KOS	-	1,188.00
91-2305-AS	BSS Loan Receivable Yap	1,021.00	-
91-2305-AS	BSS Loan Receivable Yap	-	700.00
91-2305-AS	BSS Loan Receivable Yap	7,526.00	-
91-2305-AS	BSS Loan Receivable Yap	7,454.00	-
91-2330-AS	Loan Rcvbl CUC	12,176.00	-
91-2331-AS	Loan Rcvbl PUC	7,987.00	-
91-2332-AS	Loan Rcvbl Yap PSC	-	11,273.25
91-7920-RE	Loan Proceeds	-	27,617.00
91-91130	Water & Sanita	55,810.50	55,810.50
	To adjust principal payments per JVE0840		
	2 CAJE 1 To record unrecorded drawdown.		
91-2312-AS	PSD/BSS Loan CHK	883.19	-
91-2312-AS	PSD/BSS Loan CHK	2,379.33	-
91-2313-AS	PSD/BSS Loan KOS	-	883.19
91-2313-AS	PSD/BSS Loan KOS	9,517.32	-
91-2314-AS	PSD/BSS Loan PNI	73,590.00	-
91-2315-AS	PSD/BSS Loan Yap	11,896.65	-
91-2315-AS	PSD/BSS Loan Yap	173,407.77	-
91-7920-RE	Loan Proceeds	-	11,896.65
91-7920-RE	Loan Proceeds	-	11,896.65
91-7920-RE	Loan Proceeds	-	73,590.00
91-7920-RE	Loan Proceeds	-	173,407.77
		271,674.26	271,674.26









Journal Entries - AJE		FA Fund	
#	Name	Debit	Credit
	1 CAJE record fixed asset infra, purchase of fire truck		
95-2811	Fixed Assets Furn and Equipmen	383,087.70	-
95-2812	Fixed Assets Motor Vehicles	3,350,223.00	-
95-2815	Fixed Assets Buildings & Impro	2,412,631.75	-
95-2818	Fixed Assets CIP	-	10,907,382.55
96-2818	Fixed Assets CIP	-	5,842,944.88
95-2851	Accum Deprec Furn & Fixt	-	71,151.14
95-2852	Accum Deprec Vehicles	-	474,614.83
95-2855	Accu. Deprec Buildings	-	60,315.80
95-2858	Accum Deprec Infrastruct	-	179,522.21
95-4020	Investment in Fixed Assets	5,842,944.88	-
95-4020	Investment in Fixed Assets	-	5,824,904.93
95-4020	Investment in Fixed Assets	-	383,087.70
95-4020	Investment in Fixed Assets	10,907,382.55	-
95-4020	Investment in Fixed Assets	-	2,412,631.75
95-4020	Investment in Fixed Assets	-	3,350,223.00
95-8610	Depreciation Expense	60,315.80	-
95-8610	Depreciation Expense	71,151.14	-
95-8610	Depreciation Expense	179,522.21	-
95-8610	Depreciation Expense	474,614.93	-
95-2817	Fixed Assets Infrastructure	5,824,904.93	-
		29,596,778.89	28,506,778.89
	To record fixed assets infrastructure, purchase of fire truck vehicle, auxiliary equipment and Yap airport terminal facilities.		
	2 CAJE to record fixed asset of CFSM projects.		
95-2815	Fixed Assets Buildings & Impro	99,694.74	-
95-2855	Accu. Deprec Buildings	-	186.16
95-2858	Accum Deprec Infrastruct	-	503,811.30
95-4020	Investment in Fixed Assets	-	1,930,318.70
95-4020	Investment in Fixed Assets	-	99,694.74







APPENDIX A-2

PAJE <1> Investment To record difference noted in Investment.	Likely Likely	(33,027)		33,027
PAJE <2> Bad debts Bad debts allowance To provide allowance on Chuuk's AR.	Likely Likely	(23,252)		23,252
PAJE <3> Expense - bad debts Allowance on Advances To expense out the advance and record allowance pending final invoices	Known Known	(20,435)		20,435
PAJE <4> Bad debts Due to Fun To provide allowance on Kosrae AR recorded in Grants Fund.	Likely Likely		(40,516)	40,516
PAJE <5> Expense - bad debts Allowance on Advances To provide allowance on past FY07 PO advances.	Likely Likely	(92,287)		92,287
PAJE <6> Accounts payable Due to Fun To record as defamed revenue grants received not remitted by NY Embassy as of 9/30/08.	Known Known		250,000 (250,000)	
PAJE <7> Accounts payable Other Income To reverse unverifiable payroll related accounts payable.	Known Known		18,892	(18,892)
PAJE <8> Expense Accounts payable To accrue FY08 expenditure	Known Known		(54,802)	54,802

The above uncorrected misstatements of the current year are a result of errors and not of fraud or illegal acts.

*Juliet J. Hany*  
Date: 6/30/2009

*Juliet J. Hany*  
Juliet J. Hany, Assistant Secretary  
Department of Finance

APPENDIX A-3

<p>PAJE &lt;20 - 1&gt; Due to from Allowance for bad debts To provide allowance for Kosrae AR.</p>	<p>Likely Likely</p>	<p>(40,516)</p>	<p>40,516</p>
<p>PAJE &lt;23 - 2&gt; Due to from Deferred revenue To record as deferred revenue grants received by NY Embassy but not remitted to GF as of 9/30/08, currently recorded as AP in GF.</p>	<p>Known Known</p>	<p>250,000</p>	<p>(250,000)</p>

The above uncorrected misstatements of the current year are a result of errors and not of fraud or illegal acts.

  
Julie Jimmy, Assistant Secretary  
Department of Finance

06/30/2009  
Date

APPENDIX B

PAJE <1>	Depreciation Accumulated depreciation To record depreciation expense for PY completed projects	Known Known	(401,819)	401,819
PAJE <2>	Depreciation Accumulated depreciation To record depreciation expense for PY completed projects	Known Known	(116,674)	116,674

The above uncorrected misstatements of the prior year detected in current year, are a result of errors and not of fraud or illegal acts.

  
 Julie Jimmy, Assistant Secretary  
 Department of Finance

06/30/2009  
 Date



Secretary of Finance  
&  
Administration

**GOVERNMENT OF THE  
FEDERATED STATES OF MICRONESIA  
Department of Finance and Administration**

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June 30, 2009

Deloitte & Touche LLP  
361 South Marine Corps Drive  
Tamuning, GU 96913

We are providing this letter in connection with your audit of the financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Federated States of Micronesia National Government (the FSM) as of and for the year ended September 30, 2008, which collectively comprise the FSM'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 or changes in fund balances of the FSM 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 of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information, in conformity with accounting principles generally accepted in the United States of America.
- b. The fair presentation of the required supplementary information, including Management's Discussion and Analysis, and additional information accompanying the basic financial statements that are 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, including fraud related to federal awards.
- d. Establishing and maintaining effective internal control over financial reporting.
- 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 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 financial statement disclosure checklist for a general-purpose government obtained from 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 audit.

1. The basic financial statements referred to above are fairly presented in conformity with accounting principles generally accepted in the United States of America. In addition:
  - a. The financial statements include all component units as well as joint ventures with an equity interest, and properly disclose all other joint ventures and other related organizations.
  - b. The financial statements properly classify all funds and activities, including special and extraordinary items.
  - c. All funds that meet the quantitative criteria in Statement No. 34 and Statement No. 37 of the Governmental Accounting Standards Board (GASB), *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, for presentation as major are identified and presented as such.
  - d. Net asset components (invested in capital assets, net of related debt; restricted; and unrestricted) and fund balance reserves and designations are properly classified and, if applicable, approved. The basic financial statements report \$14,977,434 of restricted net assets, of which \$5,677,561 is restricted by enabling legislation.
  - e. Expenses have been appropriately classified in or allocated to functions and programs in the statement of activities, and allocations have been made on a reasonable basis.
  - f. Revenues are appropriately classified in the statement of activities within program revenues, general revenues, contributions to term or permanent endowments, or contributions to permanent fund principal.
  - g. Interfund, internal, and intra-entity activity and balances have been appropriately classified and reported.
  - h. Deposits and investment securities are properly classified in category of custodial credit risk.
  - i. Capital assets, including infrastructure assets, are properly capitalized, reported, and, if applicable, depreciated.
  - j. Required supplementary information is measured and presented within prescribed guidelines.

- k. Applicable laws and regulations are followed in adopting, approving and amending budgets.
  - l. Costs to federal awards have been charged in accordance with applicable cost principles.
2. The FSM has made available to you all:
- a. Public Laws enacted by the FSM's Legislature.
  - b. Financial records and related data for all financial transactions of the FSM and for all funds administered by the FSM. The records, books, and accounts, as provided to you, record the financial and fiscal operations of all funds administered by the FSM 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, except as disclosed in the Schedule of Findings and Questioned Costs Section of your Independent Auditors' Reports on Internal Control and on Compliance.
  - c. Contracts and grant agreements (including amendments, if any) and any other correspondence that has taken place with federal agencies.
3. There has been no:
- a. Action taken by the FSM management that contravenes the provisions of federal laws and local laws and regulations, or of contracts and grants applicable to the FSM, except as disclosed in the Schedule of Findings and Questioned Costs Section of your Independent Auditors' Reports on Internal Control and on Compliance.
  - b. Communication from other 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. We believe the effects of the uncorrected financial statement misstatements detected in the current year that relate to the prior year presented, when combined with those misstatements aggregated by you during the prior-year audit engagement and pertaining to the prior year presented, are immaterial, both individually and in the aggregate, to the financial statements for the year ended September 30, 2007 taken as a whole. A summary of such uncorrected misstatements has been attached as Appendix B.

6. The FSM has not performed a 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 the FSM and do not believe that the financial statements are materially misstated as a result of fraud.
7. We have no knowledge of any fraud or suspected fraud affecting the FSM 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.
8. We have no knowledge of any allegations of fraud or suspected fraud affecting the FSM received in communications from employees, former employees, analysts, regulators, or others.
9. 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) Statement No. 5, *Accounting for Contingencies*, except as disclosed in Note 12 to the basic financial statements.
10. The Schedule of Expenditures of Federal Awards was prepared in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. We have identified in that schedule all awards provided by federal agencies in the form of grants, contracts, loans, loan guarantees, property, cooperative agreements, interest subsidies, insurance, or direct appropriations, except as disclosed in the Schedule of Findings and Questioned Costs Section of your Independent Auditors' Reports on Internal Control and on Compliance. In addition, we have accurately completed the appropriate sections of the data collection form.
11. We are responsible for compliance with local, state and federal laws, rules and regulations, including compliance with the requirements of OMB Circular A-133, and provisions of grants and contracts relating to the FSM'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. The FSM is responsible for maintaining accounting and administrative control over revenues, obligations, expenditures, assets, and liabilities.
12. We are responsible for establishing and maintaining, and have established and maintained, effective internal control over compliance for federal programs that provides reasonable assurance that we are managing federal awards in compliance with laws, regulations, and provisions of contracts or grant agreements that could have a material effect on its federal programs, except as disclosed in the Schedule of Findings and Questioned Costs Section of your Independent Auditors' Reports on Internal Control and on Compliance.

13. During the year ended September 30, 2008, the FSM National Government reconciled amounts previously expended in the prior years for Compact Infrastructure and other related funds and added such to capital assets. As a result of this determination, the 2007 financial statements have been restated from the amounts previously reported to reflect the retroactive adjustment as disclosed in Note 11 to the financial statements.
14. We have:
  - a. Identified the requirements of laws, regulations, and the provisions of contracts and grant agreements that are considered to have a direct and material effect on each federal program as identified in Part 3 of the Compliance Supplement.
  - b. Complied, in all material respects, with the requirements identified above in connection with federal awards except as disclosed in the Schedule of Findings and Questioned Costs Section of your Independent Auditors' Reports on Internal Control and on Compliance.
  - c. Identified and disclosed interpretations of any compliance requirements that have varying interpretations.
  - d. Made available all information related to federal financial reports and claims for advances and reimbursements. Federal financial reports and claims for advances and reimbursements are supported by the books and records from which the financial statements have been prepared and are prepared on a basis consistent with that presented in the Schedule of Expenditures of Federal Awards. The copies of federal program financial reports provided are true copies of the reports submitted, or electronically transmitted, to the federal agency or pass-through entity, as applicable.
  - e. Monitored subrecipients to determine that they have expended pass-through assistance in accordance with applicable laws and regulations and have met the requirements of Circular A-133.
  - f. Taken appropriate corrective action on a timely basis after receipt of a subrecipient's auditor's report that identifies noncompliance with laws, regulations, or the provisions of contracts or grant agreements.
  - g. Considered the results of the subrecipient's audits and made any necessary adjustments to the auditee's own books and records.
  - h. Identified and disclosed all amounts questioned and any known noncompliance with the requirements of federal awards, including the results of other audits or program reviews related to the objectives of the audit.
  - i. Identified previous financial audits, attestation engagements, performance audits, or other studies related to the objectives of the audit and the corrective actions taken to address significant findings and recommendations, including the status of follow-up on prior audit findings (and information about all management decisions) by federal awarding agencies and pass-through entities.

- j. Provided to you our views on the reported findings, conclusions, and recommendations for your report.
15. We are responsible for follow-up on all prior-year(s) findings. We have prepared a summary schedule of prior-year findings reporting the status of our efforts in implementation of the prior-year's corrective action plan.
  16. We have included in the corrective action plan for current-year findings, where required, the name of the person in our organization responsible for implementation of the actions, the best actions to be taken, and the estimate of a completion date. We have taken timely and appropriate steps to remedy fraud, illegal acts, violation of provisions of contracts or grant agreements, or abuse that you report.
  17. 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.
  18. In June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. GASB Statement No. 45 establishes standards for the measurement, recognition, and display of other post employment benefits expense/expenditures and related liabilities, note disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employers. The provisions of this statement are effective for periods beginning after December 15, 2007. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the FSM.
  19. In December 2006, GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. GASB Statement No. 49 provides guidance and consistency under which a governmental entity would be required to report a liability related to pollution remediation. The provisions of this statement are effective for periods beginning after December 15, 2007. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the FSM.
  20. In June 2007, GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. GASB Statement No. 51 addresses whether and when intangible assets should be considered capital assets for financial reporting purposes. The provisions of this statement are effective for periods beginning after June 15, 2009. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the FSM.
  21. In November 2007, GASB issued Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*. GASB Statement No. 52 improves the quality of financial reporting by requiring endowments to report their land and other real estate investments at fair value, creating consistency in reporting among similar entities that exist to invest resources for the purpose of generating income. The provisions of this statement are effective for periods beginning after June 15, 2008. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the FSM.
  22. In June 2008, GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. GASB Statement No. 53 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. The provisions of this statement are effective for periods beginning after June 15, 2009. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the FSM.

23. We have adopted the provisions of GASB Statement No. 39 of the Governmental Accounting Standards Board, *Determining Whether Certain Organizations Are Component Units*, an amendment of Statement No. 14 of the Governmental Accounting Standards Board, *The Financial Reporting Entity*. No organizations were identified that meet the criteria established in GASB Statement No. 39.

Except where otherwise stated below, matters less than \$162,000 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.

24. Except as listed in Appendices A and B, there are no transactions that have not been properly recorded in the accounting records underlying the financial statements.
25. The FSM has no plans or intentions that may affect the carrying value or classification of assets and liabilities.
26. 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 the FSM is contingently liable.
27. In preparing the financial statements in conformity with accounting principles generally accepted in the United States of America, 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:
1. 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.
  2. The effect of the change would be material to the financial statements.
28. 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.

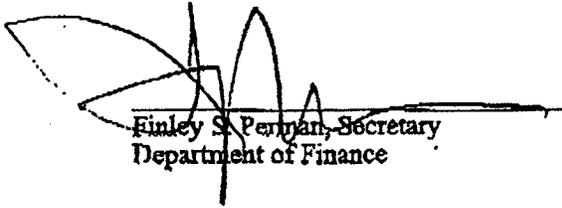
- c. It is at least reasonably possible that the events that could cause the severe impact will occur in the near term.

29. There are no:

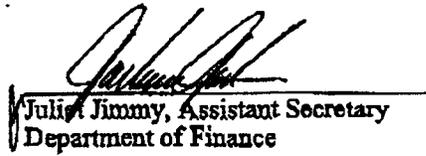
- a. Violations or possible violations of laws or regulations whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency except as disclosed in the Schedule of Findings and Questioned Costs Section of your Independent Auditors' Reports on Internal Control and on Compliance.
  - b. Other liabilities or gain or loss contingencies that are required to be accrued or disclosed by FASB Statement No. 5, *Accounting for Contingencies*, except as disclosed in Note 4 to the basic financial statements.
30. The FSM 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.
31. The FSM has complied with all aspects of contractual agreements that may have an effect on the financial statements in the event of noncompliance, including all significant limitations and restrictions of bond indentures, except as disclosed in the Schedule of Findings and Questioned Costs Section of your Independent Auditors' Reports on Internal Control and on Compliance.
32. No department or agency of the FSM has reported a material instance of noncompliance to us, except as disclosed in the Schedule of Findings and Questioned Costs Section of your Independent Auditors' Reports on Internal Control and on Compliance.
33. The FSM has identified all derivative instruments as defined by GASB Technical Bulletin 2003-1, *Disclosure Requirements for Derivatives Not Reported at Fair Value on the Statement of Net Assets (TB 03-1)*, and appropriately disclosed such derivatives in accordance with TB 03-1.
34. No events have occurred subsequent to September 30, 2008 that require consideration as adjustments to or disclosures in the financial statements.
35. Management is aware of its requirement to disclose whether, subsequent to September 30, 2008, any changes in internal control or other factors that might significantly affect internal control, including any corrective action taken by management with regard to significant deficiencies and material weaknesses have occurred. We represent to you that no such changes or other factors have occurred to the date of this letter.
36. The FSM is responsible for determining and maintaining the adequacy of the allowance for uncollectible receivables, as well as estimates used to determine such amounts.
37. With regard to the fair value measurements and disclosures of certain assets, liabilities, and specific components of equity, such as investments, we believe that:

- a. The measurement methods, including the related assumptions, used in determining fair value were appropriate and were consistently applied.
  - 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 subsequent to September 30, 2008 that requires adjustment to the fair value measurements and disclosures included in the financial statements.
38. Management of the FSM believes that it is in compliance with all significant limitations and restrictions of Asian Development Bank loan covenants as of September 30, 2008.
  39. The FSM is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. It is the policy of the primary government not to purchase commercial insurance for the risks of loss to which it is exposed. Instead, the FSM management believes it is more economical to manage its risks internally. In the event of claim settlements and judgments, the FSM reports all of its risk management activities in its General Fund. Claims expenditures and liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. These losses include an estimate of claims that have been incurred but not reported. No losses have occurred as a result of these risks in any of the past three fiscal years.
  40. The FSM National Government has entered into house lease agreements varying from one to five years. The aggregate amount of future lease payments has not been accumulated as renewal is subject to annual appropriations.
  41. The FSM National Government is party to various legal proceedings, many of which are normal recurrences in governmental operations. The Attorney General of the FSM National Government is of the opinion that the probable outcome of suits existing at September 30, 2008, is not predictable. No provision for any liability has been made in the accompanying financial statements because management believes that no unfavorable outcome is likely to occur.
  42. The FSM National Government is a full faith and credit guarantor of FSMPC's loan to the Bank of Guam. The National Government is jointly and severally liable for FSMPC's obligations under the loan and waived the sovereign immunity of the National Government with regard to any legal action arising from the guaranty.
  43. Management of FSM has determined that the loan to its component unit, FSM Petroleum Corporation, is of a long-term obligation as we do not expect repayment during fiscal year 2009.
  44. With respect to unresolved prior year questioned costs, we consider questioned costs reported in Finding No. 2003-04, 2004-02, 2004-03, 2004-08, 2004-09, 2004-10, 2008-11, 2005-03, 2005-07, 2005-11, 2005-13, 2005-15, and 2005-16 in the amount of \$1,142,533 to be resolved. Specifically, in accordance with OMB Circular A-133, Section .315(b)(4), we no longer consider these matters valid as they were reported to federal agencies on August 14, 2006, August 25, 2006 and September 5, 2006 which is in excess of the two year threshold.

45. The FSM National Government has assumed a construction management role for various infrastructure grant related expenditures. These expenditures are accounted for at the government-wide level as construction in progress until completion and are maintained on the National Government's books and are depreciated thereon until formal turnover occurs.
  
46. The FSM National Government will absorb the SDR adjustment related to the Early Retirement Program loans and such will not be passed on to the recipient States.



Binley S. Periman, Secretary  
Department of Finance



Julius Jimmy, Assistant Secretary  
Department of Finance

<p>PAJE &lt;1&gt; Fixed Asset Equity - Fixed asset Depreciation expense Accumulated depreciation</p> <p>To record likely misstatement of unrecorded capitalizable expenditures and the maximum likely depreciation expense.</p>	<p>Likely Likely Likely Likely</p>	<p>850,034   (116,873)</p>		<p>(150,088)</p>	<p>116,873</p>
<p>PAJE &lt;2&gt; Equity - Fixed asset Fixed Asset To reverse capital project built on a private institution premises - Baptist Church.</p>	<p>Likely Likely</p>	<p>(39,895)</p>		<p>39,895</p>	
<p>PAJE &lt;3&gt; Equity - Fixed asset Fixed Asset To reverse NBV of CIA aircraft which appears to be no longer working.</p>	<p>Likely Likely</p>	<p>(146,735)</p>		<p>146,735</p>	
<p>PAJE &lt;4&gt; Equity in Asset Fixed Asset To record likely extrapolated error based on assets not verified as existing.</p>	<p>Likely Likely</p>	<p>(87,899)</p>		<p>87,899</p>	
<p>PAJE &lt;5&gt;. GF Investment gain/loss Investment To record difference noted in investment.</p>	<p>Known Known</p>	<p>(33,027)</p>			<p>33,027</p>
<p>PAJE &lt;6&gt;. GF Bad debts Bad debts allowance To provide allowance on Chevits AR.</p>	<p>Likely Likely</p>	<p>(21,252)</p>			<p>21,252</p>
<p>PAJE &lt;7&gt;. GF Expense - bad debts Allowance on Advance To expense out the advance and record allowance pending final invoice.</p>	<p>Likely Likely</p>	<p>(26,439)</p>			<p>26,439</p>
<p>PAJE &lt;8&gt;. GF and Grants Fund Bad debts Allowance on advance To provide allowance on Kosrae AR recorded in Grants Fund.</p>	<p>Likely Likely</p>		<p>(40,518)</p>		<p>40,518</p>
<p>PAJE &lt;9&gt;. GF Expense - bad debts Allowance on advance To provide allowance on past FY07 PO advances.</p>	<p>Likely Likely</p>	<p>(92,287)</p>			<p>92,287</p>
<p>PAJE &lt;10&gt;. GF and Grants Fund Accounts payable Due to from To record as deferred revenue grants received not remitted by NY Embassy as of 9/30/08.</p>	<p>Known Known</p>		<p>250,000</p>		<p>(250,000)</p>
<p>PAJE &lt;11&gt;. GF Accounts payable Other income To reverse unverifiable payroll related accounts payable.</p>	<p>Known Known</p>		<p>16,892</p>		<p>(16,892)</p>
<p>PAJE &lt;12&gt;. GF Expenditure Accounts payable To accrue FY08 expenditure</p>	<p>Known Known</p>		<p>(64,802)</p>		<p>64,802</p>

The above uncorrected misstatements of the current year are a result of errors and not of fraud or illegal acts.

  
 Julia Jimmy, Assistant Secretary  
 Department of Finance

06/30/2009  
 Date

APPENDIX A-2

PAJE <1> Investment grants/loss Investment To record differences noted in investment.	Likely Likely	(33,027)		33,027
PAJE <2> Bad debts Bad debts allowance To provide allowance on Chuatz AR.	Likely Likely	(23,252)		23,252
PAJE <3> Expense - bad debts Allowance on Advances To expense out the advance and record allowance pending final invoice	Known Known	(28,437)		28,438
PAJE <4> Bad debts Due to fund To provide allowance on Kosone AR recorded in Grants Fund.	Likely Likely		(40,518)	40,516
PAJE <5> Expense - bad debts Allowance on Advances To provide allowance on past FY07 PO advances.	Likely Likely	(92,287)		92,287
PAJE <6> Accounts payable Due to/from To record as defamed revenue grants received not remitted by NY Embassy as of 9/30/06.	Known Known		250,000 (250,000)	
PAJE <7> Accounts payable Other income To reverse unverifiable payroll related accounts payable.	Known Known		18,892	(18,892)
PAJE <8> Expensures Accounts payable To accrue FY08 expenditure	Known Known		(54,802)	54,802

The above uncorrected misstatements of the current year are a result of errors and not of fraud or illegal acts.

*Juliet Jimmy*  
Juliet Jimmy, Assistant Secretary  
Department of Finance

*6/30/2007*  
Date

<p>PAJE &lt;20 - 1&gt;                  Due to from                  Allowance for bad debts                  To provide allowance for Kosrae AR.</p>	<p>Likely                  Likely</p>	<p>(40,516)</p>	<p>40,516</p>
<p>PAJE &lt;23 - 2&gt;                  Due to from                  Deferred revenue                  To record as deferred revenue grants received by NY                  Embassy but not remitted to GF as of 9/30/08, currently                  recorded as AP in GF.</p>	<p>Known                  Known</p>	<p>250,000</p>	<p>(250,000)</p>

The above uncorrected misstatements of the current year are a result of errors and not of fraud or illegal acts.

  
 Julie Jimmy, Assistant Secretary  
 Department of Finance

06/30/2009  
 Date

APPENDIX B

PAJE <1>	Depreciation	Accumulated depreciation	To record depreciation expense for PY completed projects	Known Known	(401,819)	401,819
PAJE <2>	Depreciation	Accumulated depreciation	To record depreciation expense for PY completed projects	Known Known	(116,674)	116,674

The above uncorrected misstatements of the prior year detected in current year, are a result of errors and not of fraud or illegal acts.

  
 Julie Jimmy, Assistant Secretary  
 Department of Finance

06/30/2009  
 Date