

June 30, 2011

His Excellency Emmanuel Mori
President
Federated States of Micronesia:

Dear Mr. President:

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, 2010, in accordance with auditing standards generally accepted in the United States of America (“generally accepted auditing standards”) and have issued our report thereon dated June 30, 2011.

We have prepared the following comments to assist you in fulfilling your obligation to oversee the financial reporting and disclosure process for which management of the FSM National Government is responsible.

OUR RESPONSIBILITY UNDER GENERALLY ACCEPTED AUDITING STANDARDS AND GENERALLY ACCEPTED GOVERNMENT AUDITING STANDARDS

Our responsibility under generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, has been described in our engagement letter dated October 14, 2010. As described in that letter, the objective of a financial statement audit conducted in accordance with the aforementioned standards is:

- To express an opinion on the fairness of each opinion unit in the FSM National Government’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, 2010 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 National Government’s internal control over financial reporting and on its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters for the year ended September 30, 2010 based on an audit of financial statements performed in accordance with the standards applicable to financial audits contained in *Government Auditing Standards*; and
- To report on the FSM National Government'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 with the oversight of management and 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 National Government'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 National Government's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the FSM National Government'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 National Government'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 National Government'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 National Government's 2010 financial statements include management's estimate of the allowance for uncollectible accounts, which is determined based upon past collection experience and aging of the accounts, and management's estimate of depreciation expense, which is based on estimated useful lives of the respective capital assets. During the year ended September 30, 2010, we are not aware of any significant changes in accounting estimates or in management's judgments relating to such estimates.

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 A to Attachment 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 Attachment I, a summary of misstatements corrected by management.

SIGNIFICANT ACCOUNTING POLICIES

The FSM National Government's significant accounting policies are set forth in Note 1 to the FSM National Government's 2010 financial statements. During the year ended September 30, 2010, there were no significant changes in previously adopted accounting policies or their application, except for the following pronouncements adopted by the FSM National Government:

- GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, which addresses whether and when intangible assets should be considered capital assets for financial reporting purposes.
- GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, which is intended to improve how state and local governments report information about derivative instruments - financial arrangements used by governments to manage specific risks or make investments - in their financial statements.
- GASB Technical Bulletin No. 2008-1, *Determining the Annual Required Contribution Adjustment for Postemployment Benefits*, which clarifies the requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, for calculating the annual required contribution (ARC) adjustment.
- GASB Statement No. 58, *Accounting and Financial Reporting for Chapter 9 Bankruptcies*, which provides guidance for governments that have petitioned for protection from creditors by filing for bankruptcy under Chapter 9 of the United States Bankruptcy Code, and establishes requirements for recognizing and measuring the effects of the bankruptcy process on assets and liabilities, and for classifying changes in those items and related costs.

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

DISAGREEMENTS WITH MANAGEMENT

We have not had any disagreements with management related to matters that are material to the FSM National Government's 2010 financial statements.

CONSULTATION WITH OTHER ACCOUNTANTS

We are not aware of any consultations that management may have had with other accountants about auditing and accounting matters during 2010.

MANAGEMENT'S REPRESENTATIONS

We have made specific inquiries of the FSM National Government's management about the representations embodied in the financial statements. Additionally, we have requested that management provide to us the written representations the FSM National Government is required to provide to its independent auditors under generally accepted auditing standards. We have attached to this letter, as Attachment II, a copy of the representation letter we obtained from management.

MAJOR ISSUES DISCUSSED WITH MANAGEMENT PRIOR TO OUR 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 National Government's management and staff and had unrestricted access to the FSM National Government's senior management in the performance of our audit.

CONTROL-RELATED MATTERS

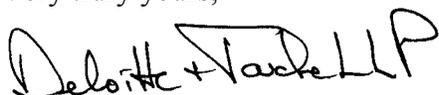
We have issued a separate report to you, also dated June 30, 2011, containing certain matters involving the FSM National Government's internal control over financial reporting that we consider to be material weaknesses or significant deficiencies under standards established by the American Institute 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, 2011, concerning certain matters involving the FSM National Government'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.

We also noted certain matters that we reported to management of the FSM National Government in a separate letter dated June 30, 2011.

* * * * *

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.

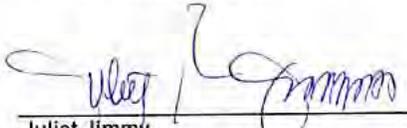
Very truly yours,



Journal Entries - AJE

#	Name	Debit	Credit
2 AJE To correct related asset			
92-4110-FB	Unreserved Fund Balance	-	3,144,653.00
92-4130-FB	R/B Restricted Capital Assets	3,144,653.00	-
		<u>3,144,653.00</u>	<u>3,144,653.00</u>
	To correct related asset.		

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

6/30/11

 Date

ATTACHMENT I, CONTINUED

Journal Entries - AJE

#	Name	Debit	Credit
2 AJE To correct GL balance -			
88 - 1199 - AS	Unrealized Gain/Loss	1,707,800.00	-
88 - 1150 - AS	People of FSM Trust Fund	-	589,892.00
88 - 7895 - RE	Unrealized Earnings	-	1,372,583.00
88 - 1157 - AS	People of FSM T/ F/Atalanta	236,595.00	-
88 - 1710 - AS	A/R Interest	-	5,521.00
88 - 1153 - AS	People of FSM T/ F/Shenkman	23,601.00	-
		<u>1,967,996.00</u>	<u>1,967,996.00</u>
	To record unrealized, accrual, and additional earnings		
3 AJE To correct related asset			
88 - 4110 - FB	Unreserved Fund Balance	719,555.00	-
88 - 4130 - FB	R/B Restricted Capital Assets	-	719,555.00
		<u>719,555.00</u>	<u>719,555.00</u>
	To correct related asset.		

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

Juliet Jimmy
Assistant Secretary for National Treasury

6/20/11

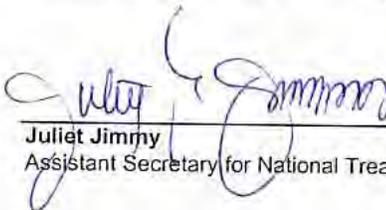
Date

ATTACHMENT I, CONTINUED

Journal Entries - AJE

#	Name	Debit	Credit
1 AJE To record PNI loan redemption			
91-1118-AS	MM Private Sector Dvlp BoH	-	135,016.71
91-2314-AS	PSD/BSS Loan PNI	135,016.71	-
		<u>135,016.71</u>	<u>135,016.71</u>
	To record loan redemption of Pohnpei from the ADB Holding account.		
2 AJE To agree 1520, 1459 and 1257 loans to conf			
91-1114-AS	ACM Cash & Equivalents BoH	104,191.00	-
91-10-92-7910	Transfer In	-	8,360.00
91-10-92-7910	Transfer In	-	95,831.00
		<u>104,191.00</u>	<u>104,191.00</u>
	To record MLFC loan payment from GF, and transfer balance of 91-1114 to GF including PY abnormal balance.		
3 AJE To correct Beg FB			
91-4110-FB	Unreserved Fund Balance	1,263,953.00	-
91-7910-DTT	Special Item PY expenditures allocated to states	-	1,263,953.00
		<u>1,263,953.00</u>	<u>1,263,953.00</u>
	To effect as FY10 transaction allocation of PY expenditures to the states determined by FSMNG in FY10.		
4 AJE To correct related asset.			
91-4110-FB	Unreserved Fund Balance	87,731.00	-
91-4130-FB	R/B Restricted Capital Assets	-	87,731.00
		<u>87,731.00</u>	<u>87,731.00</u>
	To correct related asset.		
8 AJE To set up encumbrances			
91-4110-FB	Unreserved Fund Balance	158,733.00	-
Encumbrances	FUND 91 ENCUMBRANCES	-	158,733.00
		<u>158,733.00</u>	<u>158,733.00</u>
	To set-up the encumbrance amount per subsidiary ledger.		

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

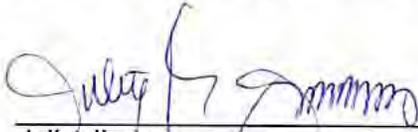
ATTACHMENT I, CONTINUED

Journal Entries - AJE

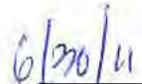
#	Name	Debit	Credit
	2 AJE To set up encumbrances		
29-4110-FB	Unreserved Fund Balance	64,312.00	-
31-4110-FB	Unreserved Fund Balance	103,625.00	-
33-4110-FB	Unreserved Fund Balance	284,632.00	-
34-4110-FB	Unreserved Fund Balance	120.00	-
35-4110-FB	Unreserved Fund Balance	147.00	-
Encumbrances	Encumbrances Non Major Fund - DTT	-	452,836.00
		<u>452,836.00</u>	<u>452,836.00</u>

To set-up encumbrances per subsidiary ledger.

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

ATTACHMENT I, CONTINUED

Journal Entries - AJE

#	Name	Debit	Credit
	1 AJE To record as revenue US Sha		
26-3710-LI	Deffered Revenue	450,786.00	-
26-7050-RE	Compact II Grant	-	450,786.00
		<u>450,786.00</u>	<u>450,786.00</u>

To record as revenue US Contribution in the DAEF.

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

6/30/11
Date

ATTACHMENT I, CONTINUED

Journal Entries - AJE

#	Name	Debit	Credit
1 AJE To revered IMF deferred revenue			
18-3710-LI	Deferred Revenues	338,961.00	-
18-10-29-7050	Compact II Grant	-	338,961.00
		338,961.00	338,961.00

To record as revenue US contribution of IMF.

2 AJE To record AR on sector funds			
10-10-29-7050	Compact II Grant	-	111,190.00
11-10-29-7050	Compact II Grant	-	162,675.00
14-10-29-7050	Compact II Grant	-	201,818.00
10-1310-AS	- C AR - Federal	111,190.00	-
11-1310-AS	- C AR - Federal	162,675.00	-
14-1310-AS	- C AR - Federal	201,818.00	-
15-1310-AS	- C AR - Federal	-	76,592.00
15-10-29-7050	Compact II Grant	76,592.00	-
		552,275.00	552,275.00

AJE - to correct AR balance in compact sector.

3 AJE To correct continuing appropriation			
19-4110-FB	Unreserved Fund Balance	-	17,635,237.00
19-4120-FB	R/R Restricted Cont Approp	17,635,237.00	-
		17,635,237.00	17,635,237.00

To correct continuing appropriation of FD 19 due to over allotment of funds.

4 AJE To set-up encumbrances			
10-4110-FB	Unreserved Fund Balance	68,457.00	-
11-4110-FB	Unreserved Fund Balance	76,289.00	-
14-4110-FB	Unreserved Fund Balance	460,881.00	-
15-4110-FB	Unreserved Fund Balance	38,763.00	-
19-4110-FB	Unreserved Fund Balance	-	-
19-4110-FB	Unreserved Fund Balance	32,162,858.00	-
sector encumb	Sector encumbrances - DTT	-	32,807,248.00
		32,807,248.00	32,807,248.00

To set up encumbrances per subsidiary detail for FS presentation and reduce Fd 19 encubrances for retainage recorded.

5 AJE To reduce encumbrance for retainage.			
19-4110-FB	Unreserved Fund Balance	-	1,716,299.00
sector encumb	Sector encumbrances - DTT	1,716,299.00	-
		1,716,299.00	1,716,299.00

To reduce encumbrance for retainage payable in Fund 19.

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

Juliet Jimmy
Assistant Secretary for National Treasury

6/20/11

Date

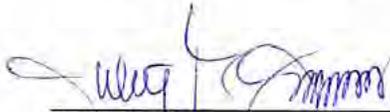
ATTACHMENT I, CONTINUED

Journal Entries - AJE

#	Name	Debit	Credit
	5 AJE To set up encumbrances		
23-4110-FB	Unreserved Fund Balance	301,016.00	-
Encumbrances	FD 23 ENCUMBRANCES	-	301,016.00
		<u>301,016.00</u>	<u>301,016.00</u>

To set up encumbrances per subsidiary ledger.

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

6/20/11
Date

ATTACHMENT I, CONTINUED

Journal Entries - AJE

#	Name	Debit	Credit
2 AJE To set up encumbrances			
20-4110-FB	Unreserved Fund Balance	-	-
20-4110-FB	Unreserved Fund Balance	20,531,303.00	-
Encumbrances	Encumbrances - DTT	-	20,531,303.00
		<u>20,531,303.00</u>	<u>20,531,303.00</u>
	To set up encumbrance per subsidiary ledger and reduce encumbrance amount for retainage recorded.		
3 AJE To reduce encumbrance for retainage.			
20-4110-FB	Unreserved Fund Balance	-	1,868,676.00
Encumbrances	Encumbrances - DTT	1,868,676.00	-
		<u>1,868,676.00</u>	<u>1,868,676.00</u>
	To reduce encumbrance for retainage payable on Fund 20.		

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

6/30/11
 Date

ATTACHMENT I, CONTINUED

Journal Entries - AJE

#	Name	Debit	Credit
2 AJE To record MLFC loan.			
01 - 8910	Transfer out - DT	8,360.00	-
01 - 8910	Transfer out - DT	95,831.00	-
01-1114-AS	ACM Cash & Equivalents BoH	-	104,191.00
		104,191.00	104,191.00

To record the MLFC loan payment thru transfer out, transfer the related balance of cash BOH cash at ADB FUND - 91-1114 to offset against the GF cash including prior years negative cash balance.

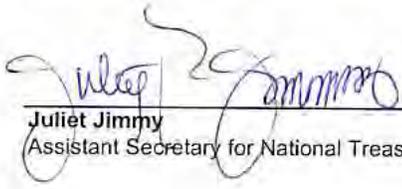
4 AJE to set up encumbrances			
01-4110-FB	Unreserved Fund Balance	2,525,850.00	-
25-4110-FB	Unreserved Fund Balance	662,390.00	-
97-4110-FB	Unreserved Fund Balance	17,589.00	-
GF - ENCUMBI	All GF encumbrances	-	3,702,466.00
53-4110-FB	Unreserved Fund Balance	496,637.00	-
		3,702,466.00	3,702,466.00

To set up encumbrances per subsidiary detail for FS presentation and reduce Fd 19 encumbrances for retainage recorded.

5 AJE To correct related asset			
01-4110-FB	Unreserved Fund Balance	1,699,208.62	-
01-4130-FB	R/B Restricted Capital Assets	-	1,699,208.62
		1,699,208.62	1,699,208.62

To correct related asset

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

6/30/11

 Date



Secretary of Finance
&
Administration

June 30, 2011

Deloitte & Touche LLP
361 SOUTH MARINE CORPS DRIVE
TAMUNING GU, 96913

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

P.O. Box PS 158
Palikir, Pohnpei FM 96941
Tel: (691) 320-2640 Fax: (691) 320-2380
E-mail: fsmsofa@mail.fm

ATTACHMENT II

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 (FSM) National Government (the "Government"), as of and for the year ended September 30, 2010, which collectively comprise the Government'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, and cash flows of the Government 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 GAAP.
- 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.

ATTACHMENT II, CONTINUED

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 GAAP. 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, where applicable.
 - c. All funds that meet the quantitative criteria in Statement No. 34 and Statement No. 37 of the Governmental Accounting Standards Board (GASB) for presentation as major are identified and presented as such and all other funds that are presented as major are particularly important to financial statement users.
 - 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 \$22,278,421 of restricted net assets, of which \$10,472,937 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-Government activity and balances have been appropriately classified and reported.
 - h. Deposits and investment securities are properly classified in the 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.

ATTACHMENT II, CONTINUED

1. Costs to federal awards have been charged in accordance with applicable cost principles.
2. The Government has provided to you all relevant information and access as agreed in the terms of the audit engagement letter, including:
 - a. Public Laws as enacted by the FSM Congress.
 - b. Financial records and related data for all financial transactions of the Government and for all funds administered by the Government. The records, books, and accounts, as provided to you, record the financial and fiscal operations of all funds administered by the Government 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 Auditor's 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 Government management that contravenes the provisions of federal laws and local laws and regulations, or of contracts and grants applicable to the Government, except as disclosed in the Schedule of Findings and Questioned Costs Section of your Independent Auditor's 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, except as disclosed in the Schedule of Findings and Questioned Costs Section of your Independent Auditors' Reports on Internal Control and on Compliance.
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. The Government 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 Government and do not believe that the financial statements are materially misstated as a result of fraud.
6. We have no knowledge of any fraud or suspected fraud affecting the Government involving:
 - a. Management.

ATTACHMENT II, CONTINUED

- b. Employees who have significant roles in internal control over financial reporting.
 - c. Others if the fraud could have a material effect on the financial statements.
7. We have no knowledge of any allegations of fraud or suspected fraud affecting the Government received in communications from employees, former employees, analysts, regulators, or others.
 8. There are no unasserted claims or assessments that legal counsel has advised us are probable of assertion and must be disclosed in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 450, *Contingencies*, except as disclosed in Note 9 to the basic financial statements.
 9. Significant assumptions used by us in making accounting estimates are reasonable.
 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 Government'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 Government 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 Auditor's Reports on Internal Control and on Compliance.
 13. The Government has obligated, expended, received, and used public funds in accordance with the purpose for which such funds have been appropriated or otherwise authorized by local or federal law. Such obligation, expenditure, receipt, or use of public funds was in accordance with any limitations, conditions, or mandatory directions imposed by local or federal law.

ATTACHMENT II, CONTINUED

14. The Government has identified in the Schedule of Expenditures of Federal Awards all awards provided by federal agencies in the form of grants, contracts, loans, loan guarantees, property, cooperative agreements, interest subsidies, insurance, or direct appropriations.
15. The Government has certified to federal granting agencies that it has not used federal funds for lobbying for specific federal awards and that it has disclosed, or will disclose, any expenditures of nonfederal funds made for lobbying purposes. The Government has also required, where applicable, all subrecipients of \$100,000 or more of federal funds to make the same certification.
16. We have disclosed to you all deficiencies in the design or operation of internal control over financial reporting identified as part of our evaluation, including separately disclosing to you all such deficiencies that are significant deficiencies or material weaknesses in internal control over financial reporting.
17. 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 dated June 2010.
 - 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 Government, 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.

ATTACHMENT II, CONTINUED

- 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.
18. 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.
19. We have included in the corrective action plan for current-year findings, 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.
20. 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.
21. No organizations were identified that meet the criteria established in GASB Statement No. 39, *Determining Whether Certain Organizations Are Component Units*, an amendment of Statement No. 14, *The Financial Reporting Entity*.
22. We are responsible for the fair presentation of the additional information accompanying the basic financial statements that is presented for the purpose of additional analysis of the basic financial statements.

Except where otherwise stated below, matters less than \$200,000 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.

23. Except as listed in Appendix A, there are no transactions that have not been properly recorded in the accounting records underlying the financial statements.
24. The Government has no plans or intentions that may affect the carrying value or classification of assets and liabilities.
25. 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).

ATTACHMENT II, CONTINUED

- b. Guarantees, whether written or oral, under which the Government is contingently liable.
26. In preparing the financial statements in conformity with GAAP, management uses estimates. All estimates have been disclosed in the financial statements for which known information available prior to the issuance of the financial statements indicates that both of the following criteria are met:
- a. It is at least reasonably possible that the estimate of the effect on the financial statements of a condition, situation, or set of circumstances that existed at the date of the financial statements will change in the near term due to one or more future confirming events.
 - b. The effect of the change would be material to the financial statements.
27. 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.
28. 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 Auditor's 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 ASC 450, *Contingencies*, except as disclosed in Note 9 to the basic financial statements.
29. The Government 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.
30. The Government has complied with all aspects of contractual agreements that may have an effect on the financial statements in the event of noncompliance, except as disclosed in the Schedule of Findings and Questioned Costs Section of your Independent Auditors' Reports on Internal Control and on Compliance.
31. No department or agency of the Government has reported a material instance of noncompliance to us.

ATTACHMENT II, CONTINUED

32. The Government has identified all derivative instruments as defined by GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, and appropriately recorded and disclosed such derivatives in accordance with GASB Statement No. 53.
33. No events have occurred after September 30, 2010 but before June 30, 2011, the date the financial statements were available to be issued that require consideration as adjustments to or disclosures in the financial statements.
34. Management has disclosed whether, subsequent to September 30, 2010, 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.
35. The Government is responsible for determining and maintaining the adequacy of the allowance for uncollectible receivables, as well as estimates used to determine such amounts.
36. 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 the 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, 2010 and before June 30, 2011, that requires adjustment to the fair value measurements and disclosures included in the financial statements.
37. The cost method is used to account for the Government's investment in common stock of an investee where the common stock is either nonmarketable or of which the Government has a 20 percent or lesser ownership interest and thus the Government does not have the ability to exercise significant influence over the investee's operating and financial policies. With respect to the Government's investment in the Bank of the FSM, the Government's investment represents a 30 percent interest; however, management is of the opinion that the Government does not exert significant influence over the investee. Accordingly, management considers the cost method to be the most appropriate basis in which to account for its investment.
38. During fiscal year 2010, the Government implemented the following pronouncements, implementation of which did not have a material effect on the financial statements:
 - GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, which addresses whether and when intangible assets should be considered capital assets for financial reporting purposes.

- GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, which is intended to improve how state and local governments report information about derivative instruments - financial arrangements used by governments to manage specific risks or make investments - in their financial statements.
 - GASB Technical Bulletin No. 2008-1, *Determining the Annual Required Contribution Adjustment for Postemployment Benefits*, which clarifies the requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, for calculating the annual required contribution (ARC) adjustment.
 - GASB Statement No. 58, *Accounting and Financial Reporting for Chapter 9 Bankruptcies*, which provides guidance for governments that have petitioned for protection from creditors by filing for bankruptcy under Chapter 9 of the United States Bankruptcy Code, and establishes requirements for recognizing and measuring the effects of the bankruptcy process on assets and liabilities, and for classifying changes in those items and related costs.
39. In March 2009, GASB issued Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, which enhances the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. The provisions of this statement are effective for periods beginning after June 15, 2010. Management has not evaluated the effect that the implementation of this statement will have on the financial statements of the Government.
40. In December 2009, GASB issued Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, which amends Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, and addresses issues related to measurement of OPEB obligations by certain employers participating in agent multiple-employer OPEB plans. The provisions of Statement 57 related to the use and reporting of the alternative measurement method are effective immediately. The provisions related to the frequency and timing of measurements are effective for actuarial valuations first used to report funded status information in OPEB plan financial statements for periods beginning after June 15, 2011. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the Government.
41. In June 2010, GASB issued Statement No. 59, *Financial Instruments Omnibus*, which updates and improves existing standards regarding financial reporting of certain financial instruments and external investment pools. The provisions of this statement are effective for periods beginning after June 15, 2010. Management has not evaluated the effect that the implementation of this statement will have on the financial statements the Government.

ATTACHMENT II, CONTINUED

- 42. Management of the Government believes that it is in compliance with all significant limitations and restrictions of Asian Development Bank loan covenants as of September 30, 2010.
- 43. The Government 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 Government management believes it is more economical to manage its risks internally. In the event of claim settlements and judgments, the Government 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.
- 44. We have appropriately identified and properly recorded and disclosed in the financial statements, where applicable, all interfund transactions, including repayment terms.
- 45. Receivables recorded in the financial statements represent valid claims against debtors for sales or other charges arising on or before the balance-sheet date and have been appropriately reduced to their estimated net realizable value.
- 46. Provision has been made, where applicable, to reduce excess or obsolete inventories to their estimated net realizable value. All inventories are the property of the Government and do not include any items consigned to it or any items billed to customers.
- 47. No evidence of fraud, possible irregularities, or dishonesty in fiscal operations of federal programs administered by the Government has been discovered, except as disclosed in the Schedule of Findings and Questioned Costs Section of your Independent Auditors' Reports on Internal Control and on Compliance.



Rose N. Nakanaga

Print Name and Title



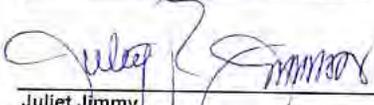
Juliet Jimmy

Print Name and Title

ATTACHMENT II, CONTINUED

Appendix A - Gov Wide Level
September 30, 2010

Entry Description	Type of Entry	Assets	Liabilities	Fund Balance Beg	Income Statement
		Dr (Cr)	Dr (Cr)		Dr (Cr)
Passed Adjusting Entries					
PAJE <1>.GW					
AR- STATES Expenditures To correct recording of PSD loan payments of the states	Known Known	35,444			(35,444)
PAJE <2>.GW					
Expenditures PO Advance To revert to expenditure untimely liquidated advances.	Known Known	(48,500)			48,500
PAJE <3>.GW					
Investment Investment earnings Accrued Expense Fund balance beginning To agree investment amount to beginning audited balance		31,816	(10,366)	5,252	(26,702)
PAJE <4>.GW					
Expenditure Accrued liabilities To accrue unpaid overtime charges of National Police and Immigration			(231,816)		231,816
		18,760	(242,182)	5,252	218,170


 Juliet Jimmy
 Assistant Secretary for National Treasury

ATTACHMENT II, CONTINUED

FSM National Government
 Appendix A - General Fund
 September 30, 2010

Entry Description	Type of Entry	Assets	Liabilities	Fund Balance	Income Statement
		Dr (Cr)	Dr (Cr)		Dr (Cr)
Passed Adjusting Entries					
PAJE <1> Expenditures Accrued liabilities To accrue unpaid overtime charges of National Police and Immigration	Known Known		(231,816)		231,816
PAJE <2> Expenditures PO Advance Encumbrance Unerserve Funds Due to/from To revert to expenditure untimely liquidated advances.	Known Known	(48,500)		19,040 (19,040)	19,040
		(19,040)	(231,816)	0	250,856

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



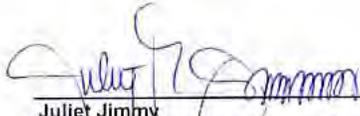
 Juliet Jimmy
 Assistant Secretary for National Treasury

ATTACHMENT II, CONTINUED

FSM National Government
 Appendix A - Grants
 September 30, 2010

Entry Description	Type of Entry	Assets	Liabilities	Income Statement
		Dr (Cr)	Dr (Cr)	Dr (Cr)
Passed Adjusting Entries				
PAJE <1> Expenditures Duet to/from To revert to expenditure untimely liquidated advances.	Known Known	(29,460)		29,460
		(29,460)	0	29,460

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

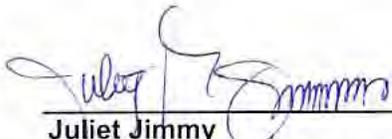


Juliet Jimmy
 Assistant Secretary for National Treasury

FSM National Government
 Appendix A - Non Major Fund
 September 30, 2010

	Type of Entry	Assets	Income Statement
		Dr (Cr)	Dr (Cr)
Passed Reclassifying Entries PAJE<1> AR - STATES Expenditures To record erroneous recording of loan payments on PSD.	Known	35,444	
	Known		(35,444)
		35,444	(35,444)

The above uncorrected adjusting entry, is not due to fraud or illegal acts. Rather, we believe that the above constitute misstatement. In connection with the Uncorrected Audit Adjustment listed above, we have reviewed and approve them on the basis of information we have provided to you.



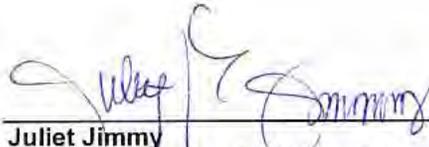
Juliet Jimmy
 Assistant Secretary for National Treasury

ATTACHMENT II, CONTINUED

FSM National Government
 Appendix A - Compact Trust Fund
 September 30, 2010

Entry Description	Type of Entry	Assets	Liabilities	Fund Balance Beg	Income Statement
		Dr (Cr)	Dr (Cr)		Dr (Cr)
PAJE <1>					
Investment	Known	31,816			
Investment earnings	Known				(26,702)
Accrued Expense	Known		(10,366)		
Fund balance beginning	Known			5,252	
To agree investment amount to beginning audited balance					
		31,816	(10,366)	5,252	(26,702)

The above uncorrected adjusting entries, are not due to fraud or illegal acts. Rather, we believe that the above constitute misstatement. In connection with the Uncorrected 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

FSM National Government
 Appendix A - Non Major Fund
 September 30, 2010

	Type of Entry	Assets	Liabilities	Other equity
		Dr (Cr)	Dr (Cr)	Dr (Cr)
Passed Reclassifying Entries				
PAJE <1>.NM				
Encumbrance	Known			8,000
Unreserve Funds	Known			(8,000)
To correct invalid encumbrance.				
				0

The above uncorrected adjusting entry, are not due to fraud or illegal acts. Rather, we believe that the above constitute misstatement. In connection with the Uncorrected 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