

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

**REPORT ON THE AUDIT OF
FINANCIAL STATEMENTS IN ACCORDANCE
WITH OMB CIRCULAR A-133**

YEAR ENDED SEPTEMBER 30, 2008

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

YEAR ENDED SEPTEMBER 30, 2008

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**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

**INDEPENDENT AUDITORS' REPORT
AND FINANCIAL STATEMENTS
AND ADDITIONAL INFORMATION**

YEAR ENDED SEPTEMBER 30, 2008

INDEPENDENT AUDITORS' REPORT

Honorable Robert Weilbacher
Governor, State of Kosrae
Federated States of Micronesia:

We have audited the accompanying financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Kosrae (the State) as of and for the year ended September 30, 2008, which collectively comprise the State's basic financial statements as set forth in Section II of the foregoing table of contents. These financial statements are the responsibility of the management of the State. Our responsibility is to express an opinion on the respective financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the State's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

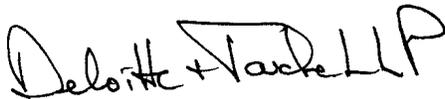
In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Kosrae as of September 30, 2008, and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 10 to the financial statements, the beginning net assets of the governmental activities within the accompanying financial statements has been restated to correct a misstatement.

The Management's Discussion and Analysis, on pages 3 through 9, as well as the Schedule of Revenues, Expenditures, and Changes in Deficit - Budget and Actual - General Fund and notes thereto, as set forth in Section III of the foregoing table of contents, are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the management of the State. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the State's respective financial statements that collectively comprise the State's basic financial statements. The combining and individual fund financial statements, as set forth in Section IV of the foregoing table of contents, which are also the responsibility of the management of the State, are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such additional information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 22, 2009 on our consideration of the State's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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

June 22, 2009

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2008

This analysis, prepared by the Department of Administration and Finance, offers readers of the Kosrae State Government's ("Kosrae State") financial statements a narrative overview of the activities of the government for the fiscal year ended September 30, 2008. We encourage readers to consider this information in conjunction with Kosrae State's financial statements, which follow. Fiscal year 2007 comparative information has been included, where appropriate. This analysis is required by the Governmental Accounting Standards Board (GASB) which provides guidelines on what must be included and excluded from this analysis.

FINANCIAL HIGHLIGHTS

- For the fiscal year ended September 30, 2008, Kosrae State's total net assets decreased by \$16.22 million (or 52%) from \$31.12 million in the prior year to \$14.90 million. This decrease is primarily attributable to the transfer of capital assets of \$12.96 million to Kosrae Port Authority, a component unit of Kosrae State Government, and investment losses incurred by the Compact Trust Fund and the Early Retirement Program due to the slump in global financial markets during fiscal year 2008.
- A General Fund budgetary surplus were incurred in fiscal year 2008 primarily due to the unanticipated receipt of proceeds from the sale of property in the State of Hawaii.
- During fiscal year 2008, Kosrae State's general fund deficit decreased by \$.09 million (52%); down from \$.17 million in the prior year to \$.08 million. The decrease primarily reflects the proceeds from the sale of capital assets of \$.55 million partially offset by an increase in expenditures for general government operations.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to Kosrae State's basic financial statements. Kosrae State's basic financial statements comprise three components: 1) governmental-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements.

This report also contains additional required supplementary information in the form of budgetary schedules, which are prepared on the budgetary basis of accounting, and other optional supplementary information, in addition to the basic financial statements themselves, which includes combining statements for governmental funds and component units.

Government-Wide Financial Statements

The government-wide statements report information about Kosrae State as a whole using accounting methods similar to those used by private-sector companies. It provides both long-term and short-term information about the State's financial status.

The statement of net assets includes all the government's assets and liabilities. The difference in the two is called net assets. Over time, increases or decreases in the States's net assets serve as indicator to measure the State's financial position.

The statement of activities, on the other hand, accounts for the State's current year revenues and expenses regardless of when cash is received or paid.

The government-wide financial statements of Kosrae State are divided into two categories:

- Governmental activities - Most of Kosrae State's basic services are included here, such as education, health, special appropriations, finance, judiciary, and general administration. Compact sector and other federal grants finance most of these activities.
- Component Units - Kosrae State includes the operating results of the Kosrae Port Authority, Kosrae Utilities Authority and Micronesia Petroleum Corporation in its report. Although legally separate, these "component units" are important because Kosrae State is financially accountable for them.

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FEDERATED STATES OF MICRONESIA**

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Fund Financial Statements

The fund financial statements provide more detailed information about Kosrae State's significant funds. Funds are accounting devices that Kosrae State uses to keep track of specific sources of funding and spending for particular services. The State uses fund accounting to comply with financial and related legal requirements. The fund financial statements present a balance sheet and a statement of revenues, expenditures, and changes in fund balances for its major and aggregated non-major funds.

Most of Kosrae State's basic services are included in governmental funds, which focus on (1) how cash and other financial assets that can be readily being converted to cash flow in and out and (2) the balances left at year-end that are available for spending. Consequently, the governmental funds statements provide a detailed short-term view that helps you determine whether there are more of fewer financial resources that can be spend in the near future to finance Kosrae State programs. Because this information does not encompass the additional long-term focus of the government-wide statements, we provide additional information at the bottom of the governmental funds statements, or on the subsequent page, that explains and reconciles the relationship (or differences) between them.

The State maintains individual governmental funds, which are categorized as major and non-major. The major funds comprise the General Fund, the Grant Assistance Fund, and the Compact Trust Fund.

FINANCIAL ANALYSIS OF KOSRAE STATE AS A WHOLE

Net assets may serve over time as a useful indicator of a government's financial position. At the end of fiscal year 2008, Kosrae State's assets exceeded liabilities by \$14.90 million. However, all these net assets are restricted as to the purposes they can be used for or are invested in capital assets. Kosrae State uses theses capital assets to provide services to its citizen; consequently, these assets are not available for future spending. Although Kosrae State's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debts must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities. The following summary of Kosrae State's net assets as of September 30, 2008, with comparable balances for the fiscal year 2007, discloses this relationship:

| | <u>2008</u> | As Restated <u>2007</u> |
|---|----------------------|----------------------------|
| Current and other non-capital assets | \$ 8,129,411 | \$ 8,367,092 |
| Capital assets | <u>13,736,286</u> | <u>28,588,638</u> |
| Total Assets | <u>21,865,697</u> | <u>36,955,730</u> |
| Long-term liabilities | 5,766,410 | 4,932,825 |
| Other liabilities | <u>1,202,104</u> | <u>901,956</u> |
| Total Liabilities | <u>6,968,514</u> | <u>5,834,781</u> |
| Net Assets | | |
| Invested in capital assets, net of related debt | 13,736,286 | 28,588,638 |
| Restricted | 6,813,187 | 6,918,225 |
| Unrestricted | <u>(5,652,290)</u> | <u>(4,385,914)</u> |
| Total Net Assets | \$ <u>14,897,183</u> | \$ <u>31,120,949</u> |

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September 30, 2008

At the end of fiscal year 2008, Kosrae State's unrestricted assets showed a deficit of \$5.65 million, an increase of \$1.27 million (or 29%) from the prior year. The increase is due to the decrease in the fair value of investments and the foreign exchange losses of ADB loans. The deficit, however, is the result of having current and long-term commitments that are greater than currently available resources. Specifically, Kosrae State did not include in past annual budgets the full amounts needed to finance its current liabilities to vendors and others or its long-term liabilities arising from Asian Development Bank (ADB) loans and unused employee leave balances. Kosrae State will include these amounts in future year's budgets as funding permits.

Net assets declined by \$16.22 million (or 52%) from the prior year. Key elements are the decrease and the differences from the prior year are shown in the following schedule.

| | <u>2008</u> | As Restated <u>2007</u> |
|---|----------------------|----------------------------|
| Revenues: | | |
| Operating grants and contributions | \$ 6,329,911 | \$ 8,877,602 |
| Capital grants and contributions | 125,000 | 60,436 |
| Charges for services | 1,439,488 | 610,527 |
| Revenue sharing | 1,076,009 | 1,003,623 |
| Unrestricted investment earnings | 132,890 | 161,830 |
| Taxes | 8,863 | 8,686 |
| Other | <u>219,278</u> | <u>76,293</u> |
| Total revenues | <u>9,331,439</u> | <u>10,798,997</u> |
| Expenses: | | |
| General Government | 3,077,834 | 2,869,820 |
| Education | 3,556,949 | 3,689,377 |
| Health Services | 2,132,536 | 1,809,580 |
| Capital projects | - | 53,325 |
| Economic Development | 1,210,225 | 2,715,325 |
| Boards, commissions and other | 2,415,514 | 904,394 |
| Environment protection & sanitation | 138,998 | 359,958 |
| Public order and safety | 186,492 | 33,962 |
| Other miscellaneous | <u>-</u> | <u>211,627</u> |
| Total expenses | <u>12,718,548</u> | <u>12,647,368</u> |
| Transfer of capital assets | (12,960,206) | - |
| Special items | <u>123,549</u> | <u>363,047</u> |
| Change in net assets | (16,223,766) | (1,485,324) |
| Net assets at the beginning of the year | <u>31,120,949</u> | <u>32,606,273</u> |
| Net assets at the end of the year | \$ <u>14,897,183</u> | \$ <u>31,120,949</u> |

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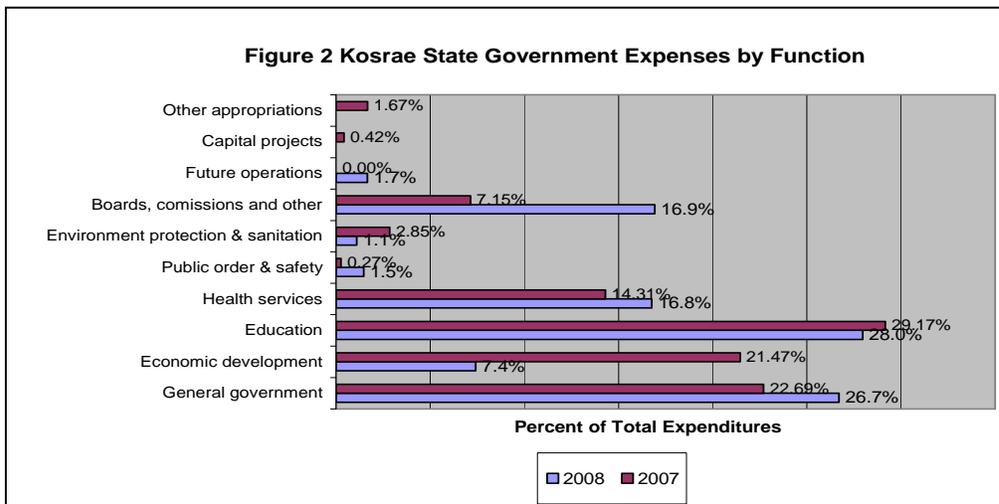
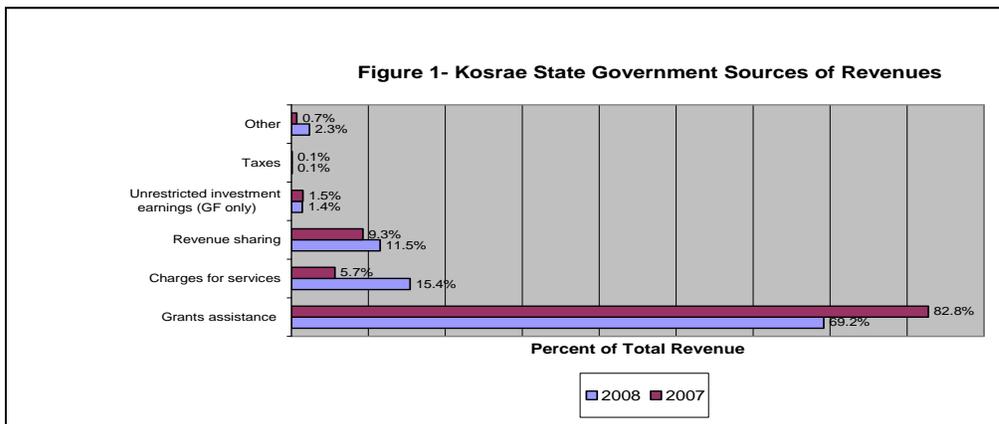
Management's Discussion and Analysis
September 30, 2008

Total revenues in fiscal year 2008 of \$9.33 million decreased by \$1.47 million from the prior year's \$10.80 million (down by 13.59%) primarily due to decreases in US Federal Grants, revenue sharing, taxes and the decrease in the fair value of the investments. In fiscal year 2008, Compact sector grants comprised 75% of all Kosrae State funding sources whereas general fund comprised only 22%.

Total expenses of \$12.72 million reflected a very slight increase of \$.07 million from the prior year expenses without special items.

The above financial analysis incorporates the restatements as more fully discussed in Note 10 to the basic financial statements.

The following graphs show the major components of revenues and expenditures of governmental funds for the year ended September 30, 2008.



FINANCIAL ANALYSIS OF KOSRAE STATE'S FUNDS

As noted earlier, Kosrae State uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. As of the end of fiscal year 2008, Kosrae State governmental funds reported a combined fund balance of \$6.97 million, which represents a \$.54 million decrease or (7.16%) from the \$7.51 million recorded at the end of fiscal 2007. This decrease is attributable mainly to the decrease in the fair value of investments. Of this

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September 30, 2008

total combined fund balance, \$8.07 million is reserved to indicate that it is not available for new spending because it has already been committed: 1) to generate income for future operations or to reflect long-term loan or investment activities (\$6.55 million); 2) to liquidate contracts and purchase orders of the prior period (\$1.34 million); or 3) to fund specific general fund and grants assistance related activities (\$0.18 million). These reserved fund balances are off-set by a combined deficit of \$1.10 million, and an increase of \$.35 million (or 46%) from fiscal year 2007. The overall increase in the unreserved fund deficit is attributed to net decrease in the fair value of investments, and the decrease in the Federal contributions due to transfer of accounting of all the FSM pass through grants to FSM National Government.

The General Fund is the chief operating fund of the State. At the end of the current fiscal year, the unreserved fund deficit of the General Fund was \$1.04 million as compared with the prior year ending unreserved fund deficit of \$1.24 million, a deterioration of \$.20 million (or 16%), while total fund balance was \$.08 million compared with a total fund balance of \$.17 million at the end of prior fiscal year, an improvement of \$.09 million. The increase in the overall fund balance of the General Fund was primarily the result of proceeds from the sale of capital assets of \$.55 million and the downward revision was to reign in expenditures when revenue collections did not match inflated revenue projections and \$.18 million resulting from bad debts net of recoveries.

The Grants Assistance Fund has a total fund balance of \$1.69 million, which primarily represents Compact Sector grant revenues received not yet expended at year end. The net decrease in fund balance during the current year in the Grants Assistance Fund was \$.15 million (or 8%), which primarily was the result of the utilization of Compact Sector grant monies received in the previous year.

The Early Retirement Fund, has a total fund balance of \$1.68 million as compared with the prior year ending fund balance of \$1.65 million, an improvement of \$.03 million due to loan proceeds of \$.44 million. The downward revision was due to the decrease of the fair value of investments of \$.28 million and \$.45 million to repay loan principal of the ADB Early Retirement Loan.

The Compact Trust Fund has a total fund balance of \$2.46 million, all of which is reserved for the funding of future operations of the primary government commencing in fiscal year 2023. The net decrease in fund balance during the current year in the Compact Trust Fund was \$.52 million (or 17%), which reflected the slump in global financial markets that commenced in January 2008.

GENERAL FUND BUDGETARY HIGHLIGHTS

During the course of the fiscal year, management and elected officials of Kosrae State revised the General Fund budget. The revised budget included an increase in the authorized expenditure budget of \$.04 million, from \$2.10 million to \$2.14 million. The primary reason for this revision was to reign in expenditures, when revenue collections did not match inflated revenue projections. Nevertheless, general fund expenditures exceeded revenues by \$.54 million. This deficiency, however, was offset by other financing sources of \$.55 million arising from the proceeds from sale of capital assets. As a result, the unreserved fund deficit decreased in fiscal year 2008 from \$1.24 million in the prior year to \$1.04 million.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

Kosrae State's investment in capital assets for the primary government as of September 30, 2008, amounted to \$47.89 million, net of accumulated depreciation of \$34.15 million, leaving a net book value of \$13.74 million. This represents a net decrease of \$14.85 million (or 52%) from fiscal year 2007. This huge decrease for the year was due to the transfer of capital assets to a component unit of Kosrae State, the Kosrae Port Authority of \$12.96 million. In addition, depreciation charges for the year contributed to the decrease.

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Management's Discussion and Analysis
September 30, 2008

The table below summarizes Kosrae State's capital assets:

| | <u>2008</u> | <u>2007</u> |
|------------------------------|----------------------|----------------------|
| Buildings | \$ 2,438,260 | \$ 3,054,453 |
| Infrastructure | 10,649,632 | 24,787,796 |
| Machinery, equipment, others | <u>648,394</u> | <u>746,389</u> |
| | \$ <u>13,736,286</u> | \$ <u>28,588,638</u> |

Additional information on Kosrae State's capital assets can be found in note 7 to the financial statements.

Long-Term Debt

The following schedule shows Kosrae State's long-term obligations for fiscal year 2008 which is greater than fiscal year 2007 balances due to ADB foreign exchange losses that were charged:

| | <u>2008</u> | <u>2007</u> |
|-------------------------------|---------------------|---------------------|
| FSMNG Loan | \$ 1,500,000 | \$ 1,500,000 |
| ADB Loans | 4,064,592 | 3,230,533 |
| Malem Water Supply Loan | 136,173 | 136,173 |
| Other Claims | <u>110,000</u> | <u>110,000</u> |
| Total non-current liabilities | \$ <u>5,810,765</u> | \$ <u>4,976,706</u> |

Interest and principal payment on ADB loans commenced in fiscal year 2008.

Additional information on Kosrae State's long-term debt obligations can be found in note 8 to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

In fiscal year 2009, despite the implementation of economic reforms in fiscal year 2008, that included the reduction of the working hours and the numbers of personnel force; Kosrae State continues to experience financial difficulty due to the programs that were no longer funded through compact grants. These programs are mainly from the capacity building sector and the private sector grants. The general fund revenues are not showing a favorable picture in fiscal year 2009 and neither is the performance of the State's investment portfolio. Request for funding from other sources including the FSM National Government is being solicited however there are no clear indications that such request will be granted. Unless other funding sources are found, the State will continue to struggle for its financial resources in the ensuing years. The State also hope that the implementation of the uniform tax for the entire FSM will alleviate this financial crisis that the government is currently facing

Compact Sector Grants will continue to be the major funding source for the State in fiscal year 2009.

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Management's Discussion and Analysis
September 30, 2008

CONTACTING KOSRAE STATE'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers, and investors and creditors, a general overview of Kosrae State's finances to demonstrate its accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Director, Administration and Finance; P.O. Box 878, Kosrae, FM, 96944.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Statement of Net Assets
September 30, 2008

| | Primary Government | Component Units |
|---|-----------------------|--------------------|
| <u>ASSETS</u> | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 389,050 | \$ 199,805 |
| Investments | - | 571,059 |
| Receivables, net | 1,199,268 | 416,155 |
| Due from component units | 244,000 | - |
| Inventories | - | 1,301,048 |
| Prepaid | 31,686 | - |
| Advances | 219,294 | 9,313 |
| Other current assets | - | 2,302 |
| Restricted assets: | | |
| Investments | - | 579,200 |
| Total current assets | 2,083,298 | 3,078,882 |
| Noncurrent assets: | | |
| Other | - | 42,196 |
| Capital assets, net of accumulated depreciation | 13,736,286 | 19,230,608 |
| Investments | 1,100,000 | - |
| Restricted assets: | | |
| Cash and cash equivalents | 211,848 | - |
| Time certificates of deposit | 588,736 | - |
| Investments | 4,145,529 | - |
| Total noncurrent assets | 19,782,399 | 19,272,804 |
| Total assets | \$ 21,865,697 | \$ 22,351,686 |
| <u>LIABILITIES</u> | | |
| Current liabilities: | | |
| Current portion of long-term obligations | \$ 44,355 | \$ 437,330 |
| Accounts payable | 896,543 | 454,762 |
| Other liabilities and accruals | 112,568 | 40,648 |
| Due to primary government | - | 525,444 |
| Deferred revenues | 148,638 | 12,743 |
| Total current liabilities | 1,202,104 | 1,470,927 |
| Noncurrent liabilities: | | |
| Noncurrent portion of long-term obligations | 5,656,410 | 392,950 |
| Other noncurrent liabilities | 110,000 | - |
| Total noncurrent liabilities | 5,766,410 | 392,950 |
| Total liabilities | 6,968,514 | 1,863,877 |
| Commitments and contingencies | | |
| <u>NET ASSETS</u> | | |
| Invested in capital assets, net of related debt | 13,736,286 | 18,871,367 |
| Restricted for: | | |
| Nonexpendable: | | |
| Future operations | 2,462,040 | - |
| Expendable: | | |
| Debt service | 1,683,489 | - |
| Compact related | 1,535,492 | - |
| Other purposes | 1,132,166 | 90,000 |
| Unrestricted | (5,652,290) | 1,526,442 |
| Total net assets | 14,897,183 | 20,487,809 |
| Total liabilities and net assets | \$ 21,865,697 | \$ 22,351,686 |

See accompanying notes to basic financial statements.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Statement of Activities
Year Ended September 30, 2008

| Functions/Programs | Program Revenues | | | Net (Expenses) Revenues and Changes in Net Assets | | |
|---|----------------------|-------------------------|--|--|-----------------------|----------------------|
| | Expenses | Charges for Services | Operating Grants and Contributions | Capital Grants and Contributions | Primary Government | Component Units |
| Primary government: | | | | | | |
| Governmental activities: | | | | | | |
| General government | \$ 3,077,834 | \$ 296,376 | \$ 1,078,899 | \$ - | \$ (1,702,559) | \$ - |
| Economic development | 1,210,225 | 199,943 | 747,438 | - | (262,844) | - |
| Education | 3,556,949 | 16,359 | 3,421,612 | - | (118,978) | - |
| Health services | 2,132,536 | 125,091 | 1,776,795 | - | (230,650) | - |
| Public order and safety | 186,492 | 166,094 | - | - | (20,398) | - |
| Environment protection and sanitation | 138,998 | 110,769 | 23,438 | - | (4,791) | - |
| Boards, commissions and other | 2,415,514 | - | - | - | (2,415,514) | - |
| Future operations | - | - | (800,441) | - | (800,441) | - |
| Capital projects | - | - | - | 125,000 | 125,000 | - |
| Other appropriations | - | 524,856 | 82,170 | - | 607,026 | - |
| Total primary government | \$ 12,718,548 | \$ 1,439,488 | \$ 6,329,911 | \$ 125,000 | (4,824,149) | - |
| Component units: | | | | | | |
| Kosrae Port Authority | \$ 606,847 | \$ 97,630 | \$ - | \$ - | - | (509,217) |
| Kosrae Utilities Authority | 2,555,438 | 1,749,889 | 12,277 | 51,175 | - | (742,097) |
| Micronesian Petroleum Corporation | 4,917,694 | 4,839,458 | - | - | - | (78,236) |
| Total component units | \$ 8,079,979 | \$ 6,686,977 | \$ 12,277 | \$ 51,175 | - | (1,329,550) |
| General revenues: | | | | | | |
| Taxes: | | | | | | |
| Revenue sharing | | | | | 1,076,009 | - |
| Excise taxes | | | | | 8,863 | - |
| Unrestricted investment earnings | | | | | 132,890 | (95,672) |
| Other | | | | | 219,278 | 34,092 |
| Transfer of capital assets | | | | | (12,960,206) | 12,960,206 |
| Total general revenues and transfers | | | | | (11,523,166) | 12,898,626 |
| Special items: | | | | | | |
| Gain on sale of capital assets | | | | | 300,395 | - |
| Bad debts, net of recoveries | | | | | (176,846) | - |
| Total special items | | | | | 123,549 | - |
| Change in net assets | | | | | (16,223,766) | 11,569,076 |
| Net assets at the beginning of the year, as restated | | | | | 31,120,949 | 8,918,733 |
| Net assets at the end of the year | | | | | \$ 14,897,183 | \$ 20,487,809 |

See accompanying notes to basic financial statements.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Balance Sheet
Governmental Funds
September 30, 2008

| | Special Revenue | | | Permanent | Other Governmental Funds | Total |
|--------------------------------------|---------------------|----------------------|--------------------------------|---------------------|--------------------------------|----------------------|
| | General | Grants Assistance | Early Retirement Program | Compact Trust | | |
| ASSETS | | | | | | |
| Cash and cash equivalents | \$ 389,050 | \$ - | \$ - | \$ - | \$ - | \$ 389,050 |
| Investments | 200,000 | 900,000 | - | - | - | 1,100,000 |
| Receivables, net: | | | | | | |
| Loans | - | - | - | - | 174,479 | 174,479 |
| Federal agencies | - | 862,665 | - | - | - | 862,665 |
| FSM National Government | 162,124 | - | - | - | - | 162,124 |
| Due from other funds | 759,307 | 1,140,246 | - | - | 896,844 | 2,796,397 |
| Due from component units | 244,000 | - | - | - | - | 244,000 |
| Prepaid | 11,124 | 20,562 | - | - | - | 31,686 |
| Advances | 34,140 | 185,154 | - | - | - | 219,294 |
| Restricted assets: | | | | | | |
| Cash and cash equivalents | 164,176 | - | - | - | 47,672 | 211,848 |
| Time certificates of deposit | 234,353 | - | - | - | 354,383 | 588,736 |
| Investments | - | - | 1,683,489 | 2,462,040 | - | 4,145,529 |
| Total assets | <u>\$ 2,198,274</u> | <u>\$ 3,108,627</u> | <u>\$ 1,683,489</u> | <u>\$ 2,462,040</u> | <u>\$ 1,473,378</u> | <u>\$ 10,925,808</u> |
| LIABILITIES AND FUND BALANCES | | | | | | |
| Liabilities: | | | | | | |
| Accounts payable | \$ 158,117 | \$ 486,474 | \$ - | \$ - | \$ 251,952 | \$ 896,543 |
| Other liabilities and accruals | 83,051 | 29,517 | - | - | - | 112,568 |
| Due to other funds | 2,037,090 | 756,330 | - | - | 2,977 | 2,796,397 |
| Deferred revenues | - | 148,605 | - | - | 33 | 148,638 |
| Total liabilities | <u>2,278,258</u> | <u>1,420,926</u> | <u>-</u> | <u>-</u> | <u>254,962</u> | <u>3,954,146</u> |
| Fund balances: | | | | | | |
| Reserved for: | | | | | | |
| Related assets | 906,468 | 920,562 | 1,683,489 | 2,462,040 | 576,534 | 6,549,093 |
| Encumbrances | 47,259 | 1,015,608 | - | - | 279,410 | 1,342,277 |
| Continuing appropriations | 6,000 | 176,563 | - | - | - | 182,563 |
| Unreserved: | | | | | | |
| General fund | (1,039,711) | - | - | - | - | (1,039,711) |
| Special revenue funds | - | (425,032) | - | - | 276,222 | (148,810) |
| Capital projects funds | - | - | - | - | 86,250 | 86,250 |
| Total fund balances (deficits) | <u>(79,984)</u> | <u>1,687,701</u> | <u>1,683,489</u> | <u>2,462,040</u> | <u>1,218,416</u> | <u>6,971,662</u> |
| Total liabilities and fund balances | <u>\$ 2,198,274</u> | <u>\$ 3,108,627</u> | <u>\$ 1,683,489</u> | <u>\$ 2,462,040</u> | <u>\$ 1,473,378</u> | |

Amounts reported for governmental activities in the statement of net assets are different because:

Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds

13,736,286

Long-term liabilities, including loans payable, are not due and payable in the current period and, therefore, are not reported in the funds. The liabilities include:

Long-term debt payable

(5,700,765)

Claims payable

(110,000)

(5,810,765)

Net assets of governmental activities

\$ 14,897,183

See accompanying notes to basic financial statements.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Statement of Revenues, Expenditures, and Changes in Fund Balances (Deficits)
Governmental Funds
Year Ended September 30, 2008

| | Special Revenue | | | Permanent | Other | Total |
|--|------------------|----------------------|--------------------------------|------------------|-----------------------|-------------------|
| | General | Grants Assistance | Early Retirement Program | Compact Trust | Governmental Funds | |
| Revenues: | | | | | | |
| Compact funding | \$ - | \$ 6,974,894 | \$ - | \$ - | \$ - | \$ 6,974,894 |
| Net decrease in the fair value of investments | - | - | (280,396) | (520,045) | - | (800,441) |
| Federal contributions | - | 155,458 | - | - | - | 155,458 |
| FSM revenue sharing | 1,076,009 | - | - | - | - | 1,076,009 |
| State taxes | 8,863 | - | - | - | - | 8,863 |
| CFSM grants | - | - | - | - | 125,000 | 125,000 |
| Fees and charges | 733,868 | - | - | - | 411,740 | 1,145,608 |
| Other grants | - | 293,880 | - | - | - | 293,880 |
| Interest income | 39,417 | 21,315 | - | - | 72,158 | 132,890 |
| Other | 219,278 | - | - | - | - | 219,278 |
| Total revenues | 2,077,435 | 7,445,547 | (280,396) | (520,045) | 608,898 | 9,331,439 |
| Expenditures: | | | | | | |
| Current: | | | | | | |
| General government | 1,410,458 | 1,520,359 | 82,922 | - | - | 3,013,739 |
| Economic development | 199,943 | 747,438 | - | - | 25,000 | 972,381 |
| Education | 16,359 | 3,421,612 | - | - | (318) | 3,437,653 |
| Health services | - | 1,798,110 | - | - | 336,689 | 2,134,799 |
| Public order and safety | 166,094 | - | - | - | 13,750 | 179,844 |
| Environment protection and sanitation | - | 23,438 | - | - | 115,560 | 138,998 |
| Boards, commissions and other | 790,807 | 82,170 | - | - | 112,287 | 985,264 |
| Debt service: | | | | | | |
| Principal repayment | - | - | 44,898 | - | - | 44,898 |
| Total expenditures | 2,583,661 | 7,593,127 | 127,820 | - | 602,968 | 10,907,576 |
| Excess (deficiency) of revenues over (under) expenditures | (506,226) | (147,580) | (408,216) | (520,045) | 5,930 | (1,576,137) |
| Other financing sources: | | | | | | |
| Proceeds from sale of capital assets | 548,177 | - | - | - | - | 548,177 |
| Loan proceeds | 222,553 | - | 444,898 | - | - | 667,451 |
| Total other financing sources | 770,730 | - | 444,898 | - | - | 1,215,628 |
| Special items: | | | | | | |
| Write-off of receivables, net of recovery | (176,846) | - | - | - | - | (176,846) |
| Net change in fund balances (deficits) | 87,658 | (147,580) | 36,682 | (520,045) | 5,930 | (537,355) |
| Fund balances (deficits) at the beginning of the year | (167,642) | 1,835,281 | 1,646,807 | 2,982,085 | 1,212,486 | 7,509,017 |
| Fund balances (deficits) at the end of the year | \$ (79,984) | \$ 1,687,701 | \$ 1,683,489 | \$ 2,462,040 | \$ 1,218,416 | \$ 6,971,662 |

See accompanying notes to basic financial statements.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

**DISCRETELY PRESENTED COMPONENT UNITS
Combining Statement of Net Assets
September 30, 2008**

| <u>ASSETS</u> | <u>Kosrae Port Authority</u> | <u>Kosrae Utilities Authority</u> | <u>Micronesian Petroleum Corporation</u> | <u>Total</u> |
|---|--------------------------------------|---|--|----------------------|
| Current assets: | | | | |
| Cash and cash equivalents | \$ 40,088 | \$ 42,881 | \$ 116,836 | \$ 199,805 |
| Investments | - | 571,059 | - | 571,059 |
| Time certificates of deposit - restricted | - | 579,200 | - | 579,200 |
| Receivables, net: | | | | |
| General | 51,359 | 174,412 | 190,384 | 416,155 |
| Inventories | - | 476,723 | 824,325 | 1,301,048 |
| Prepayments | - | 9,313 | - | 9,313 |
| Other | 2,302 | - | - | 2,302 |
| Total current assets | <u>93,749</u> | <u>1,853,588</u> | <u>1,131,545</u> | <u>3,078,882</u> |
| Noncurrent assets: | | | | |
| Other | - | 42,196 | - | 42,196 |
| Capital assets, net of accumulated depreciation | 12,381,647 | 4,857,830 | 1,991,131 | 19,230,608 |
| Total noncurrent assets | <u>12,381,647</u> | <u>4,900,026</u> | <u>1,991,131</u> | <u>19,272,804</u> |
| Total assets | <u>\$ 12,475,396</u> | <u>\$ 6,753,614</u> | <u>\$ 3,122,676</u> | <u>\$ 22,351,686</u> |
| <u>LIABILITIES AND NET ASSETS</u> | | | | |
| Current liabilities: | | | | |
| Current portion of long-term debt | \$ - | \$ 84,567 | \$ 352,763 | \$ 437,330 |
| Accounts payable | 24,407 | 91,026 | 339,329 | 454,762 |
| Accrued liabilities | - | 26,412 | 14,236 | 40,648 |
| Deferred revenue | - | 12,743 | - | 12,743 |
| Due to primary government | - | - | 525,444 | 525,444 |
| Total current liabilities | <u>24,407</u> | <u>214,748</u> | <u>1,231,772</u> | <u>1,470,927</u> |
| Noncurrent liabilities: | | | | |
| Noncurrent portion of long-term debt | - | 274,674 | 118,276 | 392,950 |
| Total noncurrent liabilities | <u>-</u> | <u>274,674</u> | <u>118,276</u> | <u>392,950</u> |
| Total liabilities | <u>24,407</u> | <u>489,422</u> | <u>1,350,048</u> | <u>1,863,877</u> |
| Net assets: | | | | |
| Invested in capital assets, net of related debt | 12,381,647 | 4,498,589 | 1,991,131 | 18,871,367 |
| Restricted | - | 90,000 | - | 90,000 |
| Unrestricted | 69,342 | 1,675,603 | (218,503) | 1,526,442 |
| Total net assets | <u>12,450,989</u> | <u>6,264,192</u> | <u>1,772,628</u> | <u>20,487,809</u> |
| Total liabilities and net assets | <u>\$ 12,475,396</u> | <u>\$ 6,753,614</u> | <u>\$ 3,122,676</u> | <u>\$ 22,351,686</u> |

See accompanying notes to basic financial statements.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

**DISCRETELY PRESENTED COMPONENT UNITS
Combining Statement of Revenues, Expenses, and Changes in Net Assets
Year Ended September 30, 2008**

| | Kosrae Port Authority | Kosrae Utilities Authority | Micronesian Petroleum Corporation | Totals |
|---|-----------------------------|----------------------------------|---|----------------------|
| Operating revenues: | | | | |
| Charge for services | \$ 97,630 | \$ 1,749,889 | \$ 4,839,458 | \$ 6,686,977 |
| Operating expenses: | | | | |
| Cost of goods sold | - | - | 4,447,895 | 4,447,895 |
| Fuel | 1,662 | 1,551,265 | 7,568 | 1,560,495 |
| Depreciation | 578,559 | 499,336 | 17,567 | 1,095,462 |
| Personnel services | 15,019 | 337,108 | 127,554 | 479,681 |
| Taxes | - | - | 212,831 | 212,831 |
| Administration and general | - | 109,269 | - | 109,269 |
| Repair and maintenance | - | 51,408 | 5,119 | 56,527 |
| Travel and entertainment | - | - | 7,351 | 7,351 |
| Bank service charges | 295 | - | 3,890 | 4,185 |
| Utilities | 10,121 | - | 8,743 | 18,864 |
| Rent | - | - | 5,400 | 5,400 |
| Supplies and materials | 357 | - | 7,177 | 7,534 |
| Insurance | - | - | 7,098 | 7,098 |
| Communications | 362 | - | 5,616 | 5,978 |
| Others | 471 | - | 6,011 | 6,482 |
| Total operating expenses | <u>606,846</u> | <u>2,548,386</u> | <u>421,925</u> | <u>3,577,157</u> |
| Operating loss | <u>(509,216)</u> | <u>(798,497)</u> | <u>(30,362)</u> | <u>(1,338,075)</u> |
| Nonoperating revenues (expenses): | | | | |
| Interest income | - | 17,120 | - | 17,120 |
| Net change in fair value of investments | - | (95,672) | - | (95,672) |
| Other income (expense) | (1) | - | 34,092 | 34,091 |
| Federal grants | - | 12,277 | - | 12,277 |
| Interest expense | - | (24,172) | (47,874) | (72,046) |
| Total nonoperating revenues (expenses), net | <u>(1)</u> | <u>(90,447)</u> | <u>(13,782)</u> | <u>(104,230)</u> |
| Capital contributions | <u>12,960,206</u> | <u>51,175</u> | <u>-</u> | <u>13,011,381</u> |
| Change in net assets | <u>12,450,989</u> | <u>(837,769)</u> | <u>(44,144)</u> | <u>11,569,076</u> |
| Net assets at beginning of year | <u>-</u> | <u>7,101,961</u> | <u>1,816,772</u> | <u>8,918,733</u> |
| Net assets at end of year | <u>\$ 12,450,989</u> | <u>\$ 6,264,192</u> | <u>\$ 1,772,628</u> | <u>\$ 20,487,809</u> |

See accompanying notes to basic financial statements.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2008

(1) Summary of Significant Accounting Policies

The accompanying financial statements of the State of Kosrae (the State) have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The Governmental Accounting Standards Board (GASB) is the recognized standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of the State's accounting policies are described below.

A. Reporting Entity

The State is one of the four states that make up the Federated States of Micronesia (FSM), along with the states of Chuuk, Pohnpei and Yap. The State is a constitutional government comprised of three branches: the Legislative Branch, consisting of 14 members elected for a term of four years by qualified voters of their respective election districts; the Executive Branch, headed by the Governor and Lt. Governor who are primarily responsible for executing the laws and administering state government services; and the Judiciary Branch made up of the State Supreme Court, which consists of a Chief Justice and up to four Associate Justices, and other courts that may be created by law.

For financial reporting purposes, the State has included all funds, organizations, agencies, boards, commissions and institutions. The State has also considered all potential component units for which it is financially accountable as well as other entities for which the nature and significance of their relationship with the State are such that exclusion would cause the State's financial statements to be misleading or incomplete. The criteria to be considered in determining financial accountability include whether the State, as the primary government, has appointed a voting majority of an organization's governing body and either has the ability to impose its will on that organization or there is potential for the organization to provide specific financial benefits to or impose specific financial burdens on the State. Financial accountability also exists if an organization is determined to be fiscally dependent on the primary government, although the primary government does not appoint a voting majority of the organization's governing board.

Each blended and discretely presented component unit of the State has a September 30 year-end.

Once financial accountability has been determined for a potential component unit, that component unit is either blended into the primary government or discretely presented from the primary government. Potential component units that do not meet the financial accountability criteria, but where a voting majority of the governing board is appointed by the State, are deemed to be related organizations. The nature and relationship of the State's component units and related organizations are disclosed in the following section.

Blended component units are entities that are legally separate from the State, but are so related to the State that they are, in substance, the same as the State or entities providing services entirely or almost entirely to the State. The State has not identified any entities that should be so blended.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

i. Discretely Presented Component Units

Discretely presented component units are entities which are legally separate from the State, but are financially accountable to the State, or whose relationships with the State are such that exclusion would cause the State's basic financial statements to be misleading or incomplete. The component units' column of the basic financial statements includes the financial data of the following major component units:

Kosrae Port Authority (KPA): KPA was created by Kosrae State Law (KSL) No. 7-91 to operate, manage, equip, and maintain all ports of entry and to expand and improve upon services offered at the ports of entry. KPA is governed by a five-member Board of Directors, of which four members are appointed by the Governor subject to the advice and consent of the Legislature, and, ex-officio, the Director of the Transportation and Infrastructure. During the year ended September 30, 2008, the State transferred capital assets of \$12,960,206 to the Authority.

Kosrae Utilities Authority (KUA): KUA was created by KSL No. 5-38 and is responsible for operating and maintaining, on a commercially accepted basis, the State's electric power. KUA is governed by a five-member Board of Directors, of which four members are appointed by the Governor subject to the advice and consent of the Legislature, and, ex-officio, the Director of the Department of Public Works.

Micronesian Petroleum Corporation (MPC): MPC was created by KSL No. 6-191 and is responsible for operating and managing the State's fuel storage facilities and to engage in the business of buying and selling petroleum products. MPC is governed by a five-member Board of Directors appointed by the Governor subject to the advice and consent of the Legislature. Dissolution of MPC occurred subsequent to fiscal year 2008, and MPC was amalgamated in the State of Kosrae.

The State's component units, departments, and funds that are separately audited issue their own financial statements. These statements may be obtained by directly contacting the various entities or obtaining them directly from the Office of the Public Auditor at the following address.

P.O. Box 727
Tofol, Kosrae, FSM 96944

B. Government-Wide Financial Statements

The Statement of Net Assets and the Statement of Activities report financial information on all of the non-fiduciary activities of the primary government and its component units. For the most part, the effect of interfund activity has been eliminated from these statements except for other charges between the primary government and the discretely presented component units. Elimination of these charges would distort the direct costs and program revenues reported for the various functions concerned.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

B. Government-Wide Financial Statements, Continued

Primary government activities are defined as either governmental or business-type activities. Governmental activities, which normally are supported by taxes, intergovernmental revenues and other non-exchange revenues, are reported separately from business-type activities, which rely to a significant extent on fees charged to external parties for goods or services. As such, business-type activities account for operations similarly to a for-profit business. Likewise, the primary government is reported separately from certain legally separate component units for which the primary government is financially accountable. Discretely presented component unit activities are presented with their business-type focus.

The Statement of Net Assets presents all of the reporting entity's non-fiduciary assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories:

- Invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation and reduced by outstanding balances for bonds, notes and other debt that are attributed to the acquisition, construction or improvement of those assets.
- Restricted net assets - nonexpendable consists of permanent funds in which donors or other outside sources have stipulated that the principal is to be maintained inviolate and in perpetuity, and invested for the purpose of producing present and future income, which may either be expended or added to the principal.
- Restricted net assets - expendable consists of resources in which the State is legally or contractually obligated to spend resources in accordance with restrictions either externally imposed by creditors, grantors, contributors, and the like, or imposed by law.
- Unrestricted net assets consist of net assets, which do not meet the definition of the two preceding categories. Unrestricted net assets often are designated, (for example, internally restricted), to indicate that management does not consider them to be available for general operations.

The government-wide Statement of Net Assets reports \$6,813,187 of restricted net assets, of which \$1,132,166 is restricted by enabling legislation.

The Statement of Activities demonstrates the degree to which the direct expenses of given functions or segments are offset by program revenues. Direct expenses are those that are clearly identifiable within a specific function or segment. Program revenues include charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges that are restricted to meeting the operational or capital requirements of a particular function. Taxes and other items not meeting the definition of program revenues are, instead, reported as general revenue.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

C. Fund Financial Statements

The fund financial statements present a balance sheet and a statement of revenues, expenditures, and changes in fund balances for its major and aggregated non-major funds.

Major individual governmental funds are reported as separate columns in the fund financial statements pursuant to GASB reporting standards, with nonmajor governmental funds being combined into a single column.

The State reports its financial position and results of operations in funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues and expenditures/expenses. Transactions between funds within a fund type, if any, have not been eliminated.

D. Measurement Focus and Basis of Accounting

The government-wide financial statements are reported using the economic resources management focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements account for the general governmental activities of the State and are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as they become susceptible to accrual; generally when they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the State considers revenues to be available if they are collected within 60 days of the end of the current fiscal period.

Significant revenues susceptible to accrual include income and gross revenue taxes, federal grants, federal reimbursements and other reimbursements for use of materials and services. Miscellaneous revenues from other financing sources are recognized when received in cash because they are generally not measurable until actually received. Investment earnings are recorded as earned, since they are both measurable and available. Expenditures generally are recorded in the period in which the related fund liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

Amounts reported as program revenue include 1) charges to customers or applicants for goods, services, or privileges provided, 2) operating grants and contributions, and 3) capital grants and contributions. Internally dedicated resources are reported as general revenues rather than as program revenues. General revenue is derived from taxation, investment income and other fees that are not allocated to specific programs.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

Discretely presented component units distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a discretely presented component unit's principal ongoing operations. All other revenues are reported as nonoperating. Operating expenses includes the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

The State reports the following fund types:

1. Governmental Funds

i. General Fund

This fund is the primary operating fund of the State. It is used to account for all governmental transactions, except those required to be accounted for in another fund.

ii. Special Revenue Funds

These funds account for specific revenue sources that have been aggregated according to enabling legislation to support specific governmental activities.

iii. Capital Projects Funds

These funds account for the acquisition or construction of major State capital facilities financed primarily from loans and federal reimbursements.

iv. Permanent Funds

This fund accounts for resources that are legally restricted to the extent that only earnings, and not principal, may be used to support programs for the benefit of the government.

GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - For State and Local Governments*, as amended by GASB Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus*, sets forth minimum criteria (percentage of the assets, liabilities, revenues or expenditures/expenses for either fund category or the governmental and enterprise combined) for the determination of major funds. Major individual governmental funds are reported as separate columns in the fund financial statements. The nonmajor funds are combined in a column in the fund financial statements and detailed in the combining statements. The State reports the following major funds:

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

Section 215 Compact Trust, a Governmental Fund Type - Permanent Fund, accounts for the State's contributions to the Trust Fund established in accordance with Section 215 of the Compact of Free Association, as amended, to provide for an additional source of revenue for the government budget that will be needed to substitute for the absence of Compact of Free Association funding.

Grants Assistance Fund, a Governmental Fund Type - Special Revenue Fund. This fund accounts for funds received under sector grants pursuant to the amended Compact of Free Association; all financial transactions of federally assisted funds, which are subgranted to the Kosrae State Government, as well as other direct federal grants that the State received from the United States government, and foreign assistance grants.

Early Retirement Program Fund – a Governmental Fund Type – Special Revenue Fund. This fund accounts for loan proceeds or funds from the General Fund invested with investment gains accrued within the fund to provide lower long-term costs of the State operations.

E. Reporting Standards

As allowed by GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, the State's discretely presented component units follow all GASB pronouncements and those Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins that were issued on or before November 30, 1989, except those that conflict with a GASB pronouncement.

F. Cash and Cash Equivalents and Time Certificates of Deposit

Cash and cash equivalents include cash held in demand accounts as well as short-term investments with a maturity date within three months of the date acquired by the State. Deposits maintained in time certificates of deposit with original maturity dates greater than ninety days are separately classified on the statement of net assets/balance sheet.

G. Investments

Investments and related investment earnings are recorded at fair value. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Investments in the equity of companies are carried at cost if less than twenty percent of the companies' total equity, on the equity method if greater than twenty percent and less than fifty percent and on a consolidated basis if greater than fifty percent.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

H Receivables

In general, tax revenue is recognized on the government-wide financial statements when assessed or levied and on the governmental fund financial statements to the extent that it is both measurable and available. Receivables are stated net of estimated allowances for uncollectible accounts. Federal receivables include those funds which are earned, primarily from FSM National Government administered federal grants, which have yet to be reimbursed by the applicable grantor.

Receivables of the primary government are primarily due from businesses and individuals residing in the State. The State establishes an allowance for doubtful accounts receivable based on the credit risk of specific customers, historical trends and other information.

I. Prepaid Items

Certain payments made to vendors or persons for services reflect costs applicable to future accounting periods and are recorded as prepaid items in both the government-wide and fund financial statements.

J. Interfund Receivables/Payables

During the course of its operations, the State records transactions between individual funds for goods provided or services rendered. Receivables and payables resulting from transactions between funds are classified as "due from other funds" or "due to other funds" on the governmental fund balance sheet.

These balances result from time lag between the dates that 1) interfund goods and services are provided or reimbursable expenditures occur, 2) transactions are recorded in the accounting system, and 3) payments between funds are made, and are scheduled to be collected in the subsequent year.

K. Inventories

Inventories of materials and supplies are determined by physical count and are valued at the lower of cost (principally average cost) or market.

Inventories of the discretely presented component units are valued at the lower of cost (FIFO) or market.

L. Restricted Assets

As of September 30, 2008, cash and cash equivalents and time certificates of deposit of the primary government were restricted for the following uses:

Certain assets of the primary government are classified as restricted assets because their use is completely restricted through loan agreements or enabling legislation. Specifically, the State has collateralized investments in the amount of \$1,683,489 for the Kosrae State Early Retirement Scheme. Furthermore, investments recorded in the Compact Trust Fund of \$2,462,040 are restricted in that they are not available to be used in current operations. As of September 30, 2008, cash and cash equivalents and time certificates of deposit of the primary government were restricted for the following uses:

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

L. Restricted Assets, Continued

| | |
|--|-------------------|
| A demand deposit account with a local bank as remaining loan proceeds of the \$2,000,000 Early Retirement loan with the Asian Development Bank. | \$ 806 |
| Time certificate of deposit of \$47,672 and demand deposit of \$354,383 with a local bank restricted for scholarships for post-secondary students. | 402,055 |
| The State has restricted a time certificate of deposit that collateralizes a bank loan to Micronesian Petroleum Corporation. | 34,353 |
| Time certificate of deposit of \$200,000 and demand deposit account of \$163,370 for the Loan Guarantee Escrow Account established for the sole purpose of loan collateralization made through the USDA Rural Development. The escrow account may be drawn down in the event of a borrower's default on the obligation under the terms of the promissory note and the deed of trust security instrument supporting such note and for which such note is guaranteed by the State, the trustee of the Loan Guarantee Escrow Account. | 363,370 |
| | \$ <u>800,584</u> |

M. Capital Assets

Capital assets, which include property, plant, equipment and infrastructure (e.g. roads, bridges, ramps and other similar items), are reported in the governmental activity column of the government-wide financial statements.

Capital assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at fair market value at the date of donation.

All land and non-depreciable land improvements are capitalized, regardless of cost. Singular pieces of machinery and equipment, other than vehicles, that equal or exceed \$50,000 are capitalized. Buildings and infrastructure projects with a cost that equals or exceeds \$100,000 are capitalized. The costs of normal maintenance and repairs that do not add to the value of assets or materially extend asset lives are not capitalized.

All vehicles have been grouped together regardless of cost and depreciated on a composite basis.

Capital assets of the primary government and the discretely presented component units are depreciated using the straight-line method over their estimated useful lives, with a full year's depreciation charged in the year of acquisition and disposal, regardless of date. Estimated useful lives are as follows:

| | |
|-------------------------------------|---------------|
| Buildings | 10 - 40 years |
| Infrastructure - roads, and bridges | 5 - 50 years |
| Machinery, equipment and others | 5 - 10 years |

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

N. Interfund/Intrafund Transactions

As a general rule, the effect of interfund activity has been eliminated in the government-wide statements. Exceptions to this rule are: 1) activities between funds reported as governmental activities and funds reported as business-type activities and 2) activities between funds that are reported in different functional categories in either the governmental or business-type activities column. Elimination of these activities would distort the direct costs and program revenues for the functions concerned.

O. Compensated Absences

It is the government's policy to permit employees to accumulate earned but unused vacation and sick pay benefits. There is no liability for unpaid accumulated sick leave since the government does not have a policy to pay any amounts when employees separate from service with the government. All vacation pay is accrued when incurred in the government-wide financial statements. A liability for these amounts is reported in governmental funds only if they have matured, for example, as a result of employee resignations and retirements. Annual leave accumulates at the rate of one working day per bi-weekly pay period. All unused annual leave is cancelled at the end of each fiscal year. Accordingly, no liability is recorded for compensated absences in the accompanying statement of net assets.

P. Fund Equity

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. The unreserved fund balances for the governmental funds represent the amount available for budgeting future operations. The reserve for related assets as of September 30, 2008, is represented by the following assets:

| | <u>General</u> | <u>Grants Assistance</u> | <u>Early Retirement Program</u> | <u>Section 215 Compact Trust</u> | <u>Other Governmental Funds</u> | <u>Totals</u> |
|------------------------------|-------------------|--------------------------|---------------------------------|----------------------------------|---------------------------------|---------------------|
| Investments | \$ 200,000 | \$ 900,000 | \$ - | \$ - | \$ - | \$ 1,100,000 |
| Receivables: | | | | | | |
| Loans | - | - | - | - | 174,479 | 174,479 |
| Due from component units | 244,000 | - | - | - | - | 244,000 |
| Advances | 45,264 | 20,562 | - | - | - | 65,826 |
| Restricted assets: | | | | | | |
| Cash and cash equivalents | 182,851 | - | - | - | 47,672 | 230,523 |
| Time certificates of deposit | 234,353 | - | - | - | 354,383 | 588,736 |
| Investments | - | - | 1,683,489 | 2,462,040 | - | 4,145,529 |
| | <u>\$ 906,468</u> | <u>\$ 920,562</u> | <u>\$ 1,683,489</u> | <u>\$ 2,462,040</u> | <u>\$ 576,534</u> | <u>\$ 6,549,093</u> |

As of September 30, 2008, continuing appropriations reported in the General Fund and Grants Assistance Fund as follows:

| | <u>General Fund</u> | <u>Grants Assistance</u> | <u>Total</u> |
|-------------------------------|---------------------|--------------------------|-------------------|
| Solid Waste Recycling Project | \$ - | \$ 117,497 | \$ 117,497 |
| Centralized Landfill Project | - | 23,775 | 23,775 |
| Other | <u>6,000</u> | <u>35,291</u> | <u>41,291</u> |
| | <u>\$ 6,000</u> | <u>\$ 176,563</u> | <u>\$ 182,563</u> |

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

Q. Risk Financing

The State 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 State management believes it is more economical to manage its risks internally. In the event of claim settlements and judgments, the State 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. However, no material losses have been sustained from this practice in the last three years.

R. New Accounting Standards

During fiscal year 2008, the State implemented GASB Statement No. 43, Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans, GASB Statement No. 48, Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfer of Assets and Future Revenues, and GASB Statement No. 50, Pension Disclosures an amendment of GASB Statements No. 25 and 27. GASB Statement No. 43 establishes uniform financial reporting for other postemployment benefit plans by state and local governments and GASB Statement No. 50 more closely aligns the financial reporting requirements for pensions with those for other post-employment benefits. GASB Statement No. 48 establishes criteria that governments will use to ascertain whether certain transactions should be regarded as a sale or a collateralized borrowing, and includes a provision that stipulates that governments should not revalue assets that are transferred between financial reporting entity components. The implementation of these pronouncement did not have a material effect on the accompanying financial statements.

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 State.

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 State.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

R. New Accounting Standards, Continued

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 the implementation of this statement will have a material effect on the financial statements of the State.

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 the implementation of this statement will have a material effect on the financial statements of the State.

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 the implementation of this statement will have a material effect on the financial statements of the State.

S. Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures/expenses during the reporting period. Actual results could differ from those estimates.

T. Deferred Revenues

In the government-wide financial statements, deferred revenue is recognized when cash, receivables or other assets are recorded prior to their being earned. In the governmental fund financial statements, deferred revenue represents monies received or revenues accrued which have not been earned or do not meet the "available" criterion for revenue recognition under the modified accrual basis of accounting. The deferred revenue in the governmental fund types has primarily resulted as federal funds are received in advance of eligible expenditures.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

U. Total Columns

Total columns are presented primarily to facilitate financial analysis. The Management's Discussion and Analysis includes certain prior year summarized comparative information in total. Such information does not include sufficient detail to constitute a full comparative presentation. Accordingly, such information should be read in conjunction with the State's financial statements for the year ended September 30, 2007 from which summarized information was derived.

V. Reclassifications

Due to the provisions of GASB Statement No. 34 Basic Financial Statements – and Management's Discussion and Analysis – For State and Local Governments, major funds presented in the previous year may not be major funds presented in the current year. Concurrently, major funds presented in the current year may not be major funds presented in the previous year. The State has consolidated the Compact Sector Grants Fund and U.S. Federal Grants Fund as part of the Grants Assistance Fund, whereas such were presented as individual major funds in the previous year. In addition, the Compact Capital Projects Fund, Foreign Assistance Fund, Compact Special Block Fund, Compact Health and Medical Fund, Compact Scholarship Fund, Compact Energy Block Grant Fund, and the Compact Special Development Fund have been consolidated with the Grants Assistance Fund whereas such were presented as nonmajor governmental funds in the previous year.

(2) Deposits and Investments

GASB Statement No. 40 addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk and foreign currency risk. As an element of interest rate risk, disclosure is required of investments that have fair values that are highly sensitive to changes in interest rates. GASB Statement No. 40 also requires disclosure of formal policies related to deposit and investment risks.

The deposit and investment policies of the State are governed by State legislation. The Treasurer is responsible for ensuring that deposits of the General Fund are maintained in commercial checking or savings accounts of any financial institution whose assets are at least \$1 billion and whose deposits are subject to Federal Deposit Insurance Corporation (FDIC) insurance. The Governor is responsible for the investment of any monies of the State that are deemed not necessary for immediate use.

The Federated Development Authority has selected investment managers who are given authority to buy and sell securities. These investment managers may invest in stocks, bonds and cash equivalents, for which minimum standards of quality of such investments at the time of purchase shall be as follows:

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2008

(2) Deposits and Investments, Continued

- i. Cash equivalents - the investment manager may engage in all normally accepted short-term investment practices including, but not limited to U.S. Treasury and government agency securities, bankers acceptances, certificates of deposit, commercial paper and repurchase agreements using any of the foregoing as collateral. The following restrictions apply: (1) Commercial paper must be rated A-1/P-1 or higher by Standard & Poors Corporation and Moody's Investor Services; and (2) Certificates of deposit must be from FDIC insured banks or FSLIC insured savings and loan associations, both of which must have assets in excess of \$2 billion. Deposits in smaller institutions are acceptable, but must not exceed the amount of the insurance, unless collateralized by U.S. Treasury obligations at 102%.
- ii. Stocks - A "B" rating by a national rating service. Non-rated stocks, such as banks or insurance companies, must be equal in quality or higher.
- iii. Bonds - Confined to issues rated "A" or higher by a national rating service, except in the case of U.S. Treasury or government agency obligations which are not rated.

The equity portfolio shall be diversified among issues and industry classifications. No more than 25% of the equity portfolio may be invested in any single classification, as described by the Standard and Poors 500 Index, unless prior approval is received from the Secretary of Finance.

No investment may be made in a single corporate entity which exceeds 5% of the total assets of the fund at the time of purchase without prior approval of the Secretary of Finance.

The Director of the Department shall be responsible for investment of all public funds collected or appropriated for use by the Kosrae State Government. Funds under this arrangement shall include all appropriations from the Kosrae State Government, whether funds are appropriated from the State Treasury or funds from other sources. Any funds in excess of the amount necessary for the operation of the Government shall be deposited or invested to earn the safest optimum interest. The Director shall determine the amount to be invested with the consideration that such amount should not cause disruption of any government service due to low or lack of funds in the operational budget. The Director shall cause all investments to be made into financially secure institutions in Kosrae or abroad as determined by the financial institution paying the highest rate of interest on savings when the investment is made.

A. Deposits

GASB Statement No. 3 previously required government entities to present deposit risks in terms of whether the deposits fell into the following categories:

Category 1 Deposits that are federally insured or collateralized with securities held by the State or its agent in the State's name;

Category 2 Deposits that are uninsured but fully collateralized with securities held by the pledging financial institution's trust department or agent in the State's name; or

Category 3 Deposits that are collateralized with securities held by the pledging financial institution's trust department or agent but not in the State's name and non-collateralized deposits.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2008

(2) Deposits and Investments, Continued

A. Deposits, Continued

GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for deposits falling into categories 1 and 2 but retained disclosures for deposits falling under category 3. Category 3 deposits are those deposits that have exposure to custodial credit risk. Custodial credit risk is the risk that in the event of a bank failure, the State's deposits may not be returned to it. Such deposits are not covered by depository insurance and are either uncollateralized, or collateralized with securities held by the pledging financial institution or held by the pledging financial institution but not in the depositor-government's name. The State does not have a deposit policy for custodial credit risk.

As of September 30, 2008, the carrying amount of the primary government's total cash and cash equivalents and time certificates of deposit was \$1,189,634 and the corresponding bank balance was \$1,316,465, which is maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2008, bank deposits in the amount of \$100,303 were FDIC insured. The State does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Therefore, these deposits are exposed to custodial credit risk.

As of September 30, 2008, the carrying amount of the discretely presented component units' total cash and cash equivalents and time certificates of deposit was \$779,005, and the corresponding bank balance was \$704,436, which were maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2008, bank deposits in the amount of \$340,088 were FDIC insured. The component units do not require collateralization of their cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Therefore, these deposits are exposed to custodial credit risk.

B. Investments

GASB Statement No. 3 previously required government entities to present investment risks in terms of whether the investments fell into the following categories:

- Category 1 Investments that are insured or registered, or securities held by the State or its agent in the State's name;
- Category 2 Investments that are uninsured and unregistered for which the securities are held by the counterparty's trust department or agent in the State's name; or
- Category 3 Investments that are uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent but not in the State's name.

GASB Statement No. 40 amended GASB Statement No. 3 to in effect eliminate disclosure for investments falling into categories 1 and 2, and provided for disclosure requirements addressing other common risks of investments such as credit risk, interest rate risk, concentration of credit risk, and foreign currency risk. GASB Statement No. 40 did retain and expand the element of custodial credit risk in GASB Statement No. 3.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2008

(2) Deposits and Investments, Continued

B. Investments, Continued

As of September 30, 2008, the State's investments at fair value are as follows:

| | |
|--------------------------|---------------------|
| Fixed income securities: | |
| Domestic fixed income | \$ <u>557,493</u> |
| Other investments: | |
| Money market funds | 1,125,996 |
| Cash management account | <u>2,462,040</u> |
| | <u>3,588,036</u> |
| | \$ <u>4,145,529</u> |

As of September 30, 2008, the State's fixed income securities, including their Moody's investors service credit ratings, had the following maturities:

| <u>Investment Type</u> | <u>Current</u> | <u>1-5</u> | <u>6-10</u> | <u>Over</u> | <u>Total</u> | <u>Ratings</u> |
|--|-----------------|------------------|-----------------|------------------|------------------|----------------|
| Corporate notes and bonds | \$ - | \$ 17,461 | \$ 9,611 | \$ - | \$ 27,072 | A1 |
| Corporate notes and bonds | 11,651 | - | 2,816 | 10,594 | 25,061 | A2 |
| Corporate notes and bonds | - | - | - | 4,528 | 4,528 | A3 |
| Corporate notes and bonds | - | 7,067 | - | 13,593 | 20,660 | AA2 |
| Corporate notes and bonds | 1,623 | - | - | 8,606 | 10,229 | AA3 |
| Corporate notes and bonds | 2,051 | - | - | - | 2,051 | AAA |
| US government agency obligations: | | | | | | |
| Federal Farm Credit Bank | - | 28,206 | - | - | 28,206 | AAA |
| Federal Home Loan Bank | 5,627 | 21,577 | - | - | 27,204 | AAA |
| Federal Home Loan Mortgage Corporation | - | 32,043 | 9,958 | 109,452 | 151,453 | AAA |
| Federal National Mortgage Association | - | 12,785 | 5,584 | 83,246 | 101,615 | AAA |
| Government National Mortgage Corporation | - | - | - | 3,259 | 3,259 | AAA |
| Housing Urban Development | - | 5,601 | - | - | 5,601 | AAA |
| Other | 15,777 | - | - | 4,357 | 20,134 | AAA |
| US Treasury obligations | 6,070 | 7,983 | 34,532 | 35,812 | 84,397 | AAA |
| Corporate notes and bonds | - | 1,699 | - | - | 1,699 | B2 |
| Corporate notes and bonds | - | 11,006 | 12,225 | 3,501 | 26,732 | BAA1 |
| Corporate notes and bonds | - | - | 5,180 | 2,601 | 7,781 | BAA2 |
| Corporate notes and bonds | <u>3,890</u> | <u>-</u> | <u>5,921</u> | <u>-</u> | <u>9,811</u> | BAA3 |
| Grand Total | <u>\$46,689</u> | <u>\$145,428</u> | <u>\$85,827</u> | <u>\$279,549</u> | <u>\$557,493</u> | |

Credit risk for investments is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. With the exception of investments in U.S. government securities, which are explicitly or implicitly guaranteed by the United States government, all other investments must be rated in accordance with the State's investment policy.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2008

(2) Deposits and Investments, Continued

B. Investments, Continued

Custodial credit risk for investments is the risk that in the event of the failure of the counterparty to the transaction, the State will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. The State's investments are held and administered by trustees. Based on negotiated trust and custody contracts, all of these investments were held in the State's name by the State's custodial financial institutions at September 30, 2008.

Concentration of credit risk for investments is the risk of loss attributed to the magnitude of an entity's investment in a single issuer. GASB Statement No. 40 requires disclosure by issuer and amount of investments in any one issuer that represents five percent (5%) or more of total investments for the State.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of debt instruments. The State does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

As of September 30, 2008, the General Fund holds 3.7% of the shares of the Pacific Island Development Bank in the amount of \$200,000. As the fair market value of this investment is not readily available, such has been recorded at cost.

As of September 30, 2008, the Grants Assistance Fund holds 5.4% of the shares of the Bank of the Federated States of Micronesia in the amount of \$500,000 and 7.3% of the shares of the Pacific Islands Development Bank in the amount of \$400,000. As the fair market value of these investments is not readily available, such have been recorded at cost.

In addition, as of September 30, 2008, the Grants Assistance Fund holds 100% of the shares of Pacific Tuna Ventures, Inc. and 50% of the shares in a joint venture with the National Fisheries Corporation of Kosrae Sea Ventures, Inc. These investments are accounted for using the equity method and, accordingly, the carrying values have been reduced to \$0.

Discretely Presented Component Units

As of September 30, 2008, investments at fair value comprise the following:

| | |
|--------------------|-------------------|
| Money market funds | \$ 254,827 |
| Common stock | <u>316,232</u> |
| | \$ <u>571,059</u> |

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2008

(3) Receivables

Receivables as of September 30, 2008, for the primary government's individual major funds and nonmajor funds in the aggregate, including applicable allowances for uncollectible accounts, are as follows:

| | <u>General</u> | <u>Grants Assistance</u> | <u>Early Retirement Program</u> | <u>Section 215 Compact Trust</u> | <u>Other Governmental Funds</u> | <u>Total</u> |
|--|-------------------|--------------------------|---------------------------------|----------------------------------|---------------------------------|---------------------|
| Receivables: | | | | | | |
| Federal agencies | \$ - | \$ 53,446 | \$ - | \$ - | \$ - | \$ 53,446 |
| Taxes | 333,807 | - | - | - | - | 333,807 |
| Loans | - | 490,130 | - | - | 1,511,842 | 2,001,972 |
| FSM National Government | - | 2,738,743 | - | - | 604,357 | 3,343,100 |
| Other | <u>100,952</u> | <u>79,558</u> | <u>-</u> | <u>-</u> | <u>362,638</u> | <u>543,148</u> |
| | 434,759 | 3,361,877 | - | - | 2,478,837 | 6,275,473 |
| Less: Allowance for uncollectible accounts | <u>(272,635)</u> | <u>(2,499,212)</u> | <u>-</u> | <u>-</u> | <u>(2,304,358)</u> | <u>(5,076,205)</u> |
| Net receivables | \$ <u>162,124</u> | \$ <u>862,665</u> | \$ <u>-</u> | \$ <u>-</u> | \$ <u>174,479</u> | \$ <u>1,199,268</u> |

Receivables of the primary government are primarily due from businesses and individuals residing in the FSM. The State establishes an allowance for doubtful accounts receivable based on the credit risk of specific customers, historical trends and other information. During the year ended September 30, 2008, the State reevaluated the allowance for doubtful debts and recorded \$176,846 of bad debt, net of recovered collections, within the General Fund. Accordingly, such has been reflected as a special item within the accompanying financial statements.

Loans receivable of the primary government as of September 30, 2008 are as follows:

Grants Assistance Fund

Note receivable due from Pacific Tuna Ventures, Inc., payable in monthly installments of \$11,875, uncollateralized, due May 1996, interest at 3% per annum. This note has been fully provided for in the allowance for uncollectible accounts. \$ 95,000

Loans receivable from post-secondary students issued under a student financial assistance program to qualified Kosraean students, uncollateralized with interest at up to 6% per annum. These loans have been fully provided for in the allowance for uncollectible accounts. 395,130
\$ 490,130

Nonmajor Governmental Funds

Low-income housing loans, details and terms of those loans have not been compiled and such have been provided for in the allowance for uncollectible accounts in the amount of \$1,298,513. \$ 1,472,992

Loans receivable from post-secondary students issued under a student financial assistance program to qualified Kosraean students, uncollateralized with interest at up to 6% per annum. These loans have been fully provided for in the allowance for uncollectible accounts. 38,850
\$ 1,511,842

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2008

(3) Receivables, Continued

Receivables as of September 30, 2008, for the component units, including applicable allowance for uncollectible accounts, are as follows:

| | <u>Kosrae Port Authority</u> | <u>Kosrae Utilities Authority</u> | <u>Micronesia Petroleum Corporation</u> | <u>Total</u> |
|---|--------------------------------------|---|---|-------------------|
| Receivables: | | | | |
| General | \$ 51,359 | \$ 423,210 | \$ 589,292 | \$ 1,063,861 |
| Less: Allowance for uncollectible accounts | <u>-</u> | <u>(248,798)</u> | <u>(398,908)</u> | <u>(647,706)</u> |
| Net receivables | \$ <u>51,359</u> | \$ <u>174,412</u> | \$ <u>190,384</u> | \$ <u>416,155</u> |

(4) Interfund Receivables and Payables

Receivables and payables between funds reflected as due to/from other funds in the combined balance sheet at September 30, 2008, are summarized as follows:

| <u>Receivable Fund</u> | <u>Payable Fund</u> | <u>Amount</u> |
|-----------------------------|-----------------------------|---------------------|
| Grants Assistance Fund | General | \$ 1,140,246 |
| Nonmajor governmental funds | General | 896,844 |
| General | Nonmajor governmental funds | 2,977 |
| General | Grants Assistance Fund | <u>756,330</u> |
| | | \$ <u>2,796,397</u> |

(5) Due from Component Units

Transactions of the primary government to component units at September 30, 2008, are as follows:

General Fund

Note receivable due from Micronesian Petroleum Corporation, interest at 1% per annum, payable in monthly installments of \$2,000, uncollateralized, due June 1, 2005. Commencing June 1, 2008, monthly installments shall be increased to \$4,000 per month. \$ 244,000

Grants Assistance Fund

Note receivable due from Micronesian Petroleum Corporation, payable in monthly installments of \$2,628, uncollateralized, due February 1, 2009, interest at 1% per annum. This note has been fully provided for in the allowance for uncollectible accounts. \$ 272,500

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2008

(6) Due to Primary Government

Transactions of the component units to the primary government at September 30, 2008 are as follows:

Micronesia Petroleum Corporation (MPC)

Loan payable to the State, in the original amount of \$300,000, due in monthly installments of \$2,628, interest at 1%, maturing on February 1, 2009. \$ 272,500

Loan payable to the State, in the original amount of \$300,000 due in monthly installments of \$2,000. Commencing June 1, 2008, installments shall be increased to \$4,000 per month, interest at 1%. 252,944

\$ 525,444

(7) Fixed Assets

Capital asset activities for the year ended September 30, 2008, are as follows:

Primary Government

| | Balance October 1, 2007 | Increases | Decreases | Balance September 30, 2008 |
|--------------------------------|-------------------------------|-----------------------|------------------------|----------------------------------|
| Governmental activities: | | | | |
| Buildings | \$ 13,758,492 | \$ - | \$ (1,305,377) | \$ 12,453,115 |
| Infrastructure | 72,885,749 | - | (40,660,381) | 32,225,368 |
| Machinery, equipment, others | <u>4,333,697</u> | <u>109,758</u> | <u>(1,230,254)</u> | <u>3,213,201</u> |
| | <u>90,977,938</u> | <u>109,758</u> | <u>(43,196,012)</u> | <u>47,891,684</u> |
| Less accumulated depreciation: | | | | |
| Buildings | (10,704,039) | (228,494) | 917,678 | (10,014,855) |
| Infrastructure | (48,097,953) | (1,357,509) | 27,879,726 | (21,575,736) |
| Machinery, equipment, others | <u>(3,587,308)</u> | <u>(168,119)</u> | <u>1,190,620</u> | <u>(2,564,807)</u> |
| | <u>(62,389,300)</u> | <u>(1,754,122)</u> | <u>29,988,024</u> | <u>(34,155,398)</u> |
| | <u>\$ 28,588,638</u> | <u>\$ (1,644,364)</u> | <u>\$ (13,207,988)</u> | <u>\$ 13,736,286</u> |

During the year ended September 30, 2008, depreciation expense was charged as follows:

| | |
|----------------------|---------------------|
| General government | \$ 67,995 |
| Economic development | 38,234 |
| Education | 119,296 |
| Health services | 81,362 |
| Public safety | 6,648 |
| Other appropriations | <u>1,440,587</u> |
| | <u>\$ 1,754,122</u> |

During the year ended September 30, 2008, the State recognized proceeds of \$522,419 from the sale of a residence in the State of Hawaii and \$25,758 from the sale of miscellaneous equipment and vehicles.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2008

(8) Long-Term Obligations

Primary Government

Malem Wastewater System Project (MWSP) Loan:

The State borrowed \$145,000 from the U.S. Department of Agriculture Rural Utilities Services for the Malem Wastewater System Project, payable in annual installments of \$7,880 commencing September 28, 2001, interest at 4.5% per annum, due September 28, 2040. As of September 30, 2008, the balance payable on this mortgage loan amounted to \$136,173.

Asian Development Bank (ADB) Loans:

The State implemented an Early Retirement Scheme (ERS) in which employees holding certain nonessential positions as identified by the State were retired early with a payout of the equivalent of two-years' wages. This ERS program is funded by a \$1,995,102 loan from the ADB through the FSM National Government, non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The activities of the ERS Program are recorded in the Early Retirement Program Fund.

The ADB loan has a grace period of ten years with the first payment due in February 2008 and the last payment in August 2037. However, pursuant to the terms of the Financing Agreement between the State and the FSM National Government, the State is required to deposit into the ERS Trust account held in the name of the State within the FSM National Government investment portfolio, 100% of the outstanding principal balance by September 30, 2002.

Funds for the repayment of the ADB loan are expected to be derived from the annual appropriations for salaries and wages earmarked for the positions abolished under the Early Retirement Scheme. The Financing Agreement requires the State to continue to appropriate salaries for the abolished positions and deposit the appropriate funds into the ERS Trust Account. These funds had not been deposited to the Trust Account as of September 30, 2002. Of the required \$1,995,102 identified for future debt service payments, \$1,683,489 is deposited in an investment account held jointly with the FSM National Government. That investment account is restricted for the repayment of this debt.

The State also entered into an agreement with the FSM National Government to borrow a portion of the proceeds of the FSM National Government Program Loans with ADB (Loan Number 1873 (SF) and Loan Number 1874 FSM (SF)), for the purpose of promoting private sector development in Kosrae, with interest at 1% to 1.5% per annum. The principal payments shall be made in 32 equal semi-annual payments with the first payment due on May 15, 2010 and the last payment on November 15, 2025. As of September 30, 2008, the State drew down an additional \$447,467 of the \$1,782,859 total borrowing. The remaining increase of \$199,610 is due to a Special Drawing Rights (SDR) adjustment recorded during the year ended September 30, 2008.

As of September 30, 2008, the State entered into an agreement with the FSM National Government to borrow a portion of the proceeds of the FSM National Government program loans with ADB (Loan Number 1816 FSM (SF)), for the purpose of funding the Basic Social Services Project, with interest at 1% to 1.5% per annum. The principal payments shall be made semiannually commencing February 1, 2009, with a maturity date of August 1, 2032. As of September 30, 2008, the State drew down an additional \$219,984 of the \$326,631 total borrowing. The remaining increase of \$11,896 is due to a SDR adjustment recorded during the year ended September 30, 2008.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2008

(8) Long-Term Obligations, Continued

Primary Government, Continued

Asian Development Bank (ADB) Loans, Continued:

During the year ended September 30, 2007, the State entered into an agreement with the FSM National Government to borrow \$1,500,000 for the purpose of repayment of Compact Sector Grant advances and to partially pay a \$500,000 bank borrowing. The principal payment shall be made in equal quarterly installments of \$37,500, non-interest bearing, on each of the first day of the month of October, January, April and July starting on October 1, 2009 and ending on July 1, 2019.

Annual debt service requirements to maturity for principal and interest are as follows:

| Year ending September 30, | Principal | Interest | Total |
|------------------------------|---------------------|-------------------|---------------------|
| 2009 | \$ 44,355 | \$ 49,092 | \$ 93,447 |
| 2010 | 287,782 | 59,103 | 346,885 |
| 2011 | 287,782 | 57,124 | 344,996 |
| 2012 | 287,967 | 55,142 | 343,109 |
| 2013 | 288,066 | 53,155 | 341,221 |
| 2014 – 2018 | 1,564,135 | 233,275 | 1,787,410 |
| 2019 – 2023 | 1,147,542 | 169,376 | 1,316,918 |
| 2024 – 2028 | 887,750 | 93,939 | 981,689 |
| 2029 – 2033 | 538,400 | 49,217 | 587,617 |
| 2034 - 2038 | 350,694 | 15,698 | 366,392 |
| 2039 - 2040 | <u>16,202</u> | <u>913</u> | <u>17,115</u> |
| | \$ <u>5,700,765</u> | \$ <u>826,034</u> | \$ <u>6,526,799</u> |

Other long-term liabilities will be liquidated in the future from governmental funds. During the year ended September 30, 2008, the following changes occurred in liabilities reported as part of the primary government's long-term liabilities in the statement of net assets:

| | Balance October 1, 2007 | Additions | Reductions | Balance September 30, 2008 | Due Within One Year |
|----------------|-------------------------------|-------------------|--------------------|----------------------------------|------------------------|
| Loans payable: | | | | | |
| ADB loans | \$ 3,230,533 | \$ 878,957 | \$ (44,898) | \$ 4,064,592 | \$ 39,902 |
| MWSP loan | 136,173 | - | - | 136,173 | 4,453 |
| FSMNG loan | <u>1,500,000</u> | - | - | <u>1,500,000</u> | - |
| | <u>4,866,706</u> | <u>878,957</u> | <u>(44,898)</u> | <u>5,700,765</u> | <u>44,355</u> |
| Other: | | | | | |
| Claims | <u>110,000</u> | - | - | <u>110,000</u> | - |
| | <u>\$ 4,976,706</u> | <u>\$ 878,957</u> | <u>\$ (44,898)</u> | <u>\$ 5,810,765</u> | <u>\$ 44,355</u> |

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2008

(8) Long-Term Obligations, Continued

Primary Government, Continued

Discretely Presented Component Units

Kosrae Utilities Authority (KUA):

Term loan payable to bank, original amount of \$450,000, interest at 2.50% greater than TCD rate pledged as collateral, monthly repayment of \$8,523, collateralized by a first security interest in a time certificate of deposit of \$579,200 held by KUA. Interest rate effective as of September 30, 2008 ranges from 5.10% to 5.85%. \$ 359,241

Micronesia Petroleum Corporation (MPC):

Loan payable to FSM Development Bank, in the original amount of \$500,000 due in monthly installments of \$5,100, with a balloon payment of approximately \$264,000 due at maturity. Interest is at 9%, maturity in September 2008, collateralized by the property and inventory of MPC. \$ 234,756

Term loan payable to Bank of the FSM, interest at 2.75% greater than TCD rate pledged as collateral by Kosrae State Government (6.25% at September 30, 2008), collateralized by a first security interest in essentially all MPC assets and a time certificate of deposit held by the State in the amount of \$34,353. 32,690

Loan payable to FSM Development Bank, ten year term, maturing on July 18, 2010, interest at 5%, monthly repayment of \$7,958, collateralized by MPC's accounts receivable and inventory. 203,593

\$ 471,039

Annual debt service requirements to maturity for principal and interest are as follows:

| <u>Year ending September 30,</u> | <u>Principal</u> | <u>Interest</u> | <u>Total</u> |
|--------------------------------------|-------------------|------------------|-------------------|
| 2009 | \$ 437,330 | \$ 50,408 | \$ 487,738 |
| 2010 | 178,318 | 19,455 | 197,773 |
| 2011 | 121,805 | 10,602 | 132,407 |
| 2012 | <u>92,827</u> | <u>4,576</u> | <u>97,403</u> |
| | \$ <u>830,280</u> | \$ <u>85,041</u> | \$ <u>915,321</u> |

During the year ended September 30, 2008, the following changes occurred in liabilities reported as part of the component unit's long-term liabilities in the statement of net assets:

| | Balance October 1, 2007 | Additions | Reductions | Balance September 30, 2008 | Due Within One Year |
|-------------------|-------------------------------|-----------|---------------------|----------------------------------|---------------------------|
| KUA loan payable | \$ 437,329 | \$ - | \$ (78,088) | \$ 359,241 | \$ 84,567 |
| MPC loans payable | <u>625,789</u> | - | <u>(154,750)</u> | <u>471,039</u> | <u>353,763</u> |
| | \$ <u>1,063,118</u> | \$ - | \$ <u>(232,838)</u> | \$ <u>830,280</u> | \$ <u>437,330</u> |

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2008

(9) Commitments and Contingencies

Sick Leave

It is the policy of the State to record expenditures for sick leave when leave is actually taken. Sick leave is compensated time for absence during working hours arising from employee illness or injury. The estimated accumulated amount of unused sick leave as of September 30, 2008 is \$275,619.

Insurance Coverage

The State does not maintain insurance coverage for a significant amount of fixed assets. In the event of a catastrophe, the State may be self-insured to a material extent.

Federal Grants

The State participates in a number of federally assisted grant programs. These programs are subject to financial and compliance audits to ascertain if Federal laws and guidelines have been followed. Cumulative questioned costs of \$463,357 relating to fiscal years 2006 and 2007 have been set forth in the State's Single Audit Report for the year ended September 30, 2008. The ultimate disposition of these questioned costs can be determined only by final action of the respective grantor agencies. Therefore, no provision for any liability that may result upon resolution of this matter has been made in the accompanying financial statements.

Pursuant to Title I, Section 105 of United States Public Law 99-239, the Government of the Federated States of Micronesia (FSM) (which includes the State) is no longer liable for debts to U.S. federal agencies arising prior to the date of the implementation of the Compact of Free Association. This matter has not yet been officially resolved with the U.S. Government.

The State is continuing its process of evaluating the collectability of its recorded receivables from the FSM National Government. Any matters that result from this evaluation will be accounted for prospectively as it is not presently possible to determine the ultimate outcome of this matter.

Loan Guarantee Escrow

As set forth in note 1L, the State has pledged an escrow account in support of certain housing loans. In the event of default, the State could be exposed to a currently indeterminable liability.

Litigation

The State is party to numerous legal proceedings, many of which are normal recurrences in governmental operations. The State's Attorney General is of the opinion that the probable outcome of suits existing at September 30, 2008, is not predictable but could have a material impact on the accompanying financial statements. Such impact has currently been estimated to approximate \$110,000, which has been recorded as a liability in the accompanying statement of net assets.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2008

(9) Commitments and Contingencies, Continued

Contingency

The State issued certain reduction-in-force checks to State employees without withholdings. This matter is being discussed between the State and FSM National Government and State management believes that no adverse impact on the accompanying financial statements will result.

The State was advised of a change in its ADB related debt due to the FSM National Government passing through certain foreign exchange losses. The State is currently discussing this matter with the FSM National Government and any adjustments that may result from this discussion will be accounted for prospectively.

(10) Restatement

Subsequent to the issuance of the State's 2007 financial statements, management of the State determined that certain vehicles were not recorded as capital assets of the governmental activities. As a result of this determination, the account balances have been restated from the amounts previously reported as follows:

| | <u>As Previously Reported</u> | <u>As restated</u> |
|--|-----------------------------------|-----------------------|
| At September 30: | | |
| Noncurrent assets: | | |
| Capital assets, net of accumulated depreciation | \$ <u>28,333,206</u> | \$ <u>28,588,638</u> |
| Net assets: | | |
| Invested in capital assets, net of related debt | \$ <u>28,333,206</u> | \$ <u>28,558,638</u> |
| For the year ended September 30: | | |
| Expenses: | | |
| General government | \$ <u>2,905,093</u> | \$ <u>2,869,820</u> |
| Economic development | \$ <u>2,773,410</u> | \$ <u>2,715,325</u> |
| Education | \$ <u>3,736,983</u> | \$ <u>3,689,377</u> |
| Health services | \$ <u>1,859,178</u> | \$ <u>1,809,580</u> |
| Public order and safety | \$ <u>63,160</u> | \$ <u>33,962</u> |
| Boards, commissions and other | \$ <u>940,065</u> | \$ <u>904,394</u> |
| Total primary government expenses | \$ <u>12,902,800</u> | \$ <u>12,647,368</u> |
| Net assets at the end of the year | \$ <u>30,865,517</u> | \$ <u>31,120,949</u> |
| Capital asset activities for the year ended September 30: | | |
| | <u>As Previously Reported</u> | <u>As restated</u> |
| Government activities: | | |
| Machinery, equipment, others | \$ <u>3,479,410</u> | \$ <u>4,333,698</u> |
| Less accumulated depreciation | \$ <u>(2,988,453)</u> | \$ <u>(3,587,309)</u> |
| | \$ <u>28,333,206</u> | \$ <u>28,588,638</u> |

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

**REQUIRED SUPPLEMENTARY INFORMATION-
OTHER THAN MANAGEMENT'S DISCUSSION AND ANALYSIS**

YEAR ENDED SEPTEMBER 30, 2008

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Schedule of Revenues, Expenditures and Changes in Deficit - Budget and Actual
General Fund
Year Ended September 30, 2008

| | <u>Budgeted Amounts</u> | | Actual - Budgetary | Variance with <u>Final Budget -</u> |
|--|-------------------------|-----------------------|-----------------------|--|
| | <u>Original</u> | <u>Final</u> | Basis (see Note 1) | |
| Revenues: | | | | |
| FSM revenue sharing | \$ 1,190,513 | \$ 1,092,705 | \$ 1,076,009 | \$ (16,696) |
| State taxes | 744,000 | 744,000 | 8,863 | (735,137) |
| Licenses and fees | - | - | 733,868 | 733,868 |
| Interest and dividends | - | - | 39,417 | 39,417 |
| Other | 163,914 | 220,000 | 219,278 | (722) |
| Total revenues | <u>2,098,427</u> | <u>2,056,705</u> | <u>2,077,435</u> | <u>20,730</u> |
| Expenditures: | | | | |
| Current: | | | | |
| General government | 1,122,912 | 1,189,154 | 1,426,426 | (237,272) |
| Economic development | 173,434 | 204,169 | 210,450 | (6,281) |
| Education | 17,257 | 17,307 | 16,359 | 948 |
| Public order and safety | 155,046 | 155,046 | 166,094 | (11,048) |
| Boards, commissions and other | 629,778 | 541,702 | 770,418 | (258,716) |
| Payments to Non-governmental Agencies | - | 30,000 | 30,000 | - |
| Total expenditures | <u>2,098,427</u> | <u>2,137,378</u> | <u>2,619,747</u> | <u>(512,369)</u> |
| Excess (deficiency) of revenues over (under) expenditures | <u>-</u> | <u>(80,673)</u> | <u>(542,312)</u> | <u>(491,639)</u> |
| Other financing sources: | | | | |
| Loan proceeds | - | - | 222,553 | (222,553) |
| Proceeds from sale of capital assets | - | - | 548,177 | (548,177) |
| Total other financing sources | <u>-</u> | <u>-</u> | <u>770,730</u> | <u>(770,730)</u> |
| Special items: | | | | |
| Write-off of receivables, net of recoveries | - | - | (176,846) | 176,846 |
| Net change in unreserved deficit | - | (80,673) | 51,572 | (314,793) |
| Other changes in unreserved deficit: | | | | |
| Increase in reserve for related assets | - | - | 157,020 | 157,020 |
| Increase in reserve for continuing appropriations | - | - | (6,000) | (6,000) |
| Unreserved deficit at the beginning of the year | <u>(1,242,303)</u> | <u>(1,242,303)</u> | <u>(1,242,303)</u> | <u>-</u> |
| Unreserved deficit at the end of the year | <u>\$ (1,242,303)</u> | <u>\$ (1,322,976)</u> | <u>\$ (1,039,711)</u> | <u>\$ (163,773)</u> |

See accompanying notes to required supplementary information - budgetary reporting.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Required Supplementary Information – Budgetary Reporting
September 30, 2008

(1) Budgetary Information

The Governor presents to the Kosrae State Legislature, prior to September 30, proposed budget estimates for the fiscal year commencing October 1. The budget estimates include the overall and total proposed expenditures of the State and the means of financing those expenditures. The Kosrae State Legislature reviews and approves these estimates making changes, as it deems appropriate. The Appropriation Committee of the Kosrae State Legislature, during the regular session of the Kosrae State Legislature, holds public hearings at which time Departments and Offices are required to justify their budget estimates. During the regular session of the Kosrae State Legislature, an appropriation bill, as required by the Constitution, is introduced and budget estimates are then legally enacted by the Kosrae State Legislature.

Formal budget integration is employed as a management control device during the year for all funds. The Kosrae State Legislature has the authority to reprogram budgeted estimates in accordance with the Constitution. All annual appropriations lapse at fiscal year end unless otherwise specified by law. Supplemental appropriations may occur throughout the year. Unexpended encumbrances at each fiscal year end are carried forward until they are expended or canceled without further legislative action. The State does not establish budgets for the operations of its other governmental funds.

Accounting principles used in developing data on a budgetary basis differ from those used in preparing the basic financial statements in conformity with GAAP. Amounts included on the Statement of Revenues, Expenditures, and Changes in Fund Deficit - Budget and Actual - General Fund (which are presented on a non-GAAP budgetary basis) are reconciled to unreserved deficit of the Governmental Fund Balance Sheet within the other changes in unreserved deficit section of that statement.

Encumbrance accounting is employed in governmental funds. For budgetary purposes, the encumbrances (i.e., purchase orders, contracts) are considered expenditures when incurred. For GAAP reporting purposes, encumbrances outstanding at year end are reported as reservations of fund balances and do not constitute expenditures or liabilities because the commitments will be reappropriated and honored during the subsequent fiscal year.

For the year ended September 30, 2008, expenditures of the General Fund exceeded budget at the program area level (i.e., the legal level of budgetary control) as follows:

| <u>Program Area</u> | <u>Excess</u> |
|-----------------------------------|---------------|
| Finance and Budget | \$ 312,797 |
| Transportation and Infrastructure | 30,665 |
| Retirement Program | 17,028 |
| Public Safety | 11,548 |
| Commerce and Industry | 5,258 |
| Legislative Branch | 2,645 |
| Other | 2,785 |
| Survey and Mapping | 1,820 |
| Housing | 673 |

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Required Supplementary Information – Budgetary Reporting, Continued
September 30, 2008

(2) Reconciliation - GAAP and Budgetary Bases of Accounting

Encumbrance accounting is employed in governmental funds. For budgetary purposes, the encumbrances (i.e., purchase orders, contracts) are considered expenditures when incurred. For GAAP reporting purposes, encumbrances outstanding at year end are reported as reservations of fund balances and do not constitute expenditures or liabilities because the commitments will be reappropriated and honored during the subsequent fiscal year.

Accounting principles used in developing data on a budgetary basis differ from those used in preparing the financial statements in conformity with GAAP. Amounts included on the Statement of Revenues, Expenditures, and Changes in Deficit - Budget and Actual - General Fund (which are presented on a non-GAAP budgetary basis) are reconciled to unreserved deficit of the Governmental Fund Balance Sheet within the other changes in unreserved deficit section of that statement. Furthermore, the net change in fund balance (deficit) to the net change in unreserved fund deficit for the General Fund is as follows:

| | |
|---------------------------------------|------------------|
| Net change in fund deficit | \$ 87,658 |
| Increase in encumbrances | <u>(36,086)</u> |
| Net change in unreserved fund deficit | \$ <u>51,572</u> |

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

OTHER SUPPLEMENTARY INFORMATION

YEAR ENDED SEPTEMBER 30, 2008

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Combining Schedule of Expenditures by Account
Governmental Funds
Year Ended September 30, 2008

| | General | Special Revenue | | Permanent | Other Governmental Funds | Total |
|--|---------------------|----------------------|--------------------------------|------------------|--------------------------------|----------------------|
| | | Grants Assistance | Early Retirement Program | Compact Trust | | |
| Expenditures: | | | | | | |
| Salaries and wages | \$ 1,254,039 | \$ 2,978,379 | \$ - | \$ - | \$ 60,227 | \$ 4,292,645 |
| Other personnel costs | 426,200 | 975,185 | - | - | 12,666 | 1,414,051 |
| Supplies and materials | 58,498 | 647,485 | - | - | 133,208 | 839,191 |
| Contractual services | 22,093 | 711,561 | - | - | 5,000 | 738,654 |
| Medical supplies | - | 340,329 | - | - | 331,689 | 672,018 |
| Travel | 155,535 | 299,999 | - | - | 350 | 455,884 |
| Scholarships | - | 410,837 | - | - | - | 410,837 |
| Utilities | 60,981 | 263,114 | - | - | 33,932 | 358,027 |
| Capital outlay | 38,611 | 238,851 | - | - | - | 277,462 |
| Benefits | 66,667 | 187,405 | - | - | 3,946 | 258,018 |
| Leased housing, building and land | 61,207 | 92,191 | - | - | 8,000 | 161,398 |
| POL | 25,330 | 104,620 | - | - | 8,682 | 138,632 |
| Training | 5,201 | 94,604 | - | - | - | 99,805 |
| Communications | 32,028 | 51,416 | - | - | 2,364 | 85,808 |
| Meeting and official allowance | 34,691 | 28,197 | - | - | 200 | 63,088 |
| Repairs and maintenance | 491 | 51,088 | - | - | - | 51,579 |
| Food stuffs | 14,396 | 32,223 | - | - | 2,000 | 48,619 |
| Principal repayment | - | - | 44,898 | - | - | 44,898 |
| Professional services | - | 34,725 | - | - | - | 34,725 |
| Contributions | 29,000 | - | - | - | - | 29,000 |
| Advertising, printing and reproduction | 4,406 | 17,007 | - | - | 924 | 22,337 |
| Rentals | 831 | 8,647 | - | - | - | 9,478 |
| Import charges | 188 | 8,018 | - | - | 140 | 8,346 |
| Bank charges | 4,234 | 2,346 | - | - | - | 6,580 |
| Medical referral stipend | - | 6,288 | - | - | - | 6,288 |
| Entertainment | - | - | - | - | 38 | 38 |
| Other | 289,034 | 8,612 | 82,922 | - | (398) | 380,170 |
| | <u>\$ 2,583,661</u> | <u>\$ 7,593,127</u> | <u>\$ 127,820</u> | <u>\$ -</u> | <u>\$ 602,968</u> | <u>\$ 10,907,576</u> |

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Statement of Revenues, Expenditures by Function, and Changes in Deficit
General Fund
Year Ended September 30, 2008
(with comparative totals for the year ended September 30, 2007)

| | 2008 | 2007 |
|---|-----------|-----------|
| Revenues: | | |
| FSM revenue sharing | 1,076,009 | 1,003,623 |
| State taxes: | | |
| Sales tax | 8,863 | 8,686 |
| Licenses and Fees | 733,868 | 354,351 |
| | 742,731 | 363,037 |
| Net increase in the fair value of investments | - | 161,830 |
| Interest and dividend income | 39,417 | - |
| Other | 219,278 | 76,293 |
| Total revenues | 2,077,435 | 1,604,783 |
| Expenditures: | | |
| Current: | | |
| General government: | | |
| Governor and staff | 199,639 | 181,969 |
| Department of Treasury and Administration | 310,649 | 42,460 |
| Judiciary Branch | 259,253 | 252,471 |
| Legislative Branch | 638,038 | 502,378 |
| Election | 2,879 | 19,949 |
| | 1,410,458 | 999,227 |
| Economic Development: | | |
| Office of the Director of Agriculture, Land and Fisheries | - | 57,979 |
| Commerce and Industry | - | 31,960 |
| Land Management and Preservation | 14,794 | 43,657 |
| Housing | 49,219 | 47,075 |
| Crop Production and Research | - | 31,865 |
| Livestock Production and Research | - | 7,816 |
| Survey and Mapping | 68,547 | 72,309 |
| Marine Surveillance | - | 32,814 |
| Fisheries Development | (68) | 49,296 |
| Foreign Investment | - | 8,107 |
| Consumer Services | - | 5,218 |
| Market and Research | - | 17,912 |
| USDA Rural Development | 67,451 | 340 |
| | 199,943 | 406,348 |
| Education: | | |
| Office of the Director | - | 270 |
| Scholarship Loan Collection | 16,359 | 14,385 |
| | 16,359 | 14,655 |
| Public Order and Safety: | | |
| Public safety | 165,594 | - |
| Parole board | 500 | 660 |
| | 166,094 | 660 |
| Environment Protection and Sanitation: | | |
| Division of Water and Wastewater | - | 50,630 |
| | - | 50,630 |

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Statement of Revenues, Expenditures by Function, and Changes in Deficit, Continued
General Fund
Year Ended September 30, 2008
(with comparative totals for the year ended September 30, 2007)

| | 2008 | 2007 |
|---|-------------|--------------|
| Expenditures, continued: | | |
| Current, continued: | | |
| Boards, Commissions and Other: | | |
| Transportation and Infrastructure | 340,219 | 235,675 |
| Community Affairs | 29,759 | 47,739 |
| Broadcast Authority | 44,997 | 45,007 |
| Sports Development | 17,469 | 33,533 |
| Retirement Program | 97,028 | 78,538 |
| RM Small Business Development Center | - | 10,685 |
| Other | 231,335 | 51,704 |
| | 760,807 | 502,881 |
| Payments to Non-governmental Agencies: | | |
| Micronesian Legal Services Corporation | 30,000 | - |
| | 30,000 | - |
| Total expenditures | 2,583,661 | 1,974,401 |
| Deficiency of revenues under expenditures | (506,226) | (369,618) |
| Other financing sources: | | |
| Proceeds from sale of capital assets | 548,177 | - |
| Loan proceeds | 222,553 | 1,500,000 |
| Operating transfers in | - | 1,951,315 |
| Total other financing sources | 770,730 | 3,451,315 |
| Special items: | | |
| Recovery of bad debts | 68,163 | 363,047 |
| Bad debts | (245,009) | - |
| | (176,846) | 363,047 |
| Net change in deficit | 87,658 | 3,444,744 |
| Deficit at the beginning of the year | (167,642) | (3,612,386) |
| Deficit at the end of the year | \$ (79,984) | \$ (167,642) |

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Statement of Revenues, Expenditures by Function and Changes in Deficit
Budget and Actual - General Fund
Year Ended September 30, 2008

| | Budgeted Amounts | | Actual Amounts Budgetary Basis | Variance |
|----------------------------------|------------------|------------------|---|------------------|
| | Original | Final | | |
| Revenues: | | | | |
| FSM revenue sharing: | \$ 1,190,513 | \$ 1,092,705 | \$ 1,076,009 | \$ (16,696) |
| State taxes: | | | | |
| Sales tax | 9,000 | 9,000 | 8,863 | (137) |
| Licences and fees | 735,000 | 735,000 | 733,868 | (1,132) |
| | <u>744,000</u> | <u>744,000</u> | <u>742,731</u> | <u>(1,269)</u> |
| Investment income and dividends | - | 39,500 | 39,417 | (83) |
| Other revenues | 163,914 | 220,000 | 219,278 | (722) |
| Total revenues | <u>2,098,427</u> | <u>2,096,205</u> | <u>2,077,435</u> | <u>(18,770)</u> |
| Expenditures: | | | | |
| Current: | | | | |
| General government: | | | | |
| Governor and staff | 163,941 | 217,182 | 201,730 | 15,452 |
| Finance and Budget | - | - | 312,797 | (312,797) |
| Judiciary Branch | 323,584 | 330,812 | 269,154 | 61,658 |
| Legislative Branch | 635,387 | 637,221 | 639,866 | (2,645) |
| Election | - | 3,939 | 2,879 | 1,060 |
| | <u>1,122,912</u> | <u>1,189,154</u> | <u>1,426,426</u> | <u>(237,272)</u> |
| Economic development: | | | | |
| Commerce and Industry | - | 377 | 5,635 | (5,258) |
| Land Management and Preservation | 15,000 | 15,000 | 14,794 | 206 |
| Housing | 54,787 | 53,036 | 53,709 | (673) |
| Survey and Mapping | 66,995 | 67,109 | 68,929 | (1,820) |
| Fisheries Development | - | 145 | (68) | 213 |
| USDA Rural Development | 36,652 | 68,502 | 67,451 | 1,051 |
| | <u>173,434</u> | <u>204,169</u> | <u>210,450</u> | <u>(6,281)</u> |
| Education: | | | | |
| Scholarship Loan Collection | 17,257 | 17,307 | 16,359 | 948 |
| | <u>17,257</u> | <u>17,307</u> | <u>16,359</u> | <u>948</u> |
| Public order and safety: | | | | |
| Public safety | 154,046 | 154,046 | 165,594 | (11,548) |
| Parole board | 1,000 | 1,000 | 500 | 500 |
| | <u>155,046</u> | <u>155,046</u> | <u>166,094</u> | <u>(11,048)</u> |

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Statement of Revenues, Expenditures by Function and Changes in Deficit, Continued
Budget and Actual - General Fund
Year Ended September 30, 2008

| | Budgeted Amounts | | Actual Amounts | Variance |
|---|-----------------------|-----------------------|-----------------------|-------------------|
| | Original | Final | Budgetary Basis | |
| Boards, commissions and other: | | | | |
| Transportation and Infrastructure | 316,694 | 317,556 | 348,221 | (30,665) |
| Community Affairs | - | 38,653 | 29,759 | 8,894 |
| Broadcast Authority | 46,709 | 47,032 | 46,606 | 426 |
| Sports Development | 22,461 | 22,461 | 17,469 | 4,992 |
| Retirement Program | 80,000 | 80,000 | 97,028 | (17,028) |
| Kosrae Port Authority | 163,914 | - | - | - |
| Other | - | 6,000 | 231,335 | (225,335) |
| | <u>629,778</u> | <u>511,702</u> | <u>770,418</u> | <u>(258,716)</u> |
| Payments to Non-governmental Agencies: | | | | |
| Micronesia Legal Services Corporation | - | 30,000 | 30,000 | - |
| | <u>-</u> | <u>30,000</u> | <u>30,000</u> | <u>-</u> |
| Total expenditures | <u>2,098,427</u> | <u>2,107,378</u> | <u>2,619,747</u> | <u>(512,369)</u> |
| Deficiency of revenues under expenditures | - | (11,173) | (542,312) | 531,139 |
| Other financing sources: | | | | |
| Loan proceeds | - | - | 222,553 | (222,553) |
| Proceeds from sale of capital assets | - | - | 548,177 | (548,177) |
| | <u>-</u> | <u>-</u> | <u>770,730</u> | <u>(770,730)</u> |
| Special items: | | | | |
| Bad debts, net of recoveries | - | - | (176,846) | 176,846 |
| Net change in unreserved deficit | - | (11,173) | 51,572 | 707,985 |
| Other changes in unreserved deficit: | | | | |
| Increase in reserve for related assets | - | - | 157,020 | 157,020 |
| Decrease in reserve for continuing appropriations | - | - | (6,000) | (6,000) |
| Unreserved deficit at the beginning of the year | (1,242,303) | (1,242,303) | (1,242,303) | - |
| Unreserved deficit at the end of the year | <u>\$ (1,242,303)</u> | <u>\$ (1,253,476)</u> | <u>\$ (1,039,711)</u> | <u>\$ 859,005</u> |

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Combined Balance Sheet
Nonmajor Governmental Funds
September 30, 2008

| | <u>Other Special Revenue</u> | <u>Other Capital Projects</u> | <u>Total</u> |
|--------------------------------------|----------------------------------|-----------------------------------|---------------------|
| <u>ASSETS</u> | | | |
| Receivables: | | | |
| Loans | \$ 174,479 | \$ - | \$ 174,479 |
| Due from other funds | 805,511 | 91,333 | 896,844 |
| Restricted assets: | | | |
| Cash and cash equivalents | 47,672 | - | 47,672 |
| Time certificates of deposit | 354,383 | - | 354,383 |
| Total assets | <u>\$ 1,382,045</u> | <u>\$ 91,333</u> | <u>\$ 1,473,378</u> |
| <u>LIABILITIES AND FUND BALANCES</u> | | | |
| Liabilities: | | | |
| Accounts payable | \$ 246,902 | \$ 5,050 | \$ 251,952 |
| Due to other funds | 2,977 | - | 2,977 |
| Deferred revenue | - | 33 | 33 |
| Total liabilities | <u>249,879</u> | <u>5,083</u> | <u>254,962</u> |
| Fund balances: | | | |
| Reserved for: | | | |
| Related assets | 576,534 | - | 576,534 |
| Encumbrances | 279,410 | - | 279,410 |
| Unreserved: | | | |
| Special revenue funds | 276,222 | - | 276,222 |
| Capital projects funds | - | 86,250 | 86,250 |
| Total fund balances | <u>1,132,166</u> | <u>86,250</u> | <u>1,218,416</u> |
| Total liabilities and fund balances | <u>\$ 1,382,045</u> | <u>\$ 91,333</u> | <u>\$ 1,473,378</u> |

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Combined Statement of Revenues, Expenditures by Account,
and Changes in Fund Balances
Nonmajor Governmental Funds
Year Ended September 30, 2008

| | <u>Other Special Revenue</u> | <u>Other Capital Projects</u> | <u>Total</u> |
|--|----------------------------------|-----------------------------------|---------------------|
| Revenues: | | | |
| Fees and charges | \$ 411,740 | \$ - | \$ 411,740 |
| CFSM grants | - | 125,000 | 125,000 |
| Interest income | 72,158 | - | 72,158 |
| Total revenues | <u>483,898</u> | <u>125,000</u> | <u>608,898</u> |
| Expenditures by account: | | | |
| Medical supplies | 331,689 | - | 331,689 |
| Supplies and materials | 124,958 | 8,250 | 133,208 |
| Salaries and wages | 46,146 | 14,081 | 60,227 |
| Utilities | 31,032 | 2,900 | 33,932 |
| Other personnel costs | 12,666 | - | 12,666 |
| Leased housing and land | - | 8,000 | 8,000 |
| POL | 6,438 | 2,244 | 8,682 |
| Contractual services | 5,000 | - | 5,000 |
| Benefits | 3,946 | - | 3,946 |
| Communications | 1,864 | 500 | 2,364 |
| Food stuffs | - | 2,000 | 2,000 |
| Advertising, printing and reproduction | 149 | 775 | 924 |
| Travel | 350 | - | 350 |
| Meeting and official allowance | 200 | - | 200 |
| Rentals | 140 | - | 140 |
| Import charges | 38 | - | 38 |
| Other | (398) | - | (398) |
| Total expenditures | <u>564,218</u> | <u>38,750</u> | <u>602,968</u> |
| Net change in fund balances | (80,320) | 86,250 | 5,930 |
| Fund balances at the beginning of the year | <u>1,212,486</u> | <u>-</u> | <u>1,212,486</u> |
| Fund balances at the end of the year | <u>\$ 1,132,166</u> | <u>\$ 86,250</u> | <u>\$ 1,218,416</u> |

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Combined Statement of Revenues, Expenditures by Function,
and Changes in Fund Balances
Nonmajor Governmental Funds
Year Ended September 30, 2008

| | <u>Other Special Revenue</u> | <u>Other Capital Projects</u> | <u>Total</u> |
|--|----------------------------------|-----------------------------------|---------------------|
| Revenues: | | | |
| Fees and charges | \$ 411,740 | \$ - | \$ 411,740 |
| CFSM grants | - | 125,000 | 125,000 |
| Interest income | 72,158 | - | 72,158 |
| | <u>483,898</u> | <u>125,000</u> | <u>608,898</u> |
| Total revenues | | | |
| Expenditures by function: | | | |
| Current: | | | |
| Economic development | - | 25,000 | 25,000 |
| Health services | 336,689 | - | 336,689 |
| Public order and safety | - | 13,750 | 13,750 |
| Environment protection and sanitation | 115,560 | - | 115,560 |
| Boards, commissions and other | 112,287 | - | 112,287 |
| | <u>564,218</u> | <u>38,750</u> | <u>602,968</u> |
| Total expenditures | | | |
| Net change in fund balances | (80,320) | 86,250 | 5,930 |
| Fund balances at the beginning of the year | <u>1,212,486</u> | <u>-</u> | <u>1,212,486</u> |
| Fund balances at the end of the year | <u>\$ 1,132,166</u> | <u>\$ 86,250</u> | <u>\$ 1,218,416</u> |

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA
NONMAJOR GOVERNMENTAL FUNDS
SPECIAL REVENUE FUNDS

Combining Balance Sheet
September 30, 2008

| | Airport Revolving | Production Loan | Scholarship Revolving Loan | Housing Revolving | Aluminum Recycling | Health Care | Sports Council | Broadcast Authority | Gifford Scholarship | Transportation Infrastructure Revolving | Total |
|--|----------------------|--------------------|----------------------------------|----------------------|-----------------------|-------------------|-------------------|------------------------|------------------------|---|---------------------|
| ASSETS | | | | | | | | | | | |
| Receivables: | | | | | | | | | | | |
| Loans | \$ - | \$ - | \$ - | \$ 174,479 | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 174,479 |
| Due from other funds | - | 1,495 | 3,918 | 340,856 | 164,220 | 264,617 | 602 | 3,335 | - | 26,468 | 805,511 |
| Restricted: | | | | | | | | | | | |
| Cash and equivalents | - | - | - | - | - | - | - | - | 47,672 | - | 47,672 |
| Time certificates of deposit | - | - | - | - | - | - | - | - | 354,383 | - | 354,383 |
| Total assets | \$ - | \$ 1,495 | \$ 3,918 | \$ 515,335 | \$ 164,220 | \$ 264,617 | \$ 602 | \$ 3,335 | \$ 402,055 | \$ 26,468 | \$ 1,382,045 |
| LIABILITIES AND FUND BALANCES | | | | | | | | | | | |
| LIABILITIES | | | | | | | | | | | |
| Liabilities: | | | | | | | | | | | |
| Accounts payable | \$ - | \$ - | \$ - | \$ 35,685 | \$ 2,908 | \$ 206,689 | \$ - | \$ - | \$ - | \$ 1,620 | \$ 246,902 |
| Due to other funds | - | - | - | - | - | - | - | - | 2,977 | - | 2,977 |
| Total liabilities | - | - | - | 35,685 | 2,908 | 206,689 | - | - | 2,977 | 1,620 | 249,879 |
| FUND BALANCES | | | | | | | | | | | |
| Fund balances: | | | | | | | | | | | |
| Reserved for: | | | | | | | | | | | |
| Related assets | - | - | - | 174,479 | - | - | - | - | 402,055 | - | 576,534 |
| Encumbrances | 3,751 | - | - | 264,639 | - | - | - | - | - | 11,020 | 279,410 |
| Unreserved (deficit) | (3,751) | 1,495 | 3,918 | 40,532 | 161,312 | 57,928 | 602 | 3,335 | (2,977) | 13,828 | 276,222 |
| Total fund balances | - | 1,495 | 3,918 | 479,650 | 161,312 | 57,928 | 602 | 3,335 | 399,078 | 24,848 | 1,132,166 |
| Total liabilities and fund balances | \$ - | \$ 1,495 | \$ 3,918 | \$ 515,335 | \$ 164,220 | \$ 264,617 | \$ 602 | \$ 3,335 | \$ 402,055 | \$ 26,468 | \$ 1,382,045 |

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
 FEDERATED STATES OF MICRONESIA
 NONMAJOR GOVERNMENTAL FUNDS
 SPECIAL REVENUE FUNDS

Combining Statement of Revenues, Expenditures By Function,
 and Changes in Fund Balances (Deficits)
 Year Ended September 30, 2008

| | Airport Revolving | Production Loan | Scholarship Revolving Loan | Housing Revolving | Aluminum Recycling | Health Care | Sports Council | Broadcast Authority | Gifford Scholarship | Transportation Infrastructure Revolving | Total |
|--|----------------------|--------------------|----------------------------------|----------------------|-----------------------|------------------|-------------------|------------------------|------------------------|---|---------------------|
| Revenues: | | | | | | | | | | | |
| Fees and charges | \$ 147,055 | \$ - | \$ - | \$ - | \$ 110,769 | \$ 125,091 | \$ 100 | \$ 2,257 | \$ - | \$ 26,468 | \$ 411,740 |
| Interest income | - | - | - | 61,800 | 449 | 266 | - | - | 9,643 | - | 72,158 |
| Total revenues | <u>147,055</u> | <u>-</u> | <u>-</u> | <u>61,800</u> | <u>111,218</u> | <u>125,357</u> | <u>100</u> | <u>2,257</u> | <u>9,643</u> | <u>26,468</u> | <u>483,898</u> |
| Expenditures by function: | | | | | | | | | | | |
| Current: | | | | | | | | | | | |
| Education | - | - | (318) | - | - | - | - | - | - | - | (318) |
| Health services | - | - | - | - | - | 336,689 | - | - | - | - | 336,689 |
| Environment protection and sanitation | - | - | - | - | 115,560 | - | - | - | - | - | 115,560 |
| Boards, commissions and other | 107,089 | - | - | - | - | - | - | 3,578 | - | 1,620 | 112,287 |
| Total expenditures | <u>107,089</u> | <u>-</u> | <u>(318)</u> | <u>-</u> | <u>115,560</u> | <u>336,689</u> | <u>-</u> | <u>3,578</u> | <u>-</u> | <u>1,620</u> | <u>564,218</u> |
| Net change in fund balances (deficits) | 39,966 | - | 318 | 61,800 | (4,342) | (211,332) | 100 | (1,321) | 9,643 | 24,848 | (80,320) |
| Fund balances (deficits) at the beginning of the year | <u>(39,966)</u> | <u>1,495</u> | <u>3,600</u> | <u>417,850</u> | <u>165,654</u> | <u>269,260</u> | <u>502</u> | <u>4,656</u> | <u>389,435</u> | <u>-</u> | <u>1,212,486</u> |
| Fund balances at the end of the year | <u>\$ -</u> | <u>\$ 1,495</u> | <u>\$ 3,918</u> | <u>\$ 479,650</u> | <u>\$ 161,312</u> | <u>\$ 57,928</u> | <u>\$ 602</u> | <u>\$ 3,335</u> | <u>\$ 399,078</u> | <u>\$ 24,848</u> | <u>\$ 1,132,166</u> |

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
 FEDERATED STATES OF MICRONESIA
 NONMAJOR GOVERNMENTAL FUNDS
 SPECIAL REVENUE FUNDS

Combining Statement of Revenues, Expenditures By Account,
 and Changes in Fund Balances (Deficits)
 Year Ended September 30, 2008

| | Airport Revolving | Production Loan | Scholarship Revolving Loan | Housing Revolving | Aluminum Recycling | Health Care | Sports Council | Broadcast Authority | Gifford Scholarship | Transportation Infrastructure Revolving | Total |
|---|----------------------|--------------------|----------------------------------|----------------------|-----------------------|------------------|-------------------|------------------------|------------------------|---|---------------------|
| Revenues: | | | | | | | | | | | |
| Fees and charges | \$ 147,055 | \$ - | \$ - | \$ - | \$ 110,769 | \$ 125,091 | \$ 100 | \$ 2,257 | \$ - | \$ 26,468 | \$ 411,740 |
| Interest income | - | - | - | 61,800 | 449 | 266 | - | - | 9,643 | - | 72,158 |
| Total revenues | <u>147,055</u> | <u>-</u> | <u>-</u> | <u>61,800</u> | <u>111,218</u> | <u>125,357</u> | <u>100</u> | <u>2,257</u> | <u>9,643</u> | <u>26,468</u> | <u>483,898</u> |
| Expenditures by account: | | | | | | | | | | | |
| Medical supplies | - | - | - | - | - | 331,689 | - | - | - | - | 331,689 |
| Supplies and materials | 8,212 | - | - | - | 115,560 | - | - | 1,186 | - | - | 124,958 |
| Salaries and wages | 46,146 | - | - | - | - | - | - | - | - | - | 46,146 |
| Utilities | 28,789 | - | - | - | - | - | - | 2,243 | - | - | 31,032 |
| Other personnel costs | 12,666 | - | - | - | - | - | - | - | - | - | 12,666 |
| Contractual services | - | - | - | - | - | 5,000 | - | - | - | - | 5,000 |
| POL | 4,818 | - | - | - | - | - | - | - | - | 1,620 | 6,438 |
| Benefits | 3,946 | - | - | - | - | - | - | - | - | - | 3,946 |
| Communications | 1,864 | - | - | - | - | - | - | - | - | - | 1,864 |
| Travel | 350 | - | - | - | - | - | - | - | - | - | 350 |
| Meeting and official allowance | 200 | - | - | - | - | - | - | - | - | - | 200 |
| Advertising, printing and reproduction | - | - | - | - | - | - | - | 149 | - | - | 149 |
| Rentals | 140 | - | - | - | - | - | - | - | - | - | 140 |
| Import charges | 38 | - | - | - | - | - | - | - | - | - | 38 |
| Other | (80) | - | (318) | - | - | - | - | - | - | - | (398) |
| Total expenditures | <u>107,089</u> | <u>-</u> | <u>(318)</u> | <u>-</u> | <u>115,560</u> | <u>336,689</u> | <u>-</u> | <u>3,578</u> | <u>-</u> | <u>1,620</u> | <u>564,218</u> |
| Net change in fund balances (deficits) | 39,966 | - | 318 | 61,800 | (4,342) | (211,332) | 100 | (1,321) | 9,643 | 24,848 | (80,320) |
| Fund balances (deficits) at the beginning of the year | <u>(39,966)</u> | <u>1,495</u> | <u>3,600</u> | <u>417,850</u> | <u>165,654</u> | <u>269,260</u> | <u>502</u> | <u>4,656</u> | <u>389,435</u> | <u>-</u> | <u>1,212,486</u> |
| Fund balances at the end of the year | <u>\$ -</u> | <u>\$ 1,495</u> | <u>\$ 3,918</u> | <u>\$ 479,650</u> | <u>\$ 161,312</u> | <u>\$ 57,928</u> | <u>\$ 602</u> | <u>\$ 3,335</u> | <u>\$ 399,078</u> | <u>\$ 24,848</u> | <u>\$ 1,132,166</u> |

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
 FEDERATED STATES OF MICRONESIA
 NONMAJOR GOVERNMENTAL FUNDS
 CAPITAL PROJECTS FUND

Combining Balance Sheet
 September 30, 2008

| | <u>CFSM Projects</u> |
|-------------------------------------|--------------------------|
| <u>ASSETS</u> | |
| Due from other funds | \$ 91,333 |
| | <u>\$ 91,333</u> |
| <u>LIABILITIES</u> | |
| Liabilities: | |
| Accounts payable | \$ 5,050 |
| Deferred revenue | <u>33</u> |
| Total liabilities | <u>5,083</u> |
| Fund balances: | |
| Unreserved | <u>86,250</u> |
| Total fund balances | <u>86,250</u> |
| Total liabilities and fund balances | <u>\$ 91,333</u> |

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
 FEDERATED STATES OF MICRONESIA
 NONMAJOR GOVERNMENTAL FUNDS
 CAPITAL PROJECTS FUND

Combining Statement of Revenues, Expenditures by Function,
 and Changes in Fund Balances
 Year Ended September 30, 2008

| | <u>CFSM Projects</u> |
|--|--------------------------|
| Revenues: | |
| CFSM grants | \$ <u>125,000</u> |
| | <u>125,000</u> |
| Expenditures by function: | |
| General government | 13,750 |
| Public order and safety | <u>25,000</u> |
| Total expenditures | <u>38,750</u> |
| Net change in fund balances | <u>86,250</u> |
| Fund balances at the beginning of the year | <u>-</u> |
| Fund balances at the end of the year | <u><u>\$ 86,250</u></u> |

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
 FEDERATED STATES OF MICRONESIA
 NONMAJOR GOVERNMENTAL FUNDS
 CAPITAL PROJECTS FUND

Combining Statement of Revenues, Expenditures by Account,
 and Changes in Fund Balances
 Year Ended September 30, 2008

| | <u>CFSM Projects</u> |
|--|--------------------------|
| Revenues: | |
| CFSM grants | \$ 125,000 |
| | <u>125,000</u> |
| Expenditures by account: | |
| Salaries and wages | 14,081 |
| Supplies and materials | 8,250 |
| Leased housing and land | 8,000 |
| Utilities | 2,900 |
| POL | 2,244 |
| Food stuffs | 2,000 |
| Advertising, printing and reproduction | 775 |
| Communications | <u>500</u> |
| Total expenditures | <u>38,750</u> |
| Net change in fund balances | 86,250 |
| Fund balances at the beginning of the year | <u>-</u> |
| Fund balances at the end of the year | <u>\$ 86,250</u> |

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

GRANTS ASSISTANCE FUND

Combining Balance Sheet
September 30, 2008

| | Section 211(a)(1) Education Sector | Section 211(a)(2) Health Sector | Section 211(a)(3) Private Sector Development | Section 211(a)(4) Capacity Building | Section 211(a)(5) Environment |
|--|---|--|---|--|-------------------------------------|
| <u>ASSETS</u> | | | | | |
| Investments | \$ - | \$ - | \$ - | \$ - | \$ - |
| Receivables: | | | | | |
| Federal agencies | 199,154 | - | 226,971 | - | - |
| Prepaid | - | 5,009 | 3,229 | 2,226 | 1,640 |
| Advances | 6,298 | 131,655 | 671 | 3,855 | - |
| Due from other funds | - | 229,660 | - | 370,880 | 49,723 |
| | <u>\$ 205,452</u> | <u>\$ 366,324</u> | <u>\$ 230,871</u> | <u>\$ 376,961</u> | <u>\$ 51,363</u> |
| <u>LIABILITIES AND FUND BALANCES</u> | | | | | |
| Liabilities: | | | | | |
| Accounts payable | \$ 47,916 | \$ 312,439 | \$ 28,826 | \$ 25,455 | \$ 13,581 |
| Other liabilities and accruals | 11,332 | 5,915 | 1,887 | 2,710 | 968 |
| Due to other funds | 146,204 | - | 200,158 | - | - |
| Deferred revenues | - | - | - | - | - |
| Total liabilities | <u>205,452</u> | <u>318,354</u> | <u>230,871</u> | <u>28,165</u> | <u>14,549</u> |
| Fund balances: | | | | | |
| Reserved for: | | | | | |
| Related assets | - | 5,009 | 3,229 | 2,226 | 1,640 |
| Continuing appropriation | - | - | - | - | - |
| Encumbrances | 167,055 | 478,974 | 45,108 | 38,261 | 3,502 |
| Unreserved (deficits) | <u>(167,055)</u> | <u>(436,013)</u> | <u>(48,337)</u> | <u>308,309</u> | <u>31,672</u> |
| Total fund balances | <u>-</u> | <u>47,970</u> | <u>-</u> | <u>348,796</u> | <u>36,814</u> |
| Total liabilities and fund balances | <u>\$ 205,452</u> | <u>\$ 366,324</u> | <u>\$ 230,871</u> | <u>\$ 376,961</u> | <u>\$ 51,363</u> |

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

GRANTS ASSISTANCE FUND

Combining Balance Sheet, Continued
September 30, 2008

| | <u>Section 211(a)(6) Infrastructure</u> | <u>Section 211(a)(7) Supplemental Education</u> | <u>U.S. Federal Grants</u> | <u>Compact Capital Projects</u> | <u>Foreign Assistance</u> |
|---|---|---|------------------------------------|---|-------------------------------|
| <u>ASSETS</u> | | | | | |
| Investments | \$ - | \$ - | \$ - | \$ 800,000 | \$ 100,000 |
| Receivables: | | | | | |
| Federal agencies | 8,615 | 427,925 | - | - | - |
| Prepaid | | 8,458 | | | - |
| Advances | - | - | 42,675 | - | - |
| Due from other funds | <u>106,245</u> | <u>-</u> | <u>51,772</u> | <u>20,924</u> | <u>138,412</u> |
| | <u>\$ 114,860</u> | <u>\$ 436,383</u> | <u>\$ 94,447</u> | <u>\$ 820,924</u> | <u>\$ 238,412</u> |
| <u>LIABILITIES AND FUND BALANCES</u> | | | | | |
| <u>Liabilities:</u> | | | | | |
| Accounts payable | \$ 5,860 | \$ 24,418 | \$ 23,617 | \$ - | \$ 3,720 |
| Other liabilities and accruals | - | 1,997 | 4,665 | - | 43 |
| Due to other funds | - | 409,968 | - | - | - |
| Deferred revenues | <u>-</u> | <u>-</u> | <u>66,165</u> | <u>-</u> | <u>82,440</u> |
| Total liabilities | <u>5,860</u> | <u>436,383</u> | <u>94,447</u> | <u>-</u> | <u>86,203</u> |
| <u>Fund balances:</u> | | | | | |
| Reserved for: | | | | | |
| Related assets | - | 8,458 | - | 800,000 | 100,000 |
| Continuing appropriation | - | - | - | - | 176,563 |
| Encumbrances | - | 137,339 | 68,113 | 58,963 | 15,484 |
| Unreserved (deficits) | <u>109,000</u> | <u>(145,797)</u> | <u>(68,113)</u> | <u>(38,039)</u> | <u>(139,838)</u> |
| Total fund balances | <u>109,000</u> | <u>-</u> | <u>-</u> | <u>820,924</u> | <u>152,209</u> |
| Total liabilities and fund balances | <u>\$ 114,860</u> | <u>\$ 436,383</u> | <u>\$ 94,447</u> | <u>\$ 820,924</u> | <u>\$ 238,412</u> |

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

GRANTS ASSISTANCE FUND

Combining Balance Sheet, Continued
September 30, 2008

| | Compact Special Block 211(b) | Compact Health & Medical 216(a)(2) | Compact Scholarship 216(a)(3) | Compact Energy Block Grant 214 | Compact Special Development 212(b) | Total |
|--|------------------------------------|---|-------------------------------------|---|---|---------------------|
| <u>ASSETS</u> | | | | | | |
| Investments | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 900,000 |
| Receivables: | | | | | | |
| Federal agencies | - | - | - | - | - | 862,665 |
| Prepaid | - | - | - | - | - | 20,562 |
| Advances | - | - | - | - | - | 185,154 |
| Due from other funds | 19,867 | 143,730 | - | 153 | 8,880 | 1,140,246 |
| | <u>\$ 19,867</u> | <u>\$ 143,730</u> | <u>\$ -</u> | <u>\$ 153</u> | <u>\$ 8,880</u> | <u>\$ 3,108,627</u> |
| <u>LIABILITIES AND FUND BALANCES</u> | | | | | | |
| <u>Liabilities:</u> | | | | | | |
| Accounts payable | \$ - | \$ 489 | \$ - | \$ 153 | \$ - | \$ 486,474 |
| Other liabilities and accruals | - | - | - | - | - | 29,517 |
| Due to other funds | - | - | - | - | - | 756,330 |
| Deferred revenues | - | - | - | - | - | 148,605 |
| | <u>-</u> | <u>489</u> | <u>-</u> | <u>153</u> | <u>-</u> | <u>1,420,926</u> |
| Fund balances: | | | | | | |
| Reserved for: | | | | | | |
| Related assets | - | - | - | - | - | 920,562 |
| Continuing appropriation | - | - | - | - | - | 176,563 |
| Encumbrances | - | - | 2,461 | - | 348 | 1,015,608 |
| Unreserved (deficits) | 19,867 | 143,241 | (2,461) | - | 8,532 | (425,032) |
| | <u>19,867</u> | <u>143,241</u> | <u>-</u> | <u>-</u> | <u>8,880</u> | <u>1,687,701</u> |
| Total fund balances | <u>19,867</u> | <u>143,241</u> | <u>-</u> | <u>-</u> | <u>8,880</u> | <u>1,687,701</u> |
| Total liabilities and fund balances | <u>\$ 19,867</u> | <u>\$ 143,730</u> | <u>\$ -</u> | <u>\$ 153</u> | <u>\$ 8,880</u> | <u>\$ 3,108,627</u> |

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

GRANTS ASSISTANCE FUND

Combining Statement of Revenues, Expenditures by Account,
and Changes in Fund Balances
Year Ended September 30, 2008

| | Section 211(a)(1) Education Sector | Section 211(a)(2) Health Sector | Section 211(a)(3) Private Sector Development | Section 211(a)(4) Capacity Building | Section 211(a)(5) Environment |
|--|---|--|---|--|-------------------------------------|
| Revenues: | | | | | |
| Compact funding | \$ 2,277,046 | \$ 1,374,185 | \$ 521,828 | \$ 1,465,007 | \$ 208,550 |
| Federal contributions | - | - | - | - | - |
| Other grants | - | - | - | - | - |
| Interest income | - | - | - | - | - |
| | <u>2,277,046</u> | <u>1,374,185</u> | <u>521,828</u> | <u>1,465,007</u> | <u>208,550</u> |
| Expenditures by function: | | | | | |
| Current: | | | | | |
| General government | - | - | - | 1,194,412 | - |
| Economic development | - | - | 547,057 | - | 195,788 |
| Education | 2,277,047 | - | - | - | - |
| Health services | - | 1,779,461 | - | - | - |
| Environment protection and sanitation | - | - | - | - | - |
| Boards, commissions, and other | - | - | - | - | - |
| | <u>2,277,047</u> | <u>1,779,461</u> | <u>547,057</u> | <u>1,194,412</u> | <u>195,788</u> |
| Total expenditures | <u>2,277,047</u> | <u>1,779,461</u> | <u>547,057</u> | <u>1,194,412</u> | <u>195,788</u> |
| Net change in fund balances | (1) | (405,276) | (25,229) | 270,595 | 12,762 |
| Fund balances at the beginning of the year | <u>1</u> | <u>453,246</u> | <u>25,229</u> | <u>78,201</u> | <u>24,052</u> |
| Fund balances at the end of the year | <u>\$ -</u> | <u>\$ 47,970</u> | <u>\$ -</u> | <u>\$ 348,796</u> | <u>\$ 36,814</u> |

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

GRANTS ASSISTANCE FUND

Combining Statement of Revenues, Expenditures by Account,
and Changes in Fund Balances, Continued
Year Ended September 30, 2008

| | Section 211(a)(6) <u>Infrastructure</u> | Section 211(a)(7) Supplemental <u>Education</u> | U.S. Federal <u>Grants</u> | Compact Capital <u>Projects</u> | Foreign <u>Assistance</u> |
|--|---|--|----------------------------------|---------------------------------------|------------------------------|
| Revenues: | | | | | |
| Compact funding | \$ 117,615 | \$ 1,010,663 | \$ - | \$ - | \$ - |
| Federal contributions | - | - | 155,458 | - | - |
| Other grants | - | - | - | - | 293,880 |
| Interest income | - | - | 345 | 20,924 | 46 |
| | <u>117,615</u> | <u>1,010,663</u> | <u>155,803</u> | <u>20,924</u> | <u>293,926</u> |
| Expenditures by function: | | | | | |
| Current: | | | | | |
| General government | 8,615 | - | 23,406 | - | 293,926 |
| Economic development | - | - | - | - | - |
| Education | - | 1,138,026 | 6,539 | - | - |
| Health services | - | - | 18,649 | - | - |
| Environment protection and sanitation | - | - | 23,438 | - | - |
| Boards, commissions, and other | - | - | 82,170 | - | - |
| | <u>8,615</u> | <u>1,138,026</u> | <u>154,202</u> | <u>-</u> | <u>293,926</u> |
| Total expenditures | <u>8,615</u> | <u>1,138,026</u> | <u>154,202</u> | <u>-</u> | <u>293,926</u> |
| Net change in fund balances | 109,000 | (127,363) | 1,601 | 20,924 | - |
| Fund balances at the beginning of the year | <u>-</u> | <u>127,363</u> | <u>(1,601)</u> | <u>800,000</u> | <u>152,209</u> |
| Fund balances at the end of the year | <u>\$ 109,000</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 820,924</u> | <u>\$ 152,209</u> |

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

GRANTS ASSISTANCE FUND

Combining Statement of Revenues, Expenditures by Account,
and Changes in Fund Balances, Continued
Year Ended September 30, 2008

| | Compact Special Block 211(b) | Compact Health & Medical 216(a)(2) | Compact Scholarship 216(a)(3) | Compact Energy Block Grant 214 | Compact Special Development 212(b) | Total |
|--|------------------------------------|---|-------------------------------------|---|---|---------------------|
| Revenues: | | | | | | |
| Compact funding | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 6,974,894 |
| Federal contributions | - | - | - | - | - | 155,458 |
| Other grants | - | - | - | - | - | 293,880 |
| Interest income | - | - | - | - | - | 21,315 |
| | <u>-</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>7,445,547</u> |
| Expenditures by function: | | | | | | |
| Current: | | | | | | |
| General government | - | - | - | - | - | 1,520,359 |
| Economic development | - | 4,593 | - | - | - | 747,438 |
| Education | - | - | - | - | - | 3,421,612 |
| Health services | - | - | - | - | - | 1,798,110 |
| Environment protection and sanitation | - | - | - | - | - | 23,438 |
| Boards, commissions, and other | - | - | - | - | - | 82,170 |
| | <u>-</u> | <u>4,593</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>7,593,127</u> |
| Total expenditures | - | 4,593 | - | - | - | 7,593,127 |
| Net change in fund balances | - | (4,593) | - | - | - | (147,580) |
| Fund balances at the beginning of the year | <u>19,867</u> | <u>147,834</u> | <u>-</u> | <u>-</u> | <u>8,880</u> | <u>1,835,281</u> |
| Fund balances at the end of the year | <u>\$ 19,867</u> | <u>\$ 143,241</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 8,880</u> | <u>\$ 1,687,701</u> |

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

GRANTS ASSISTANCE FUND

Combining Statement of Revenues, Expenditures by Account,
and Changes in Fund Balances
Year Ended September 30, 2008

| | Section 211(a)(1) Education Sector | Section 211(a)(2) Health Sector | Section 211(a)(3) Private Sector Development | Section 211(a)(4) Capacity Building | Section 211(a)(5) Environment |
|--|---|--|---|--|-------------------------------------|
| Revenues: | | | | | |
| Compact funding | \$ 2,277,046 | \$ 1,374,185 | \$ 521,828 | \$ 1,465,007 | \$ 208,550 |
| Federal contributions | - | - | - | - | - |
| Other grants | - | - | - | - | - |
| Interest income | - | - | - | - | - |
| | <u>2,277,046</u> | <u>1,374,185</u> | <u>521,828</u> | <u>1,465,007</u> | <u>208,550</u> |
| Expenditures by account: | | | | | |
| Salaries and wages | 1,394,007 | 859,884 | 246,157 | 378,360 | 123,383 |
| Other personnel costs | 2,618 | - | 545 | 498,200 | 1,200 |
| Contractual services | 54,739 | 71,805 | 104,558 | 14,780 | 12,919 |
| Supplies and materials | 310,783 | 67,814 | 33,755 | 44,594 | 14,065 |
| Scholarship | 199,000 | - | - | - | - |
| Medical supplies | - | 340,329 | - | - | - |
| Travel | 10,328 | 64,106 | 81,702 | 47,821 | 9,890 |
| Utilities | 87,140 | 128,556 | 13,472 | 17,531 | 6,641 |
| Capital outlay | 31,612 | 101,573 | 12,725 | 6,850 | - |
| Benefits | 91,090 | 45,087 | 14,595 | 16,373 | 8,325 |
| POL | 30,550 | 6,244 | 11,874 | 14,386 | 7,791 |
| Training | - | - | 825 | 78,846 | - |
| Leased housing/land | 45,907 | 18,382 | 2,338 | 12,207 | 3,795 |
| Communications | 3,138 | 5,605 | 9,744 | 15,598 | 4,010 |
| Repairs and maintenance | 9,022 | 13,196 | 738 | 16,092 | 935 |
| Professional services | - | 4,125 | 9,380 | 17,220 | - |
| Food stuffs | 817 | 27,409 | - | (348) | - |
| Meeting and official allowance | 1,400 | - | 720 | 8,000 | 1,220 |
| Advertising, printing and reproduction | 350 | 11,582 | 498 | 1,769 | 395 |
| Rentals | 17 | 250 | 2,599 | 3,786 | 55 |
| Other | 2 | 7,226 | 832 | 45 | - |
| Import charges | 4,527 | - | - | - | 1,164 |
| Medical referral stipend | - | 6,288 | - | - | - |
| Bank charges | - | - | - | 2,302 | - |
| | <u>2,277,047</u> | <u>1,779,461</u> | <u>547,057</u> | <u>1,194,412</u> | <u>195,788</u> |
| Net change in fund balances | (1) | (405,276) | (25,229) | 270,595 | 12,762 |
| Fund balances at the beginning of the year | <u>1</u> | <u>453,246</u> | <u>25,229</u> | <u>78,201</u> | <u>24,052</u> |
| Fund balances at the end of the year | <u>\$ -</u> | <u>\$ 47,970</u> | <u>\$ -</u> | <u>\$ 348,796</u> | <u>\$ 36,814</u> |

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

GRANTS ASSISTANCE FUND

Combining Statement of Revenues, Expenditures by Account,
and Changes in Fund Balances, Continued
Year Ended September 30, 2008

| | Section 211(a)(6) Infrastructure | Section 211(a)(7) Supplemental Education | U.S. Federal Grants | Compact Capital Projects | Foreign Assistance |
|--|--|---|---------------------------|--------------------------------|-----------------------|
| Revenues: | | | | | |
| Compact funding | \$ 117,615 | \$ 1,010,663 | \$ - | \$ - | \$ - |
| Federal contributions | - | - | 155,458 | - | - |
| Other grants | - | - | - | - | 293,880 |
| Interest income | - | - | 345 | 20,924 | 46 |
| | <u>117,615</u> | <u>1,010,663</u> | <u>155,803</u> | <u>20,924</u> | <u>293,926</u> |
| Expenditures by account: | | | | | |
| Salaries and wages | - | 171,971 | 75,233 | - | (270,616) |
| Other personnel costs | - | - | 173 | - | 472,449 |
| Contractual services | - | 420,779 | 6,479 | - | 21,332 |
| Supplies and materials | 8,615 | 95,430 | 17,732 | - | 54,697 |
| Scholarship | - | 211,837 | - | - | - |
| Medical supplies | - | - | - | - | - |
| Travel | - | 82,682 | 3,470 | - | - |
| Utilities | - | 8,491 | 1,215 | - | 68 |
| Capital outlay | - | 61,828 | 23,775 | - | - |
| Benefits | - | 10,561 | 901 | - | 473 |
| POL | - | 8,770 | 17,649 | - | 7,356 |
| Training | - | 14,933 | - | - | - |
| Leased housing/land | - | 4,319 | 5,309 | - | - |
| Communications | - | 12,858 | 1,345 | - | (883) |
| Repairs and maintenance | - | 11,105 | - | - | - |
| Professional services | - | - | - | - | 4,000 |
| Food stuffs | - | 1,293 | - | - | 3,052 |
| Meeting and official allowance | - | 16,857 | - | - | - |
| Advertising, printing and reproduction | - | 576 | 295 | - | 1,542 |
| Rentals | - | 1,530 | - | - | 410 |
| Other | - | (96) | 601 | - | 2 |
| Import charges | - | 2,302 | 25 | - | - |
| Medical referral stipend | - | - | - | - | - |
| Bank charges | - | - | - | - | 44 |
| Total expenditures | <u>8,615</u> | <u>1,138,026</u> | <u>154,202</u> | <u>-</u> | <u>293,926</u> |
| Net change in fund balances | 109,000 | (127,363) | 1,601 | 20,924 | - |
| Fund balances at the beginning of the year | <u>-</u> | <u>127,363</u> | <u>(1,601)</u> | <u>800,000</u> | <u>152,209</u> |
| Fund balances at the end of the year | <u>\$ 109,000</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 820,924</u> | <u>\$ 152,209</u> |

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

GRANTS ASSISTANCE FUND

Combining Statement of Revenues, Expenditures by Account,
and Changes in Fund Balances, Continued
Year Ended September 30, 2008

| | Compact Special Block 211(b) | Compact Health & Medical 216(a)(2) | Compact Scholarship 216(a)(3) | Compact Energy Block Grant 214 | Compact Special Development 212(b) | Total |
|--|------------------------------------|---|-------------------------------------|---|---|---------------------|
| Revenues: | | | | | | |
| Compact funding | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 6,974,894 |
| Federal contributions | - | - | - | - | - | 155,458 |
| Other grants | - | - | - | - | - | 293,880 |
| Interest income | - | - | - | - | - | 21,315 |
| | <u>-</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>7,445,547</u> |
| Expenditures by account: | | | | | | |
| Salaries and wages | - | - | - | - | - | 2,978,379 |
| Other personnel costs | - | - | - | - | - | 975,185 |
| Contractual services | - | 4,170 | - | - | - | 711,561 |
| Supplies and materials | - | - | - | - | - | 647,485 |
| Scholarship | - | - | - | - | - | 410,837 |
| Medical supplies | - | - | - | - | - | 340,329 |
| Travel | - | - | - | - | - | 299,999 |
| Utilities | - | - | - | - | - | 263,114 |
| Capital outlay | - | 488 | - | - | - | 238,851 |
| Benefits | - | - | - | - | - | 187,405 |
| POL | - | - | - | - | - | 104,620 |
| Training | - | - | - | - | - | 94,604 |
| Leased housing/land | - | (66) | - | - | - | 92,191 |
| Communications | - | 1 | - | - | - | 51,416 |
| Repairs and maintenance | - | - | - | - | - | 51,088 |
| Professional services | - | - | - | - | - | 34,725 |
| Food stuffs | - | - | - | - | - | 32,223 |
| Meeting and official allowance | - | - | - | - | - | 28,197 |
| Advertising, printing and reproduction | - | - | - | - | - | 17,007 |
| Rentals | - | - | - | - | - | 8,647 |
| Other | - | - | - | - | - | 8,612 |
| Import charges | - | - | - | - | - | 8,018 |
| Medical referral stipend | - | - | - | - | - | 6,288 |
| Bank charges | - | - | - | - | - | 2,346 |
| | <u>-</u> | <u>4,593</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>7,593,127</u> |
| Total expenditures | - | 4,593 | - | - | - | 7,593,127 |
| Net change in fund balances | - | (4,593) | - | - | - | (147,580) |
| Fund balances at the beginning of the year | <u>19,867</u> | <u>147,834</u> | <u>-</u> | <u>-</u> | <u>8,880</u> | <u>1,835,281</u> |
| Fund balances at the end of the year | <u>\$ 19,867</u> | <u>\$ 143,241</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 8,880</u> | <u>\$ 1,687,701</u> |

See Accompanying Independent Auditors' Report.

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

Honorable Robert Weilbacher
Governor, State of Kosrae
Federated States of Micronesia:

We have audited the financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Kosrae as of and for the year ended September 30, 2008, which collectively comprise the State of Kosrae's basic financial statements and have issued our report thereon dated June 22, 2009. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

For purposes of this report, our consideration of internal control over financial reporting and our tests of compliance with certain provisions of laws, regulations, contracts and grants, and other matters did not include the discretely presented component units, which were all audited by us. We have issued separate reports on our consideration of internal control over financial reporting and our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements, and other matters for these entities. The findings, if any, included in those reports are not included herein.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the State of Kosrae's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the State of Kosrae's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the State of Kosrae's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies described in the accompanying Schedule of Findings and Questioned Costs (pages 78 through 85) as items 2008-03 and 2008-04 to be significant deficiencies in internal control over financial reporting.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

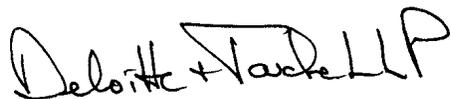
Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that none of the significant deficiencies described above is a material weakness.

Compliance and Other Matters

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

The State of Kosrae's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. We did not audit the State of Kosrae's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the management of the State of Kosrae, federal awarding agencies, pass-through entities, and the cognizant audit and other federal agencies, and is not intended to be and should not be used by anyone other than these specified parties.

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

June 22, 2009

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS
APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER
COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133 AND ON THE
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**

Honorable Robert Weilbacher
Governor, State of Kosrae
Federated States of Micronesia:

Compliance

We have audited the compliance of the State of Kosrae with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended September 30, 2008. The State of Kosrae's major federal programs are identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs (pages 78 through 85). Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the State of Kosrae's management. Our responsibility is to express an opinion on the State of Kosrae's compliance based on our audit.

As discussed in Note 2B to the Schedule of Expenditures of Federal Awards, Kosrae State Government's basic financial statements include the operations of certain entities whose federal awards are not included in the Schedule of Expenditures of Federal Awards for the year ended September 30, 2008. Our audit, described below, did not include the operations of the entities identified in Note 2B as these entities conducted separate audits in accordance with OMB Circular A-133, if required.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the State of Kosrae's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the State of Kosrae's compliance with those requirements.

In our opinion, the State of Kosrae complied, in all material respects, with the requirements referred to above that are applicable to its Compact of Free Association Sector Grants major program (CFDA # 15.875) for the year ended September 30, 2008. The results of our auditing procedures also disclosed other instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which is described in the accompanying Schedule of Findings and Questioned Costs as items 2008-01 and 2008-02.

Internal Control Over Compliance

The management of the State of Kosrae is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the State of Kosrae'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, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the State of Kosrae's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the entity's internal control that might be significant deficiencies or material weaknesses as defined below. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies and others that we consider to be material weaknesses.

A *control deficiency* in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs as items 2008-01 and 2008-02 to be significant deficiencies.

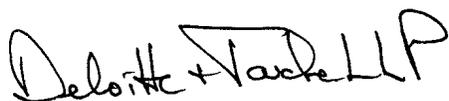
A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. We did not consider any of the deficiencies described in the accompanying Schedule of Findings and Questioned Costs to be material weaknesses.

The State of Kosrae's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. We did not audit the State of Kosrae's responses and, accordingly, we express no opinion on them.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Kosrae as of and for the year ended September 30, 2008, and have issued our report thereon dated June 22, 2009. Our audit was performed for the purpose of forming an opinion on the financial statements that collectively comprise the State of Kosrae's basic financial statements. The accompanying schedule of expenditures of federal awards (pages 74 and 75) is presented for the purpose of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. This schedule is the responsibility of the management of the State of Kosrae. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects when considered in relation to the basic financial statements taken as a whole.

This report is intended solely for the information and use of the management of the State of Kosrae, federal awarding agencies, pass-through entities, and the cognizant audit and other federal agencies, and is not intended to be and should not be used by anyone other than these specified parties.

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

June 22, 2009

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Summary Schedule of Expenditures of Federal Awards, by Grantor
Year Ended September 30, 2008

| Agency/Program | Expenditures |
|--|---------------------|
| U.S. Department of Agriculture | \$ 105,318 |
| U.S. Department of the Interior | 7,166,298 |
| U.S. Department of Education | 6,539 |
| U.S. Department of Health and Human Services | 18,649 |
| U.S. Department of Transportation | <u>2,108</u> |
| GRAND TOTAL | <u>\$ 7,298,912</u> |

Note: All awards are received in a subgrantee capacity through the FSM National Government, except for the following, which are received directly from the grantor agencies:

| | |
|---------------------------------------|------------------------|
| U.S. Department of Agriculture: | |
| Rural Self-Help TA | 10.420 |
| Community Facilities Loans and Grants | 10.766 |
| U.S. Department of Transportation: | |
| Airport Improvement Program | 20.12XXWPUKS/NDBWB5070 |

| | |
|---|---------------------|
| Reconciliation to the basic financial statements: | |
| Grants Assistance Fund | \$ 7,593,127 |
| Less: | |
| Foreign Asssitance Fund | (293,926) |
| Amounts of non-federal awards included herein | <u>(289)</u> |
| | <u>\$ 7,298,912</u> |

See accompanying notes to schedule of expenditures of federal awards.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Schedule of Expenditures of Federal Awards
Year Ended September 30, 2008

| Agency/Program | CFDA# | Expenditures |
|--|------------------------|---------------------|
| U.S. DEPARTMENT OF AGRICULTURE | | |
| Rural Self-Help TA | 10.420 | \$ 81,880 |
| Community Facilities Loans and Grants | 10.766 | 23,438 |
| Total U.S. Department of Agriculture | | <u>\$ 105,318</u> |
| U.S. DEPARTMENT OF EDUCATION | | |
| Special Education - Grants to States | 84.027 | \$ 6,539 |
| Total U.S. Department of Education | | <u>\$ 6,539</u> |
| U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES | | |
| Preventive Health and Health Services Block Grant | 93.991 | \$ 640 |
| Maternal and Child Health Services Block Grant to the States | 93.994 | 173 |
| Cancer Prevention and Control Program (See Note) | 93 Unknown | 17,836 |
| Total U.S. Department of Health and Human Services | | <u>\$ 18,649</u> |
| U.S. DEPARTMENT OF THE INTERIOR | | |
| Economic, Social and Political Development of the Territories: | 15.875 | |
| Compact Health and Medical 216(a)(2) | | \$ 4,593 |
| Compact II Capacity Building Sector | | 1,194,412 |
| Compact II Education Sector | | 2,277,047 |
| Compact II Environment Sector | | 195,788 |
| Compact II Health Sector | | 1,779,461 |
| Compact II Private Sector | | 547,057 |
| Compact II Infrastructure Sector | | 8,615 |
| Supplemental Education Grant Sector | | 1,138,026 |
| Technical Assistance: | | |
| Road Maintenance Equipment | | 21,299 |
| Total U.S. Department of the Interior | | <u>\$ 7,166,298</u> |
| U.S. DEPARTMENT OF TRANSPORTATION | | |
| Airport Improvement Program | 20.12XXWPUKS/NDBWB5070 | \$ 2,108 |
| Total U.S. Department of Transportation | | <u>\$ 2,108</u> |
| GRAND TOTAL | | <u>\$ 7,298,912</u> |

Note: The grant is received through the University of Hawaii and the grant number is U55/CCU923887.02.

See accompanying notes to schedule of expenditures of federal awards.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 2008

(1) Scope of Review

The Kosrae State Government is a governmental entity governed by its own Constitution. All significant operations of the State are included in the scope of the OMB Circular A-133 audit (the "Single Audit"). The U.S. Department of the Interior has been designated as the State's cognizant agency for the Single Audit.

A. Programs Subject to Single Audit

- U.S. Department of Agriculture
- U.S. Department of Education
- U.S. Department of Health and Human Services
- U.S. Department of the Interior
- U.S. Department of Labor
- U.S. Department of Homeland Security

(2) Summary of Significant Accounting Policies

A. Basis of Accounting

For purposes of this report, certain accounting procedures were followed which help illustrate the expenditures of the individual programs. All expenses and capital outlays are reported as expenditures on the accrual basis of accounting.

B. Single Audit Reporting Entity

For purposes of complying with The Single Audit Act of 1984, as amended in 1996, Kosrae State Government's reporting entity is defined in Note 1A to its September 30, 2008 basic financial statements; except that all of the discretely presented component units are excluded. Accordingly, the accompanying Schedule of Expenditures of Federal Awards presents the federal award programs administered by Kosrae State Government, as defined above, for the year ended September 30, 2008.

C. CFDA #15.875

CFDA #15.875 represents the Office of Insular Affairs (OIA), U. S. Department of the Interior. Funding from this source is subject to varying rules and regulations since OIA administers the Compact of Free Association, which is a treaty, and is not a federal program. The Compact is comprised of various funded programs, each with separate compliance requirements. To maximize audit coverage of OIA funding, the OIG has recommended that programs administered under CFDA #15.875 be grouped by like compliance requirements and such groupings be separately evaluated as major programs.

(3) Component Units

The Kosrae Utilities Authority (KUA), a discretely presented component unit of the State of Kosrae separately satisfies the requirements of OMB Circular A-133.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Programs Selected for
Audit In Accordance With OMB Circular A-133
Year Ended September 30, 2008

| <u>Grantor</u> <u>Program Title</u> | <u>CFDA No.</u> | <u>2008</u> <u>Fiscal Year</u> <u>Expenditures</u> |
|--|-----------------|--|
| <u>Major Programs</u> | | |
| <u>U.S. Dept. of the Interior</u> | | |
| Compact of Free Association: | | |
| Compact Sector Grants | | |
| Compact II Capacity Building Sector | 15.875 | \$ 1,194,412 |
| Compact II Education Sector | 15.875 | 2,277,047 |
| Compact II Environment Sector | 15.875 | 195,788 |
| Compact II Health Sector | 15.875 | 1,779,461 |
| Compact II Private Sector | 15.875 | 547,057 |
| Compact II Infrastructure Sector | 15.875 | 8,615 |
| Supplemental Education Grant Sector | 15.875 | 1,138,026 |
| Total U.S. Federal program expenditures selected | | \$ <u>7,140,406</u> |
| Total U.S. Federal program expenditures | | \$ <u>7,298,912</u> |
| % of total U.S. Federal Program expenditures covered by Major Programs | | <u>98%</u> |

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs
Year Ended September 30, 2008

Part I - Summary of Auditors' Results

Financial Statements

- | | | |
|----|--|-------------|
| 1. | Type of auditors' report issued: | Unqualified |
| | Internal control over financial reporting: | |
| 2. | Material weakness(es) identified? | No |
| 3. | Significant deficiency(ies) identified that is not considered to be a material weakness? | Yes |
| 4. | Noncompliance material to the financial statements noted? | No |

Federal Awards

Internal control over major programs:

- | | | |
|----|--|-------------|
| 5. | Material weakness(es) identified? | No |
| 6. | Significant deficiency(ies) identified that is not considered to be a material weakness? | Yes |
| 7. | Type of auditors' report issued on compliance for major programs: | Unqualified |
| 8. | Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB Circular A-133? | Yes |
| 9. | The State's major programs were as follows: | |

| | |
|--------------------|------------------------|
| <u>CFDA Number</u> | <u>Federal Program</u> |
|--------------------|------------------------|

| | |
|--------|--|
| 15.875 | U.S. Department of the Interior – Compact of Free Association –Sector Grants |
|--------|--|

- | | | |
|-----|--|-----------|
| 10. | Dollar threshold used to distinguish between Type A and Type B Programs, as those terms are defined in OMB Circular A-133: | \$300,000 |
| 11. | The State qualified as a low-risk auditee, as that term is defined in OMB Circular A-133? | No |

Part II - Financial Statement Findings Section

| | |
|-----------------------|--------------------|
| <u>Finding Number</u> | <u>Findings</u> |
| 2008-03 | Fixed Assets |
| 2008-04 | Equity Investments |

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2008

Part III - Federal Award Findings and Questioned Cost Section

| <u>Reference Number</u> | <u>CFDA#</u> | <u>Findings</u> | <u>Questioned Costs</u> |
|-----------------------------|--------------|---------------------------------------|-------------------------|
| 2008-01 | 15.875 | Procurement, Suspension and Debarment | \$ - |
| 2008-02 | 15.875 | Allowable Costs/Cost Principles | \$ - |

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2008

Finding No.: 2008-01
Federal Agency: U.S. Department of the Interior
CFDA Program: 15.875 Compact Sector Grant
Grant Number: CSG-FSM-2007-HLT
Area: Procurement, Suspension and Debarment
Questioned Costs: \$0

Criteria:

Procurements shall provide full and open competition among vendors, and any allowable exceptions should be approved and documented in the procurement file.

Condition:

For one (1%) of fifty-six transactions tested, we noted noncompliance with procurement requirements. The State did not go through an open bidding process for the following purchase as such exceeds \$25,000

| <u>Acct</u> | <u>Date</u> | <u>Tran</u> | <u>Inl</u> | <u>Des</u> | <u>Ref1</u> | <u>Ref2</u> | <u>Amt</u> |
|------------------------|-------------|-------------|------------|--------------------------------|-------------|-------------|------------|
| 11-70-70-11110-07-8610 | 12/17/07 | 5010 | APJ | Oxygen Generating Sytems Inter | 7162 | 7413 | \$69,295 |

Since the State's procurement procedure is more stringent than the Compact's procedure, the State may utilize its own procurement procedures. Thus as competitive procurement appears to be adequately documented, the amount of \$69,295 will not be questioned although this amount was expended in noncompliance with State procurement regulations.

Cause:

There appears to be weak internal controls over ensuring compliance with applicable procurement requirements.

Effect:

The State is in noncompliance with applicable procurement requirements.

Prior Year Status:

The above condition is reiterative of conditions identified in the prior year audit of Kosrae State Government.

Recommendation:

The State of Kosrae State Government should strengthen internal controls over ensuring compliance with applicable procurement requirements.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2008

Finding No.: 2008-01, Continued

Auditee Response and Corrective Action Plan:

We agree that we did not follow the Kosrae State Government Financial Management Regulations (FMR) in the purchase of the above equipment. The procurement was done through price quotations only. Effective immediately, Mr. Switson Robert is tasked in ensuring the State complies with the FMR on open competitive bidding.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2008

Finding No.: 2008-02
Federal Agency: U.S. Department of the Interior
CFDA Program: 15.875 Compact Sector Grant
Grant Number: CSG-FSM-2006-SEG
Area: Allowable Costs/Cost Principles
Questioned Costs: \$0

Criteria:

Contractors should not be entitled to government share benefits.

Condition:

CFDA#15.875 Compact Sector Grants-Supplemental Education Grant: JV8m0021 and JV8m0045 were recorded to transfer salaries to contractual services expenditures. Total salaries transferred aggregate \$46,006 and benefits \$2,413. This transfer relates to individuals hired under contract, who appear to be treated as employees, since the State bears responsibility for all withholdings and deducts taxes from the contractor payments at individual tax rates. As a result, these contractors actually appear to be employees. Hence, the basis of the transfer appears inappropriate.

Of the \$46,006 salaries and wages transferred, \$34,495 was noted from the Compact Sector Supplemental Education Grant. Of the \$2,413 benefits transferred, \$439 is from the Compact Sector Supplemental Education Grant and the remaining balance was General Fund transfers.

Cause:

The State does not appear to have effectuated a legal determination that defines the difference between a contractor and an employee.

Effect:

A misclassification of expenditures between salaries and contractual expenditures could result from this condition.

No questioned costs result from item two as the issue is the appropriate classification of these expenditures.

Recommendation:

We recommend that the State reexamine the distinction between a contractor and an employee and ensure that employee salaries are appropriately classified in the financial statements.

Auditee Response and Corrective Action Plan:

We agree with the finding however we believe that your reference for the cause of the non-compliance should be reworded. We certainly are aware of the difference between a contract and an employee. The citation was due to budgetary classification.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2008

Financial Statements Findings Section

Finding No.: 2008-03
Area: Fixed Assets

Criteria:

1. In accordance to Financial Management Regulation 5.2 State property should be reported and assigned a property tag number to each item upon receipt.
2. In accordance to Financial Management Regulation 5.6. All property custodians should provide a list of the property under their control every six months to the Director or designee.
3. Management's response received on January 11, 2008 regarding Asset Maintenance were as follows:

The State required all maintenance plans to be submitted by February 18, 2008.

After receiving plans from departments and agencies, the Director will review the documents, with the assistance of division of planning and statistics and finance office, and make recommendations to the Governor by February 29, 2008 on the appropriate schemes to be undertaken.

Conditions:

1. As of November 13, 2008 not all property was assigned a tag number upon receipt.
2. Property listings for July 2008 were only provided by one custodian as of November 13, 2008.
3. No maintenance plans were provided for review.

Cause:

There appears to be a weakness in internal controls over ensuring regulations and plans to correct ineffective controls are followed.

Effect:

Fixed assets acquisitions and dispositions may not be recorded. Expected life of fixed assets may be shortened.

Recommendation:

We recommend the State strengthen internal controls to ensure that there are periodic reviews to ensure that asset maintenance activities are monitored and performed.

Auditee Response and Corrective Action Plan:

We partially agree with the citation and acknowledged that this is a repeated finding. Currently the State does not have a comprehensive fixed asset maintenance plan however the Department of Education and Health Services have their respective maintenance plans.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2008

Finding No.: 2008-03, Continued
Area: Fixed Assets

Auditee Response and Corrective Action Plan, Continued:

As part of our corrective action, beginning in fiscal year 2010; the Director of the Department of Administration and Finance will work very closely with the Director of the Transportation and Infrastructure to write up fixed asset maintenance plan for the State.

Since we believe that this finding is FSM wide issue, we will also seek the assistance of the FSM National Government for the possibility of coming up with a uniform maintenance fixed asset plan for the entire FSM.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2008

Finding No.: 2008-04
Area: Equity Investments

Criteria:

Kosrae State Government should ensure that audited financial statements are furnished by all investees of Kosrae State Government at the end of each fiscal year.

Condition:

Unaudited financial statements were not submitted for KSVI and SEMO in support of Kosrae State equity investments. No financial statements for Pacific Tuna Industries were furnished in support of Kosrae State equity investments

Cause:

The cause of this condition is the lack of financial statements by investees.

Effect:

The effect of this condition is a misstatement of the financial statements.

Prior Year Status:

The above condition is reiterative of conditions identified in the prior year audit of Kosrae State Government.

Recommendation:

We recommend that the Department of Administration ensures that audited financial statements are furnished by its material investees at the end of each fiscal year.

Auditee Response and Corrective Action Plan:

We agree with the above finding. Due to the current financial condition of the investees that reduces the investees activities and operation to almost none; the record-keeping in the respective entities also deteriorated thus it is quite difficult to obtain their financial statements. In fiscal year 2009; the Director of Administration and Finance will work with the appropriate offices to ensure that financial statements are secured from the companies.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Unresolved Prior Years' Findings and Questioned Costs
Year Ended September 30, 2008

The following is a summary of unresolved questioned costs of the State of Kosrae as of September 30, 2008:

| | Questioned Costs Set Forth in Prior Audit Reports <u>2007</u> | Questioned Costs Resolved in Fiscal Year <u>2008</u> | Questioned Costs at <u>September 30, 2008</u> |
|-------------------------------------|--|---|--|
| Unresolved Questioned Costs FY 2002 | \$ 72,138 | \$ 72,138 | \$ - |
| Unresolved Questioned Costs FY 2003 | 39,811 | 39,811 | - |
| Unresolved Questioned Costs FY 2004 | 237,645 | 237,645 | - |
| Unresolved Questioned Costs FY 2005 | 462,459 | 462,459 | - |
| Unresolved Questioned Costs FY 2006 | 642,789 | 229,432 | 413,357 |
| Unresolved Questioned Costs FY 2007 | <u>162,753</u> | <u>112,753</u> | <u>50,000</u> |
| | \$ <u>1,617,595</u> | \$ <u>1,205,963</u> | \$ <u>463,357</u> |

The prior year status of findings is contained in the accompanying Schedule of Findings and Questioned Costs (pages 78-85).