

**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, 2009

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

YEAR ENDED SEPTEMBER 30, 2009

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FEDERATED STATES OF MICRONESIA**

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**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

YEAR ENDED SEPTEMBER 30, 2009

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, 2009, 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.

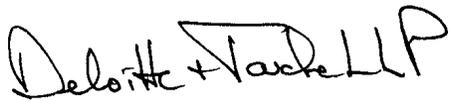
In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Kosrae as of September 30, 2009, 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 9 to the financial statements, the beginning net assets of the aggregate discretely presented component units has been restated for the dissolution of Micronesia Petroleum Corporation.

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 23, 2010 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 + Touche LLP". The signature is written in a cursive, stylized font.

June 23, 2010

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2009

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, 2009. We encourage readers to consider this information in conjunction with Kosrae State's financial statements, which follow. Fiscal year 2008 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, 2009, Kosrae State's total net assets increased by \$1.49 million (or 10%) from \$14.90 million in the prior year to \$16.39 million. This increase is primarily attributable to the gain from discontinuation of Micronesian Petroleum Corporation (MPC); a former component unit of the State and the receipt of the final proceeds from the sale of property in the State of Hawaii. On the other hand, an additional liability was assumed by the State as a result of MPC's dissolution.
- A General Fund budgetary surplus was earned in fiscal year 2009 in the amount of \$0.69 million mainly due to the gain from the discontinuation of MPC's operations and a recovery of prior year receivables. In addition, the final proceeds from the sale of property in the State of Hawaii and the operating transfers from a special revenue fund contributed to the positive result.
- During fiscal year 2009, Kosrae State's general fund balance recovered and registered an ending fund balance of \$0.66 million. In fiscal year 2008, the general fund ending fund balance was a deficit of \$0.08 million.

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 State's net assets serve as indicator to measure the State's financial position.

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

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2009

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 Utilities Corporation and Kosrae Port Authority in its report. Although separate, these "component units" are important because Kosrae State is financially accountable for them. Micronesia Petroleum Corporation (MPC), a former component unit of the State was dissolved in March 2009 by Kosrae State Law no. 9-91. Due to its dissolution, all its assets and liabilities were transferred to the State, effective October 1, 2008.

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 2009, Kosrae State's assets exceeded liabilities by \$16.39 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 these 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 debt 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, 2009, with comparable balances for the fiscal year 2008, discloses this relationship:

	<u>2009</u>	<u>2008</u>
ASSETS		
Current and other non-capital assets	\$ 9,221,088	\$ 8,129,411
Capital assets	<u>14,757,241</u>	<u>13,736,286</u>
Total Assets	<u>23,978,329</u>	<u>21,865,697</u>

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2009

LIABILITIES		
Long-term liabilities	\$ 5,630,102	\$ 5,766,410
Other liabilities	<u>1,959,597</u>	<u>1,202,104</u>
Total Liabilities	<u>7,589,699</u>	<u>6,968,514</u>
NET ASSETS		
Invested in capital assets, net of related debt	14,757,241	13,736,286
Restricted	7,126,979	6,813,187
Unrestricted	<u>(5,495,590)</u>	<u>(5,652,290)</u>
Total Net Assets	<u>\$ 16,388,630</u>	<u>\$ 14,897,183</u>

At the end of fiscal year 2009, Kosrae State's unrestricted net assets showed a deficit of \$5.49 million, a decrease of \$0.16 million (or 3%) from the prior year. The slight decrease is due to the improved general fund result which offset the depreciation cost of capital assets. 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 increased by \$1.49 million (or 10%) from the prior year. Key elements of the differences from the prior year are shown in the following schedule.

	<u>2009</u>	<u>2008</u>
Revenues:		
Operating grants and contributions	\$ 8,865,031	\$ 6,329,911
Capital grants and contributions	2,017,245	125,000
Charges for services	427,596	1,439,488
Revenue sharing	1,039,493	1,076,009
Unrestricted investment earnings	123,151	132,890
Taxes	518,783	8,863
Other	<u>383,853</u>	<u>219,278</u>
Total revenues	<u>13,375,152</u>	<u>9,331,439</u>
Expenses:		
General government	2,423,383	3,077,834
Education	4,147,301	3,556,949
Health services	2,504,432	2,132,536
Economic development	1,326,337	1,210,225
Boards, commissions and other	1,364,191	2,415,514
Environment protection and sanitation	109,350	138,998
Public order and safety	<u>317,319</u>	<u>186,492</u>
Total expenses	<u>12,192,313</u>	<u>12,718,548</u>
Transfer of capital assets	-	(12,960,206)
Special items	<u>308,608</u>	<u>123,549</u>
Change in net assets	1,491,447	(16,223,766)
Net assets at the beginning of the year	<u>14,897,183</u>	<u>31,120,949</u>
Net assets at the end of the year	<u>\$ 16,388,630</u>	<u>\$ 14,897,183</u>

STATE OF KOSRAE FEDERATED STATES OF MICRONESIA

Management's Discussion and Analysis September 30, 2009

Figure 1 below showed that the total revenues in fiscal year 2009 of \$13.37 million increased by \$4.04 million from the prior year's \$9.33 million (up by 43%). The increase was primarily due to the increase in the current year's operating grants and contributions of \$2.54 million and the capital assets received from MPC's discontinuation of \$1.99 million, which is reflected within capital contribution revenues. In fiscal year 2009, operating grants and contributions comprised 66% of all Kosrae State funding sources whereas the local sourced funding (taxes, fees and charges) comprised only 15%.

Figure 2 presented that the total expenses of \$12.19 million reflected a 4% decrease from the prior year expenses without special items.

The following graphs show the major components of revenues and expenses for the year ended September 30, 2009.

Figure 1 - Kosrae State Government Sources of Revenues

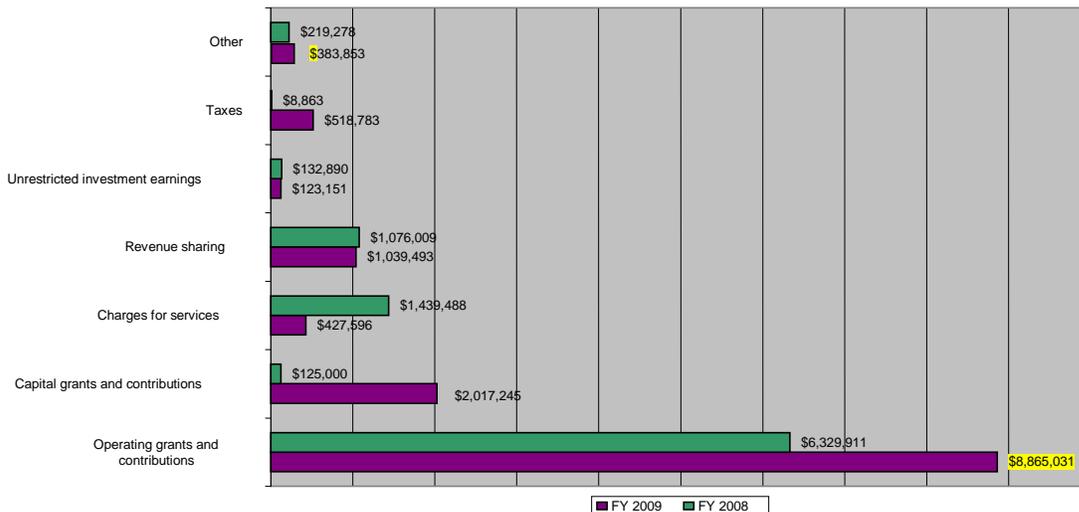
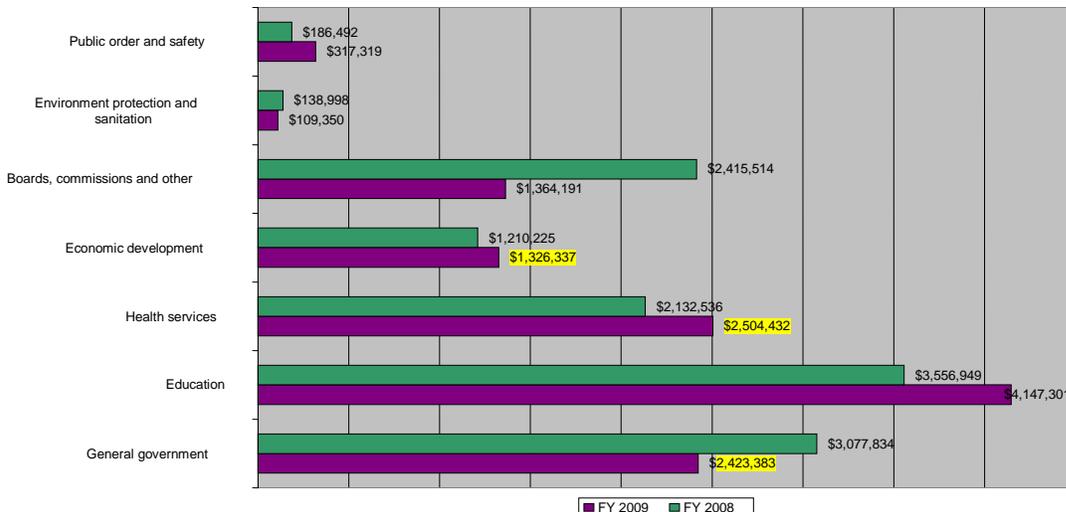


Figure 2 - Kosrae State Government Expenses by Functions



**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2009

FINANCIAL ANALYSIS OF KOSRAE STATE'S GOVERNMENTAL 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 2009, Kosrae State governmental funds reported a combined fund balance of \$7.83 million which represents \$0.86 million increase or (12%) from the \$6.97 million recorded at the end of fiscal 2008. This increase is attributable mainly to the increase in the General Fund from the gain in the dissolution of MPC's operation. Of this total combined fund balance, \$8.20 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 (\$6.65 million); 2) to liquidate contracts and purchase orders of the prior period (\$1.24 million); or 3) to fund specific general fund and grants assistance related activities (\$0.31 million). These reserved fund balances are off-set by a combined deficit of \$0.37 million, and a decrease of \$0.73 million (or 66%) from fiscal year 2008. The overall decrease in the unreserved fund deficit is attributed to the recovery of General Fund due to the discontinuation of MPC's operations and the increase in the Grants Assistance Fund.

The General Fund is the main operating fund of the State. At the end of the current fiscal year, the unreserved fund deficit of the General Fund was \$0.31 million as compared with the prior year ending unreserved fund deficit of \$1.04 million, an improvement of \$0.73 million (or 60%) while total fund balance was \$0.66 million compared with a total fund deficit of \$0.08 million at the end of prior fiscal year, an improvement of \$0.74 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 \$0.10 million and the gain on the discontinuation of the former component unit's operations.

The Grants Assistance Fund has a total fund balance of \$1.79 million, which primarily represents Compact Sector grant revenues received not yet expended at year end. The net increase in fund balance during the current year in the Grants Assistance Fund was \$0.10 million or (6%), which primarily was the result of the utilization of the Compact Sector Grant received in the previous year.

The Early Retirement Program Fund, has a total fund balance of \$1.55 million as compared with the prior year ending fund balance of \$1.68 million; a deterioration of \$0.13 million. The downward revision was due to the decrease in the fair value of investments of \$0.05 million and the repayment of ADB loan principal of \$0.12 million.

The Compact Trust Fund has a total fund balance of \$2.50 million, all of which is reserved for the funding of future operations of the primary government commencing in fiscal year 2023. The slight increase in fund balance during the current year in the Compact Trust Fund was \$0.04 million (or 2 %), which reflected an insignificant increase in the fair value of investments.

GENERAL FUND BUDGETARY HIGHLIGHTS

During the course of the fiscal year, management and elected officials of Kosrae State Government did not find it necessary to revise the General Fund budget. Nevertheless, general fund revenues exceeded expenditures on the budgetary basis by \$0.05 million. In addition, the other financing sources of \$0.15 million and the special items of \$0.50 million contributed to the positive net change in unreserved fund balance of \$0.69 million. The unreserved fund deficit decreased in fiscal year 2009 from \$1.04 million in the prior year to \$0.31 million.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2009

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

Kosrae State's investment in capital assets for the primary government as of September 30, 2009, amounted to \$51.80 million, net of accumulated depreciation of \$37.04 million, leaving a net book value of \$14.76 million. This represents a net increase of \$1.02 million (or 7.4%) from fiscal year 2008. The increase for the year was due to the transfer of assets from MPC of \$1.99 million, current year additions of \$0.17 less depreciation charge of \$1.14 million.

The table below summarizes Kosrae State's capital assets:

	<u>2009</u>	<u>2008</u>
Buildings	\$ 3,906,929	\$ 2,438,260
Infrastructure	10,197,338	10,649,632
Machinery, equipment, others	<u>652,974</u>	<u>648,394</u>
	\$ <u>14,757,241</u>	\$ <u>13,736,286</u>

Additional information on Kosrae State's capital assets can be found in note 5 to the financial statements.

Long-Term Debt

The following schedule shows Kosrae State's long-term debt obligations for fiscal year 2009 which is greater than fiscal year 2008 balances due to the addition of the FSM DB Loan; and MPC's loan which is absorbed by the State due to its dissolution in March 2009:

	<u>2009</u>	<u>2008</u>
FSM National Government loan	\$ 1,500,000	\$ 1,500,000
Asian Development Bank (ADB) loans	4,035,056	4,064,592
FSM Development Bank loan	289,578	-
Malem Water Supply loan	<u>136,173</u>	<u>136,173</u>
Total non-current liabilities	\$ <u>5,960,807</u>	\$ <u>5,700,765</u>

Interest and principal payment on ADB loans commenced in fiscal year 2008. During the current year, the State's long-term debt increased as a result of additional debt associated with the dissolution of MPC.

Additional information on Kosrae State's long-term debt obligations can be found in notes 6 and 7 to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The General Fund operations will continue to experience difficulty in funding due to the decrease in local taxes. In fiscal year 2010, there was a scheme to swap Compact Sector funding (Private Sector) of more than \$100,000 with the FSM National Government in lieu of an operating subsidy. As of this writing however, the plan has not materialized. In fiscal year 2009, although the discontinuation of MPC's operation has brought some funds to the General Fund, the State has also inherited the entity's outstanding loans from the FSM Development Bank.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2009

With the same phase of revenue collection and the absence of possible alternative sources of revenues for the ensuing years, the State's financial capability to fund its General Fund operations will be a challenge.

Grants Assistance Funds (specifically Compact funding) will continue to be the major funding sources for Kosrae State in fiscal year 2010 with the total approved funding of \$6,089,153 as follows:

Education Sector	\$2,524,286
Health Sector	\$2,217,716
Environment Sector	\$ 253,343
Private Sector	\$ 687,760
Capacity Building Sector	\$ 406,048

In addition, the Supplemental Education Grant for fiscal year 2009, with a total grant award of \$1.29 million, is available in fiscal year 2010.

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, 2009

	Primary Government	Component Units
<u>ASSETS</u>		
Current assets:		
Cash and cash equivalents	\$ 1,061,525	\$ 334,305
Investments	-	432,520
Receivables, net	1,450,567	185,417
Inventories	-	351,473
Prepayments	32,340	43,785
Advances	394,891	-
Restricted assets:		
Time certificates of deposit	-	383,979
Total current assets	2,939,323	1,731,479
Noncurrent assets:		
Capital assets, net of accumulated depreciation	14,757,241	16,316,947
Investments	1,100,000	-
Restricted assets:		
Cash and cash equivalents	578,143	-
Time certificates of deposit	554,383	-
Investments	4,049,239	-
Total noncurrent assets	21,039,006	16,316,947
Total assets	\$ 23,978,329	\$ 18,048,426
<u>LIABILITIES</u>		
Current liabilities:		
Current portion of long-term obligations	\$ 565,705	\$ 95,245
Accounts payable	579,816	98,439
Other liabilities and accruals	343,536	128,875
Deferred revenues	470,540	185,557
Total current liabilities	1,959,597	508,116
Noncurrent liabilities:		
Noncurrent portion of long-term obligations	5,395,102	167,940
Other noncurrent liabilities	235,000	-
Total noncurrent liabilities	5,630,102	167,940
Total liabilities	7,589,699	676,056
Commitments and contingencies		
<u>NET ASSETS</u>		
Invested in capital assets, net of related debt	14,757,241	16,053,762
Restricted for:		
Nonexpendable:		
Future operations	2,499,606	-
Expendable:		
Debt service	1,549,633	-
Compact related	1,634,191	-
Other purposes	1,443,549	90,000
Unrestricted	(5,495,590)	1,228,608
Total net assets	16,388,630	17,372,370
Total liabilities and net assets	\$ 23,978,329	\$ 18,048,426

See accompanying notes to basic financial statements.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Statement of Activities
Year Ended September 30, 2009

Functions/Programs	Expenses	Program Revenues		Net (Expenses) Revenues and Changes in Net Assets		
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Primary Government	Component Units
Primary government:						
Governmental activities:						
General government	\$ 2,423,383	\$ 180,996	\$ 700,501	\$ 24,051	\$ (1,517,835)	\$ -
Economic development	1,326,337	825	738,246	1,993,194	1,405,928	-
Education	4,147,301	2,666	4,221,999	-	77,364	-
Health services	2,504,432	157,819	2,853,926	-	507,313	-
Public order and safety	317,319	-	-	-	(317,319)	-
Environment protection and sanitation	109,350	78,529	231,088	-	200,267	-
Boards, commissions and other	1,364,191	6,761	81,705	-	(1,275,725)	-
Future operations	-	-	37,566	-	37,566	-
Total primary government	<u>\$ 12,192,313</u>	<u>\$ 427,596</u>	<u>\$ 8,865,031</u>	<u>\$ 2,017,245</u>	<u>(882,441)</u>	<u>-</u>
Component units:						
Kosrae Port Authority	\$ 855,373	\$ 171,141	\$ -	\$ -	-	(684,232)
Kosrae Utilities Authority	2,637,055	1,903,456	12,689	62,331	-	(658,579)
Total component units	<u>\$ 3,492,428</u>	<u>\$ 2,074,597</u>	<u>\$ 12,689</u>	<u>\$ 62,331</u>	<u>-</u>	<u>(1,342,811)</u>
General revenues:						
Taxes:						
Revenue sharing					1,039,493	-
State taxes					518,783	-
Unrestricted investment earnings					123,151	-
Other					383,853	-
Special items:						
Gain on sale of capital assets					97,828	-
Gain from discontinuation of component unit operations					314,328	-
Loss on receivables of discontinued component unit, net					(103,548)	-
Total general revenues and special items					<u>2,373,888</u>	<u>-</u>
Change in net assets					<u>1,491,447</u>	<u>(1,342,811)</u>
Net assets at the beginning of the year, as previously reported					14,897,183	20,487,809
Prior period adjustment (note 9)					-	(1,772,628)
Net assets at the beginning of the year, as restated					<u>14,897,183</u>	<u>18,715,181</u>
Net assets at the end of the year					<u>\$ 16,388,630</u>	<u>\$ 17,372,370</u>

See accompanying notes to basic financial statements.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Balance Sheet

Governmental Funds
September 30, 2009

	Special Revenue			Permanent	Other	Total
	General	Grants Assistance	Early Retirement Program	Compact Trust	Governmental Funds	
ASSETS						
Cash and cash equivalents	\$ 1,061,525	\$ -	\$ -	\$ -	\$ -	\$ 1,061,525
Investments	200,000	900,000	-	-	-	1,100,000
Receivables, net:						
General	387,666	-	-	-	2,415	390,081
Loans	-	-	-	-	372,551	372,551
Federal agencies	-	687,935	-	-	-	687,935
Due from other funds	534,633	1,272,834	-	-	634,725	2,442,192
Prepaid items	-	32,340	-	-	-	32,340
Advances	52,400	342,491	-	-	-	394,891
Restricted assets:						
Cash and cash equivalents	526,201	-	-	-	51,942	578,143
Time certificates of deposit	200,000	-	-	-	354,383	554,383
Investments	-	-	1,549,633	2,499,606	-	4,049,239
Total assets	<u>\$ 2,962,425</u>	<u>\$ 3,235,600</u>	<u>\$ 1,549,633</u>	<u>\$ 2,499,606</u>	<u>\$ 1,416,016</u>	<u>\$ 11,663,280</u>
LIABILITIES AND FUND BALANCES						
Liabilities:						
Accounts payable	\$ 226,443	\$ 275,417	\$ -	\$ -	\$ 77,956	\$ 579,816
Other liabilities and accruals	171,915	171,621	-	-	-	343,536
Due to other funds	1,907,559	531,655	-	-	2,978	2,442,192
Deferred revenues	-	470,507	-	-	33	470,540
Total liabilities	<u>2,305,917</u>	<u>1,449,200</u>	<u>-</u>	<u>-</u>	<u>80,967</u>	<u>3,836,084</u>
Fund balances:						
Reserved for:						
Related assets	926,201	900,000	1,549,633	2,499,606	778,876	6,654,316
Encumbrances	42,080	974,053	-	-	227,319	1,243,452
Continuing appropriations	-	196,399	-	-	-	196,399
Unreserved:						
General fund	(311,773)	-	-	-	-	(311,773)
Special revenue funds	-	(284,052)	-	-	286,109	2,057
Capital projects funds	-	-	-	-	42,745	42,745
Total fund balances	<u>656,508</u>	<u>1,786,400</u>	<u>1,549,633</u>	<u>2,499,606</u>	<u>1,335,049</u>	<u>7,827,196</u>
Total liabilities and fund balances	<u>\$ 2,962,425</u>	<u>\$ 3,235,600</u>	<u>\$ 1,549,633</u>	<u>\$ 2,499,606</u>	<u>\$ 1,416,016</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

14,757,241

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

(5,960,807)

Claims payable

(235,000)

(6,195,807)

Net assets of governmental activities

\$ 16,388,630

See accompanying notes to basic financial statements.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Statement of Revenues, Expenditures, and Changes in Fund Balances (Deficit)
Governmental Funds
Year Ended September 30, 2009

	Special Revenue			Permanent	Other	Total
	General	Grants Assistance	Early Retirement Program	Compact Trust	Governmental Funds	
Revenues:						
Compact funding	\$ -	\$ 8,670,899	\$ -	\$ -	\$ -	\$ 8,670,899
Net change in the fair value of investments	-	-	(52,419)	37,566	-	(14,853)
Federal contributions	-	153,394	-	-	-	153,394
FSM revenue sharing	1,039,493	-	-	-	-	1,039,493
State taxes	518,783	-	-	-	-	518,783
CFSM grants	-	-	-	-	24,051	24,051
Fees and charges	180,996	-	-	-	246,600	427,596
Other grants	-	55,591	-	-	-	55,591
Interest income	31,188	6,581	-	-	85,382	123,151
Other	383,853	-	-	-	-	383,853
Total revenues	<u>2,154,313</u>	<u>8,886,465</u>	<u>(52,419)</u>	<u>37,566</u>	<u>356,033</u>	<u>11,381,958</u>
Expenditures:						
Current:						
General government	1,052,827	1,097,592	-	-	28,302	2,178,721
Economic development	177,912	1,050,681	-	-	-	1,228,593
Education	(102)	4,034,078	-	-	-	4,033,976
Health services	-	2,512,280	-	-	8,413	2,520,693
Public order and safety	274,961	-	-	-	38,290	313,251
Environment protection and sanitation	-	11,430	-	-	97,920	109,350
Boards, commissions and other	561,567	81,705	-	-	15,317	658,589
Debt service	-	-	119,172	-	-	119,172
Total expenditures	<u>2,067,165</u>	<u>8,787,766</u>	<u>119,172</u>	<u>-</u>	<u>188,242</u>	<u>11,162,345</u>
Excess (deficiency) of revenues over (under) expenditures	87,148	98,699	(171,591)	37,566	167,791	219,613
Other financing sources (uses):						
Proceeds from sale of capital assets	97,828	-	-	-	-	97,828
Proceeds from issuance of long-term debt	-	-	37,735	-	-	37,735
Operating transfers in	51,158	-	-	-	-	51,158
Operating transfers out	-	-	-	-	(51,158)	(51,158)
Total other financing sources (uses), net	<u>148,986</u>	<u>-</u>	<u>37,735</u>	<u>-</u>	<u>(51,158)</u>	<u>135,563</u>
Special items:						
Discontinued operations of MPC	603,906	-	-	-	-	603,906
Write-off of receivables, net of recovery	(103,548)	-	-	-	-	(103,548)
Net change in fund balances (deficit)	736,492	98,699	(133,856)	37,566	116,633	855,534
Fund balances (deficit) at the beginning of the year	<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>
Fund balances at the end of the year	<u>\$ 656,508</u>	<u>\$ 1,786,400</u>	<u>\$ 1,549,633</u>	<u>\$ 2,499,606</u>	<u>\$ 1,335,049</u>	<u>\$ 7,827,196</u>

See accompanying notes to basic financial statements.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Reconciliation of the Statement of Revenues, Expenditure, and Changes in Fund
Balances of Governmental Funds to the Statement of Activities
Year Ended September 30, 2009

Amounts reported for governmental activities in the statement of activities are different from changes in fund balances because:

Net change in fund balances - total governmental funds	\$ 855,534
<p>Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense.</p>	
<p>This is the amount by which capital outlays exceeded depreciation in the current period.</p>	1,020,955
<p>The issuance of long-term debt (e.g. bonds, leases) provides current financial resources to governmental funds, while the repayment of principal of long-term debt consumes the current financial resources of governmental funds. Neither transaction has any effect on net assets.</p>	
<p>This is the amount that represents the MPC loan with FSM Development Bank.</p>	(289,578)
<p>This is the additional loan proceeds received from ADB Loans.</p>	(37,735)
<p>This is the repayment against the ADB Early Retirement Program Loan.</p>	67,271
<p>This is the increase in claims payable.</p>	<u>(125,000)</u>
Change in net assets of governmental activities	\$ <u>1,491,447</u>

See accompanying notes to basic financial statements.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Combining Statement of Net Assets

Component Units
September 30, 2009

<u>ASSETS</u>	<u>Kosrae Port Authority</u>	<u>Kosrae Utilities Authority</u>	<u>Total</u>
Current assets:			
Cash and cash equivalents	\$ 53,333	\$ 280,972	\$ 334,305
Investments	-	432,520	432,520
Time certificates of deposit - restricted	-	383,979	383,979
Receivables, net:			
General	16,160	169,257	185,417
Inventories	-	351,473	351,473
Prepayments	-	43,785	43,785
Total current assets	69,493	1,661,986	1,731,479
Noncurrent assets:			
Capital assets, net of accumulated depreciation	11,804,859	4,512,088	16,316,947
Total assets	\$ 11,874,352	\$ 6,174,074	\$ 18,048,426
<u>LIABILITIES AND NET ASSETS</u>			
Current liabilities:			
Current portion of long-term debt	\$ -	\$ 95,245	\$ 95,245
Accounts payable	11,884	86,555	98,439
Accrued liabilities	95,711	33,164	128,875
Deferred revenues	-	185,557	185,557
Total current liabilities	107,595	400,521	508,116
Noncurrent liabilities:			
Noncurrent portion of long-term debt	-	167,940	167,940
Total noncurrent liabilities	-	167,940	167,940
Total liabilities	107,595	568,461	676,056
Net assets:			
Invested in capital assets, net of related debt	11,804,859	4,248,903	16,053,762
Restricted	-	90,000	90,000
Unrestricted	(38,102)	1,266,710	1,228,608
Total net assets	11,766,757	5,605,613	17,372,370
Total liabilities and net assets	\$ 11,874,352	\$ 6,174,074	\$ 18,048,426

See accompanying notes to basic financial statements.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Combining Statement of Revenues, Expenses, and Changes in Net Assets
and Changes in Net Assets
Component Units
Year Ended September 30, 2009

	Kosrae Port Authority	Kosrae Utilities Authority	Total
Operating revenues:			
Charge for services	\$ 171,141	\$ 1,903,456	\$ 2,074,597
Operating expenses:			
Cost of services	278,585	1,886,715	2,165,300
Depreciation and amortization	572,979	510,828	1,083,807
Administration and general	-	194,921	194,921
Total operating expenses	<u>851,564</u>	<u>2,592,464</u>	<u>3,444,028</u>
Operating loss	<u>(680,423)</u>	<u>(689,008)</u>	<u>(1,369,431)</u>
Nonoperating revenues (expenses):			
Interest income	-	3,770	3,770
Net change in fair value of investments	-	(38,539)	(38,539)
Other income (expense)	(3,809)	-	(3,809)
Federal grants	-	8,919	8,919
Interest expense	-	(6,052)	(6,052)
Total nonoperating revenues (expenses), net	<u>(3,809)</u>	<u>(31,902)</u>	<u>(35,711)</u>
Capital contributions	-	62,331	62,331
Change in net assets	<u>(684,232)</u>	<u>(658,579)</u>	<u>(1,342,811)</u>
Net assets at beginning of year	<u>12,450,989</u>	<u>6,264,192</u>	<u>18,715,181</u>
Net assets at end of year	\$ <u>11,766,757</u>	\$ <u>5,605,613</u>	\$ <u>17,372,370</u>

See accompanying notes to basic financial statements.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2009

(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, 2009

(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 Department of Transportation and Infrastructure.

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 Transportation and Infrastructure.

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, 2009

(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 three 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 \$7,126,979 of restricted net assets, of which \$1,443,549 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, 2009

(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, 2009

(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, 2009

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

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 State, 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.

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.

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, 2009

(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 governmental 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, 2009, 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 \$1,549,633 for the Kosrae State Early Retirement Scheme. Furthermore, investments recorded in the Compact Trust Fund of \$2,499,606 are restricted in that they are not available to be used in current operations. As of September 30, 2009, 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, 2009

(1) Summary of Significant Accounting Policies, Continued

L. Restricted Assets, Continued

Deposit account established for the purpose of receiving payments pursuant to the Compact of Free Association, as amended:	\$ 380,431
Deposit account established for the Housing Renovation program.	145,770
Deposit account established for the Gifford scholarship fund.	51,942
Time certificate of deposit with a local bank restricted for scholarships for post-secondary students.	354,383
Time certificate of deposit 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.	200,000
	\$ <u>1,132,526</u>
Component Units:	
Time certificate of deposit with a local bank pledged supporting Kosrae Utility Authority debt.	\$ <u>383,979</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, 2009

(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 200 hours per year. 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, 2009, 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	-	-	-	-	372,551	372,551
Restricted assets:						
Cash and cash equivalents	526,201	-	-	-	51,942	578,143
Time certificates of deposit	200,000	-	-	-	354,383	554,383
Investments	-	-	1,549,633	2,499,606	-	4,049,239
	<u>\$ 926,201</u>	<u>\$ 900,000</u>	<u>\$ 1,549,633</u>	<u>\$ 2,499,606</u>	<u>\$ 778,876</u>	<u>\$ 6,654,316</u>

As of September 30, 2009, continuing appropriations reported in the General Fund and Grants Assistance Fund as follows:

	<u>General Fund</u>	<u>Grants Assistance</u>	<u>Total</u>
Infrastructure Maintenance Fund Matching	\$ -	\$ -	\$ 109,000
Other	-	196,399	196,399
	<u>\$ -</u>	<u>\$ 196,399</u>	<u>\$ 305,399</u>

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2009

(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 2009, the State implemented the following pronouncements:

- GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, which establishes standards for the measurement, recognition, and display of other postemployment benefits expense/expenditures and related liabilities, note disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employers.
- GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, which provides guidance and consistency under which a governmental entity would be required to report a liability related to pollution remediation.
- GASB Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*, which 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.
- GASB Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, which improves financial reporting by contributing to the GASB's efforts to codify all GAAP for state and local governments so that they derive from a single source.
- GASB Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*, which incorporates accounting and financial reporting guidance previously only contained in the American Institute of Certified Public Accountants (AICPA) auditing literature into the GASB's accounting and financial reporting literature for state and local governments, and addresses three issues from the AICPA's literature - related party transactions, going concern considerations, and subsequent events.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2009

(1) Summary of Significant Accounting Policies, Continued

R. New Accounting Standards, Continued

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

In June 2007, GASB issued statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, which addresses whether and when intangible assets should be considered capital assets for financial reporting purposes. The provisions of this statement are effective for periods beginning after June 15, 2009. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the State.

In June 2008, GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, which is intended to improve how state and local governments report information about derivative instruments - financial arrangements used by governments to manage specific risks or make investments - in their financial statements. The provisions of this statement are effective for periods beginning after June 15, 2009. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the State.

In December 2008, GASB issued Technical Bulletin No. 2008-1, *Determining the Annual Required Contribution Adjustment for Postemployment Benefits*, which clarifies the requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, for calculating the annual required contribution (ARC) adjustment. The provisions of this statement are effective for periods beginning after December 15, 2008. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the State.

In March 2009, GASB issued Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, which enhances the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. The provisions of this statement are effective for periods beginning after June 15, 2010. Management does not believe that 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 disclosure 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.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2009

(1) Summary of Significant Accounting Policies, Continued

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 financial statements has primarily resulted as federal funds are received in advance of eligible expenditures.

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, 2008 from which summarized information was derived.

(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:

- 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%.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2009

(2) Deposits and Investments, Continued

- 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 Secretary of Administration and Finance shall be responsible for investment of all public funds collected or appropriated for use by the State. Funds under this arrangement shall include all appropriations from the State, 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 State shall be deposited or invested to earn the safest optimum interest. The Secretary 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 Secretary 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.

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.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2009

(2) Deposits and Investments, Continued

A. Deposits, Continued

As of September 30, 2009, the carrying amount of the primary government's total cash and cash equivalents and time certificates of deposit was \$2,194,051 and the corresponding bank balance was \$2,912,017, which is maintained in financial institutions subject to FDIC insurance. As of September 30, 2009, bank deposits in the amount of \$250,303 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, 2009, the carrying amount of the discretely presented component units' total cash and cash equivalents and time certificates of deposit was \$718,284, and the corresponding bank balance was \$714,427, which were maintained in financial institutions subject to FDIC insurance. As of September 30, 2009, bank deposits in the amount of \$302,337 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.

As of September 30, 2009, the State's investments at fair value are as follows:

Fixed income securities:	
Domestic fixed income	\$ <u>527,439</u>
Other investments:	
Money market funds	3,496,792
Cash management account	<u>25,008</u>
	<u>3,521,800</u>
	\$ <u>4,049,239</u>

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2009

(2) Deposits and Investments, Continued

B. Investments, Continued

As of September 30, 2009, the State's fixed income securities, including their Moody's investors service credit ratings, had the following maturities:

<u>Investment Type</u>	<u>Investment Maturities (In Years)</u>				<u>Fair Value</u>	<u>Ratings</u>
	<u>Current</u>	<u>1-5</u>	<u>6-10</u>	<u>Over</u>		
Corporate notes and bonds	\$ -	\$ -	\$ 4,162	\$ 21,745	\$ 25,907	A1
Corporate notes and bonds	-	10,138	9,768	-	19,906	A2
Corporate notes and bonds	-	3,002	-	5,109	8,111	A3
Corporate notes and bonds	-	8,603	-	6,608	15,211	AA2
Corporate notes and bonds	-	13,505	9,525	-	23,030	AA1
Corporate notes and bonds	-	5,619	5,848	-	11,467	AAA
U.S Government agency obligations:						
Federal Home Loan Mortgage Corporation	-	-	-	8,444	8,444	AAA
Federal National Mortgage Association	7,583	29,495	3,763	94,567	135,408	AAA
Federal Farm Credit Bank	-	11,359	-	-	11,359	AAA
FNMA	-	9,106	5,676	84,418	99,200	AAA
General Electric CAP	-	8,787	-	-	8,787	AA2
Government National MTG	-	-	-	2,917	2,917	AAA
PNC Funding Corp	-	4,609	-	-	4,609	A3
Tennessee Valley Authority	-	-	-	4,556	4,556	AAA
Municipal Obligations	-	-	-	1,726	1,726	AA2
US Treasury obligations	-	46,871	29,903	28,378	105,152	AAA
Corporate notes and bonds	-	15,536	19,047	-	34,583	BAA1
Corporate notes and bonds	-	<u>3,091</u>	-	<u>3,975</u>	<u>7,066</u>	BAA2
Grand Total	\$ <u>7,583</u>	\$ <u>169,721</u>	\$ <u>87,692</u>	\$ <u>262,443</u>	\$ <u>527,439</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.

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, 2009.

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.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2009

(2) Deposits and Investments, Continued

B. Investments, Continued

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, 2009, 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, 2009, 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, 2009, 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, 2009, investments at fair value comprise the following:

Money market funds	\$ 259,180
Common stock	<u>173,340</u>
	<u>\$ 432,520</u>

(3) Receivables

Receivables as of September 30, 2009, 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:						
General	\$ 718,456	\$ -	\$ -	\$ -	\$ -	\$ 718,456
Federal agencies	-	687,935	-	-	-	687,935
Taxes	335,184	-	-	-	-	335,184
Loans	-	762,630	-	-	1,707,248	2,469,878
FSM National Government	-	2,009,204	-	-	606,772	2,615,976
Other	<u>109,117</u>	<u>23,234</u>	<u>-</u>	<u>-</u>	<u>365,304</u>	<u>498,655</u>
	1,162,757	3,483,003	-	-	2,679,324	7,325,084
Less: Allowance for uncollectible accounts	<u>(775,091)</u>	<u>(2,795,068)</u>	<u>-</u>	<u>-</u>	<u>(2,304,358)</u>	<u>(5,874,517)</u>
Net receivables	<u>\$ 387,666</u>	<u>\$ 687,935</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 374,966</u>	<u>\$ 1,450,567</u>

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2009

(3) Receivables, Continued

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, 2009, the State reevaluated the allowance for doubtful debts and recorded \$103,548 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, 2009 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. \$ 367,500

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

\$ 762,630

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. \$ 1,671,064

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. 36,184

\$ 1,707,248

Receivables as of September 30, 2009, for the component units, including applicable allowance for uncollectible accounts, are as follows:

	<u>Kosrae Port Authority</u>	<u>Kosrae Utilities Authority</u>	<u>Total</u>
Receivables:			
General	\$ 59,398	\$ 369,448	\$ 428,846
Less: Allowance for uncollectible accounts	<u>(43,238)</u>	<u>(200,191)</u>	<u>(243,429)</u>
Net receivables	<u>\$ 16,160</u>	<u>\$ 169,257</u>	<u>\$ 185,417</u>

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2009

(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, 2009, are summarized as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
Grants Assistance	General	\$ 1,272,834
Nonmajor governmental funds	General	634,725
General	Nonmajor governmental funds	2,978
General	Grants Assistance	<u>531,655</u>
		<u>\$ 2,442,192</u>

(5) Fixed Assets

Capital asset activities for the year ended September 30, 2009, are as follows:

Primary Government

	Balance October <u>1, 2008</u>	<u>Increases</u>	<u>Decreases</u>	Balance September <u>30, 2009</u>
Governmental activities:				
Buildings	\$ 12,453,115	\$ 2,713,345	\$ -	\$ 15,166,460
Infrastructure	32,225,368	200,000	-	32,425,368
Machinery, equipment, others	<u>3,213,201</u>	<u>995,485</u>	<u>-</u>	<u>4,208,686</u>
	<u>47,891,684</u>	<u>3,908,830</u>	<u>-</u>	<u>51,800,514</u>
Less accumulated depreciation:				
Buildings	(10,014,855)	(1,244,676)	-	(11,259,531)
Infrastructure	(21,575,736)	(652,294)	-	(22,228,030)
Machinery, equipment, others	<u>(2,564,807)</u>	<u>(990,905)</u>	<u>-</u>	<u>(3,555,712)</u>
	<u>(34,155,398)</u>	<u>(2,887,875)</u>	<u>-</u>	<u>(37,043,273)</u>
	<u>\$ 13,736,286</u>	<u>\$ (1,020,955)</u>	<u>\$ -</u>	<u>\$ 14,757,241</u>

During the year ended September 30, 2009, depreciation expense was charged as follows:

General government	\$ 67,761
Economic development	97,744
Education	118,425
Health services	103,969
Public safety	8,103
Other appropriations	<u>741,602</u>
	<u>\$ 1,137,604</u>

During the year ended September 30, 2009, the State recognized residual proceeds of \$97,828 from the sale in 2008 of a residence in the State of Hawaii.

During the year ended September 30, 2009, the State recorded a transfer of capital assets from Micronesia Petroleum Corporation with a cost of \$3,743,464, accumulated depreciation of \$1,836,824 and depreciation expense of \$86,553. These amounts are included in the above presentation.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2009

(6) 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, 2009, 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 \$2,000,000 loan from the ADB (Loan Number 1520 (SF)) 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 \$2,000,000 identified for future debt service payments, \$1,549,633 is deposited in an investment account held jointly with the FSM National Government. That investment account is restricted for the repayment of this debt. As of September 30, 2009, the balance payable on this loan amounted to \$1,915,102.

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, 2009, the balances payable on these loans amounted to \$910,573 and \$908,408, respectively.

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 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, 2009, the balance payable on this loan amounted to \$300,973.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2009

(6) Long-Term Obligations, Continued

Primary Government, Continued

Asian Development Bank (ADB) Loans, Continued:

The State also 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. As of September 30, 2009, the balance payable on this loan amounted to \$1,500,000.

Additionally, a loan payable to the FSM Development Bank exists, ten year term, maturing on July 18, 2010, interest at 5% monthly repayment of \$7,958. As of September 30, 2009, the balance payable on this loan amounted to \$289,578. This loan originated with a discontinued component unit and was assumed by the State through its dissolution.

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>
2010	\$ 565,705	\$ 56,983	\$ 622,688
2011	288,809	55,042	343,851
2012	288,899	53,098	341,997
2013	288,994	50,753	339,747
2014	297,015	48,721	345,736
2015 – 2019	1,623,488	209,492	1,832,980
2020 – 2024	1,003,466	144,029	1,147,495
2025 – 2029	837,454	78,420	915,874
2030 – 2034	467,063	35,244	502,307
2035 – 2039	<u>299,914</u>	<u>11,101</u>	<u>311,015</u>
	\$ <u>5,960,807</u>	\$ <u>742,883</u>	\$ <u>6,703,690</u>

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. Interest rate effective as of September 30, 2009 ranges from 5.10% to 5.85%. Loan proceeds were used to acquire acquisition.

\$ 263,185

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2009

(6) Long-Term Obligations, Continued

Discretely Presented Component Units, Continued

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

Year ending September 30,	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2010	\$ 95,245	\$ 7,033	\$ 102,278
2011	98,338	3,940	102,278
2012	<u>69,602</u>	<u>868</u>	<u>70,470</u>
	<u>\$ 263,185</u>	<u>\$ 11,841</u>	<u>\$ 275,026</u>

(7) Change in Long-Term Obligations

Primary Government

Long-term liabilities will be liquidated in the future from governmental funds. During the year ended September 30, 2009, 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, 2008	<u>Additions</u>	<u>Reductions</u>	Balance September 30, 2009	Due Within One Year
Loans payable:					
ADB loans:					
Loan 1520	\$ 1,955,102	\$ -	\$ (40,000)	\$ 1,915,102	\$ 40,000
Loan 1816	326,631	1,613	(27,271)	300,973	27,271
Loan 1873	910,573	-	-	910,573	28,455
Loan 1874	872,286	36,122	-	908,408	28,388
FSMDB loan	-	289,578	-	289,578	289,578
MWSP loan	136,173	-	-	136,173	2,013
FSMNG loan	<u>1,500,000</u>	<u>-</u>	<u>-</u>	<u>1,500,000</u>	<u>150,000</u>
	<u>5,700,765</u>	<u>327,313</u>	<u>(67,271)</u>	<u>5,960,807</u>	<u>565,705</u>
Other:					
Claims	<u>110,000</u>	<u>125,000</u>	<u>-</u>	<u>235,000</u>	<u>-</u>
	<u>\$ 5,810,765</u>	<u>\$ 442,313</u>	<u>\$ (67,271)</u>	<u>\$ 6,195,807</u>	<u>\$ 565,705</u>

The above debt of \$289,578 was previously recorded on the books of MPC, a dissolved component unit, and the State recognized no related cash or expenditures in connection with this transaction.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2009

(7) Change in Long-Term Obligations, Continued

Discretely Presented Component Units

During the year ended September 30, 2009, 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, 2008	<u>Additions</u>	<u>Reductions</u>	Balance September 30, 2009	Due Within One Year
KUA loan payable	\$ 359,241	\$ -	\$ (96,056)	\$ 263,185	\$ 95,245

(8) 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, 2009 is \$301,412.

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

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.

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 an amount in excess of the escrow account balance, an amount that is presently indeterminable.

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, 2009, is not predictable but could have a material impact on the accompanying financial statements. Such impact has currently been estimated to approximate \$235,000, 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, 2009

(8) 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.

(9) Prior Period Adjustment and Special Items

Effective in fiscal year 2009, the Micronesian Petroleum Corporation (MPC), a component unit of the State in fiscal years 2008 and prior, was dissolved and its net assets were transferred into the State's general fund.

This event gave rise to a prior period adjustment of \$1,772,628 reflecting the net assets of MPC as of September 30, 2008 and also gave rise to a gain from discontinuation of component unit operations in 2009 and a loss on attempted collection of the MPC outstanding receivables.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

YEAR ENDED SEPTEMBER 30, 2009

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Revenues, Expenditures, and Changes in Deficit - Budget and Actual
General Fund
Year Ended September 30, 2009

	Budgeted Amounts		Actual - Budgetary Basis (see Note 1)	Variance with Final Budget -
	Original	Final		
Revenues:				
FSM revenue sharing	\$ 689,668	\$ 889,668	\$ 1,039,493	\$ 149,825
State taxes	416,384	531,316	518,783	(12,533)
Licenses and fees	33,807	305,316	180,996	(124,320)
Interest and dividends	-	-	31,188	31,188
Other	180,498	193,715	383,853	190,138
Total revenues	1,320,357	1,920,015	2,154,313	234,298
Expenditures:				
Current:				
General government	1,058,350	1,058,350	1,052,827	5,523
Economic development	148,115	199,273	196,187	3,086
Education	396	396	(102)	498
Public order and safety	279,473	279,473	274,961	4,512
Boards, commissions and other	630,693	630,693	585,372	45,321
Total expenditures	2,117,027	2,168,185	2,109,245	58,940
Excess (deficiency) of revenues over (under) expenditures	(796,670)	(248,170)	45,068	293,238
Other financing sources:				
Proceeds from sale of capital assets	-	-	97,828	97,828
Operating transfers in	-	51,158	51,158	-
Total other financing sources	-	51,158	148,986	97,828
Special items:				
Discontinued operations of MPC	-	-	603,906	603,906
Write-off of receivables, net of recovery	-	-	(103,548)	(103,548)
Total special items	-	-	500,358	500,358
Net change in unreserved deficit	(796,670)	(197,012)	694,412	891,424
Other changes in unreserved deficit:				
Increase in reserve for related assets	-	-	(19,733)	(19,733)
Decrease in reserve for continuing appropriations	-	-	6,000	6,000
Encumbrances for supplies and equipment ordered but not received are reported in the year the order is placed for budgetary purposes but in the year the supplies are received for financial reporting purposes	47,259	47,259	47,259	-
Unreserved deficit at the beginning of the year	(1,039,711)	(1,039,711)	(1,039,711)	-
Unreserved deficit at the end of the year	<u>\$ (1,789,122)</u>	<u>\$ (1,189,464)</u>	<u>\$ (311,773)</u>	<u>\$ 877,691</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, 2009

(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.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Required Supplementary Information – Budgetary Reporting, Continued
September 30, 2009

(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 balance (deficit)	\$ 736,492
Encumbrances	<u>(42,080)</u>
Net change in unreserved fund deficit	\$ <u>694,412</u>

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

OTHER SUPPLEMENTARY INFORMATION

YEAR ENDED SEPTEMBER 30, 2009

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Combining Schedule of Expenditures by Account
Governmental Funds
Year Ended September 30, 2009

	Special Revenue			Permanent	Other	Total
	General	Grants Assistance	Early Retirement Program	Compact Trust	Governmental Funds	
Expenditures:						
Salaries and wages:						
Regular	\$ 1,336,192	\$ 2,913,693	\$ -	\$ -	\$ -	\$ 4,249,885
Overtime	28,557	129,465	-	-	-	158,022
Fringe benefits	154,078	350,960	-	-	-	505,038
Other personnel costs	10,209	(1,075)	-	-	-	9,134
Travel and transportation	78,022	432,620	-	-	14,239	524,881
Communications	31,689	57,057	-	-	2,260	91,006
Dues, membership, and subscriptions	11,200	821	-	-	-	12,021
Food stuffs	4,636	52,748	-	-	1,486	58,870
Port charges	106	849	-	-	-	955
Capital outlays	-	39,751	-	-	-	39,751
Office supplies and materials	34,133	793,471	-	-	101,883	929,487
POL	15,812	124,929	-	-	15,667	156,408
Printing and reproduction	1,377	25,642	-	-	63	27,082
Rental services	643	6,886	-	-	6,820	14,349
Repairs and maintenance	2,710	35,932	-	-	-	38,642
Utilities	86,026	286,067	-	-	9,109	381,202
Subsidies and contributions	23,000	-	-	-	-	23,000
Medical referral	-	19,358	-	-	-	19,358
Medical supplies	-	456,153	-	-	8,413	464,566
Contractual services	90,468	1,813,403	-	-	-	1,903,871
Professional services	-	27,699	-	-	-	27,699
Retirement contributions	80,732	50,255	-	-	-	130,987
Scholarships and allowances	-	369,708	-	-	-	369,708
Training	-	352,841	-	-	-	352,841
Leased housing, buildings and land	71,663	131,571	-	-	10,000	213,234
Equipment	-	314,135	-	-	-	314,135
Principal repayment	-	-	67,271	-	-	67,271
Interest payments	-	-	51,901	-	-	51,901
Miscellaneous	5,912	2,827	-	-	18,302	27,041
	<u>\$ 2,067,165</u>	<u>\$ 8,787,766</u>	<u>\$ 119,172</u>	<u>\$ -</u>	<u>\$ 188,242</u>	<u>\$ 11,162,345</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Statement of Revenues, Expenditures by Function,
and Changes in Fund Balance (Deficit)
General Fund
Year Ended September 30, 2009
(with comparative totals for the year ended September 30, 2008)

	2009	2008
Revenues:		
FSM revenue sharing	1,039,493	1,076,009
State taxes:		
Sales tax	518,783	501,483
Fees and charges:		
Licenses and fees	180,996	220,851
Interest and dividend income	31,188	39,417
Other:		
Sales of petroleum products	32,229	-
Other	351,624	239,675
	383,853	239,675
Total revenues	2,154,313	2,077,435
Expenditures:		
Current:		
General government:		
Office of the Governor	141,359	199,639
Department of Administration and Finance	251,082	310,649
Judiciary Branch	147,483	259,253
Legislative Branch	510,903	638,038
Election	2,000	2,879
	1,052,827	1,410,458
Economic Development:		
Department of Resources and Economic Affairs	54,825	-
Land Management and Preservation	(74)	14,794
Housing	99,382	49,219
Survey and Mapping	60	68,547
Mangrove Crab Project	23,719	-
Fisheries Development	-	(68)
USDA Rural Development	-	67,451
	177,912	199,943
Education:		
Scholarship Loan Collection	(102)	16,359
Public Order and Safety:		
Office of the Attorney General	274,681	165,594
Parole board	280	500
	274,961	166,094
Boards, Commissions and Other:		
Department of Transportation and Infrastructure	317,263	340,219
Community Affairs	13,261	29,759
Broadcast Authority	39,307	44,997
Sports Council	15,559	17,469
Retirement Pension Program	80,732	97,028
RM Small Business Development Center	1,825	-
Land Court	85,659	-
Historic Preservation	5,347	-
SDA School	6,000	30,000
Municipal governments	16,000	-
Other	(19,386)	231,335
	561,567	790,807
Total expenditures	2,067,165	2,583,661
Excess (deficiency) of revenues over (under) expenditures	87,148	(506,226)

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Statement of Revenues, Expenditures by Function,
and Changes in Fund Balance (Deficit), Continued
General Fund
Year Ended September 30, 2009
(with comparative totals for the year ended September 30, 2008)

	2009	2008
Other financing sources:		
Proceeds from sale of capital assets	97,828	548,177
Loan proceeds	-	222,553
Operating transfers in	51,158	-
Total other financing sources	148,986	770,730
Special items:		
Discontinued operations of MPC	603,906	-
Write-off of receivables, net of recovery	(103,548)	(176,846)
	500,358	(176,846)
Net change in fund balance (deficit)	736,492	87,658
Deficit at the beginning of the year	(79,984)	(167,642)
Fund balance (deficit) at the end of the year	\$ 656,508	\$ (79,984)

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, 2009

	Budgeted Amounts		Actual Amounts	Variance
	Original	Final	Budgetary Basis	
Revenues:				
FSM revenue sharing:	\$ 689,668	\$ 889,668	\$ 1,039,493	\$ 149,825
State taxes:				
Sales tax	416,384	531,316	518,783	(12,533)
Fees and charges:				
Licences and fees	33,807	305,316	180,996	(124,320)
Interest and dividend income	-	-	31,188	31,188
Other:				
Sales of petroleum products	-	-	32,229	32,229
Other	180,498	193,715	351,624	157,909
	180,498	193,715	383,853	190,138
Total revenues	1,320,357	1,920,015	2,154,313	234,298
Expenditures:				
Current:				
General government:				
Office of the Governor	143,893	143,893	141,359	2,534
Department of Administration and Finance	250,190	250,190	251,082	(892)
Judiciary Branch	148,189	148,189	147,483	706
Legislative Branch	514,078	514,078	510,903	3,175
Election	2,000	2,000	2,000	-
	1,058,350	1,058,350	1,052,827	5,523
Economic development:				
Department of Resources and Economic Affairs	73,118	73,118	54,825	18,293
Land Management and Preservation	450	450	(74)	524
Housing	48,886	100,044	117,657	(17,613) ⁽¹⁾
Survey and Mapping	60	60	60	-
Mangrove Crab Project	25,601	25,601	23,719	1,882
	148,115	199,273	196,187	3,086
Education:				
Scholarship Loan Collection	396	396	(102)	498
Public order and safety:				
Office of the Attorney General	278,473	278,473	274,681	3,792
Parole board	1,000	1,000	280	720
	279,473	279,473	274,961	4,512

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, Continued
General Fund
Year Ended September 30, 2009

	Budgeted Amounts		Actual Amounts	Variance
	Original	Final	Budgetary Basis	
Boards, commissions and other:				
Department of Transportation and Infrastructure	323,855	323,855	317,263	6,592
Community Affairs	15,534	15,534	13,261	2,273
Broadcast Authority	39,393	39,393	39,307	86
Sports Council	16,473	16,473	15,559	914
Retirement Pension Program	90,000	90,000	80,732	9,268
Small Business Development Center	2,148	2,148	1,825	323
Land Court	88,551	88,551	85,659	2,892
Historic Preservation	22,786	22,786	5,347	17,439
SDA school	6,000	6,000	6,000	-
Municipal governments	16,000	16,000	16,000	-
Housing Improvement Program	9,953	9,953	-	9,953
Other	-	-	4,419	(4,419)
	<u>630,693</u>	<u>630,693</u>	<u>585,372</u>	<u>45,321</u>
Total expenditures	<u>2,117,027</u>	<u>2,168,185</u>	<u>2,109,245</u>	<u>58,940</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(796,670)</u>	<u>(248,170)</u>	<u>45,068</u>	<u>293,238</u>
Other financing sources:				
Proceeds from sale of capital assets	-	-	97,828	97,828
Operating transfers in	-	51,158	51,158	-
Total other financing sources	-	51,158	148,986	97,828
Special items:				
Discontinued operations of MPC	-	-	603,906	603,906
Write-off of receivables, net of recovery	-	-	(103,548)	(103,548)
	<u>-</u>	<u>-</u>	<u>500,358</u>	<u>500,358</u>
Net change in unreserved deficit	<u>(796,670)</u>	<u>(197,012)</u>	<u>694,412</u>	<u>891,424</u>
Other changes in unreserved deficit:				
Increase in reserve for related assets	-	-	(19,733)	(19,733)
Decrease in reserve for continuing appropriations	-	-	6,000	6,000
Encumbrances for supplies and equipment ordered but not received are reported in the year the order is placed for budgetary purposes but in the year the supplies are received for financial reporting purposes	47,259	47,259	47,259	-
Unreserved deficit at the beginning of the year	<u>(1,039,711)</u>	<u>(1,039,711)</u>	<u>(1,039,711)</u>	<u>-</u>
Unreserved deficit at the end of the year	<u>\$ (1,789,122)</u>	<u>\$ (1,189,464)</u>	<u>\$ (311,773)</u>	<u>\$ 877,691</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Combined Balance Sheet
Nonmajor Governmental Funds
September 30, 2009

	<u>Other Special Revenue</u>	<u>Other Capital Projects</u>	<u>Total</u>
<u>ASSETS</u>			
Receivables:			
General	\$ -	\$ 2,415	\$ 2,415
Loans	372,551	-	372,551
Due from other funds	592,224	42,501	634,725
Restricted assets:			
Cash and cash equivalents	51,942	-	51,942
Time certificates of deposit	354,383	-	354,383
Total assets	<u>\$ 1,371,100</u>	<u>\$ 44,916</u>	<u>\$ 1,416,016</u>
 <u>LIABILITIES AND FUND BALANCES</u>			
Liabilities:			
Accounts payable	\$ 76,782	\$ 1,174	\$ 77,956
Due to other funds	2,978	-	2,978
Deferred revenue	-	33	33
Total liabilities	<u>79,760</u>	<u>1,207</u>	<u>80,967</u>
Fund balances:			
Reserved for:			
Related assets	778,876	-	778,876
Encumbrances	226,355	964	227,319
Unreserved:			
Special revenue funds	286,109	-	286,109
Capital projects funds	-	42,745	42,745
Total fund balances	<u>1,291,340</u>	<u>43,709</u>	<u>1,335,049</u>
Total liabilities and fund balances	<u>\$ 1,371,100</u>	<u>\$ 44,916</u>	<u>\$ 1,416,016</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, 2009

	<u>Other Special Revenue</u>	<u>Other Capital Projects</u>	<u>Total</u>
Revenues:			
Fees and charges	\$ 246,600	\$ -	\$ 246,600
CFSM grants	-	24,051	24,051
Interest income	85,382	-	85,382
Total revenues	<u>331,982</u>	<u>24,051</u>	<u>356,033</u>
Expenditures by function:			
Current:			
General government	-	28,302	28,302
Health services	8,413	-	8,413
Public order and safety	-	38,290	38,290
Environment protection and sanitation	97,920	-	97,920
Boards, commissions and other	15,317	-	15,317
Total expenditures	<u>121,650</u>	<u>66,592</u>	<u>188,242</u>
Excess (deficiency) of revenues over (under) expenditures	210,332	(42,541)	167,791
Other financing uses:			
Operating transfers out	<u>(51,158)</u>	<u>-</u>	<u>(51,158)</u>
Net change in fund balances	159,174	(42,541)	116,633
Fund balances at the beginning of the year	<u>1,132,166</u>	<u>86,250</u>	<u>1,218,416</u>
Fund balances at the end of the year	<u>\$ 1,291,340</u>	<u>\$ 43,709</u>	<u>\$ 1,335,049</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, 2009

	Other Special Revenue	Other Capital Projects	Total
Revenues:			
Fees and charges	\$ 246,600	\$ -	\$ 246,600
CFSM grants	-	24,051	24,051
Interest income	85,382	-	85,382
Total revenues	331,982	24,051	356,033
Expenditures by account:			
Travel and transportation	-	14,239	14,239
Communications	661	1,599	2,260
Food stuffs	-	1,486	1,486
Office supplies and materials	98,346	3,537	101,883
POL	13,167	2,500	15,667
Printing and reproduction	63	-	63
Rental services	-	6,820	6,820
Utilities	1,000	8,109	9,109
Medical supplies	8,413	-	8,413
Leased housing, buildings and land	-	10,000	10,000
Miscellaneous	-	18,302	18,302
Total expenditures	187,454	66,592	254,046
Excess (deficiency) of revenues over (under) expenditures	144,528	(42,541)	101,987
Other financing uses:			
Operating transfers out	(51,158)	-	(51,158)
Net change in fund balances	93,370	(42,541)	50,829
Fund balances at the beginning of the year	1,132,166	86,250	1,218,416
Fund balances at the end of the year	\$ 1,225,536	\$ 43,709	\$ 1,269,245

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

**NONMAJOR GOVERNMENTAL FUNDS
SPECIAL REVENUE FUNDS**

Combining Balance Sheet
September 30, 2009

	<u>Agriculture Revolving</u>	<u>Production Loan</u>	<u>Scholarship Revolving Loan</u>	<u>Home Improvement Program Revolving</u>	<u>Aluminum Recycling</u>	<u>Health Care</u>	<u>Sports Council</u>	<u>Broadcast Authority</u>	<u>Gifford Scholarship</u>	<u>Transportation Infrastructure Revolving</u>	<u>Total</u>
<u>ASSETS</u>											
Receivables:											
Loans	\$ -	\$ -	\$ -	\$ 372,551	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 372,551
Due from other funds	-	1,495	6,584	160,960	144,843	257,760	716	4,656	-	15,210	592,224
Restricted:											
Cash and equivalents	-	-	-	-	-	-	-	-	51,942	-	51,942
Time certificates of deposit	-	-	-	-	-	-	-	-	354,383	-	354,383
Total assets	<u>\$ -</u>	<u>\$ 1,495</u>	<u>\$ 6,584</u>	<u>\$ 533,511</u>	<u>\$ 144,843</u>	<u>\$ 257,760</u>	<u>\$ 716</u>	<u>\$ 4,656</u>	<u>\$ 406,325</u>	<u>\$ 15,210</u>	<u>\$ 1,371,100</u>
<u>LIABILITIES AND FUND BALANCES</u>											
Liabilities:											
Accounts payable	\$ -	\$ -	\$ -	\$ 23,763	\$ 2,666	\$ 50,000	\$ -	\$ 353	\$ -	\$ -	\$ 76,782
Due to other funds	-	-	-	-	-	-	-	-	2,978	-	2,978
Total liabilities	<u>-</u>	<u>-</u>	<u>-</u>	<u>23,763</u>	<u>2,666</u>	<u>50,000</u>	<u>-</u>	<u>353</u>	<u>2,978</u>	<u>-</u>	<u>79,760</u>
Fund balances:											
Reserved for:											
Related assets	-	-	-	372,551	-	-	-	-	406,325	-	778,876
Encumbrances	365	-	-	225,790	-	-	-	200	-	-	226,355
Unreserved (deficit)	<u>(365)</u>	<u>1,495</u>	<u>6,584</u>	<u>(88,593)</u>	<u>142,177</u>	<u>207,760</u>	<u>716</u>	<u>4,103</u>	<u>(2,978)</u>	<u>15,210</u>	<u>286,109</u>
Total fund balances	<u>-</u>	<u>1,495</u>	<u>6,584</u>	<u>509,748</u>	<u>142,177</u>	<u>207,760</u>	<u>716</u>	<u>4,303</u>	<u>403,347</u>	<u>15,210</u>	<u>1,291,340</u>
Total liabilities and fund balances	<u>\$ -</u>	<u>\$ 1,495</u>	<u>\$ 6,584</u>	<u>\$ 533,511</u>	<u>\$ 144,843</u>	<u>\$ 257,760</u>	<u>\$ 716</u>	<u>\$ 4,656</u>	<u>\$ 406,325</u>	<u>\$ 15,210</u>	<u>\$ 1,371,100</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 Function,
and Changes in Fund Balances (Deficits)
Year Ended September 30, 2009

	Agriculture Revolving	Production Loan	Scholarship Revolving Loan	Home Improvement Program Revolving	Aluminum Recycling	Health Care	Sports Council	Broadcast Authority	Gifford Scholarship	Transportation Infrastructure Revolving	Total
Revenues:											
Fees and charges	\$ -	\$ -	\$ 2,666	\$ 825	\$ 78,529	\$ 157,819	\$ 540	\$ 2,692	\$ -	\$ 3,529	\$ 246,600
Interest income	-	-	-	80,431	256	426	-	-	4,269	-	85,382
Total revenues	<u>-</u>	<u>-</u>	<u>2,666</u>	<u>81,256</u>	<u>78,785</u>	<u>158,245</u>	<u>540</u>	<u>2,692</u>	<u>4,269</u>	<u>3,529</u>	<u>331,982</u>
Expenditures by function:											
Current:											
Health services	-	-	-	-	-	8,413	-	-	-	-	8,413
Environment protection and sanitation	-	-	-	-	97,920	-	-	-	-	-	97,920
Boards, commissions and other	-	-	-	-	-	-	426	1,724	-	13,167	15,317
Total expenditures	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>97,920</u>	<u>8,413</u>	<u>426</u>	<u>1,724</u>	<u>-</u>	<u>13,167</u>	<u>121,650</u>
Excess (deficiency) of revenues over (under) expenditures	-	-	2,666	81,256	(19,135)	149,832	114	968	4,269	(9,638)	210,332
Other financing uses:											
Operating transfers out	<u>-</u>	<u>-</u>	<u>-</u>	<u>(51,158)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(51,158)</u>
Net change in fund balances	-	-	2,666	30,098	(19,135)	149,832	114	968	4,269	(9,638)	159,174
Fund balances at the beginning of the year	-	1,495	3,918	479,650	161,312	57,928	602	3,335	399,078	24,848	1,132,166
Fund balances at the end of the year	<u>\$ -</u>	<u>\$ 1,495</u>	<u>\$ 6,584</u>	<u>\$ 509,748</u>	<u>\$ 142,177</u>	<u>\$ 207,760</u>	<u>\$ 716</u>	<u>\$ 4,303</u>	<u>\$ 403,347</u>	<u>\$ 15,210</u>	<u>\$ 1,291,340</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, 2009

	Agriculture Revolving	Production Loan	Scholarship Revolving Loan	Home Improvement Program Revolving	Aluminum Recycling	Health Care	Sports Council	Broadcast Authority	Gifford Scholarship	Transportation Infrastructure Revolving	Total
Revenues:											
Fees and charges	\$ -	\$ -	\$ 2,666	\$ 825	\$ 78,529	\$ 157,819	\$ 540	\$ 2,692	\$ -	\$ 3,529	\$ 246,600
Interest income	-	-	-	80,431	256	426	-	-	4,269	-	85,382
Total revenues	-	-	2,666	81,256	78,785	158,245	540	2,692	4,269	3,529	331,982
Expenditures by account:											
Medical supplies	-	-	-	-	-	8,413	-	-	-	-	8,413
Office supplies and materials	-	-	-	-	97,920	-	426	-	-	-	98,346
Utilities	-	-	-	-	-	-	-	1,000	-	-	1,000
POL	-	-	-	-	-	-	-	-	-	13,167	13,167
Communications	-	-	-	-	-	-	-	661	-	-	661
Printing and reproduction	-	-	-	-	-	-	-	63	-	-	63
Total expenditures	-	-	-	-	97,920	8,413	426	1,724	-	13,167	121,650
Excess (deficiency) of revenues over (under) expenditures	-	-	2,666	81,256	(19,135)	149,832	114	968	4,269	(9,638)	210,332
Other financing uses:											
Operating transfers out	-	-	-	(51,158)	-	-	-	-	-	-	(51,158)
Net change in fund balances	-	-	2,666	30,098	(19,135)	149,832	114	968	4,269	(9,638)	159,174
Fund balances at the beginning of the year	-	1,495	3,918	479,650	161,312	57,928	602	3,335	399,078	24,848	1,132,166
Fund balances at the end of the year	\$ -	\$ 1,495	\$ 6,584	\$ 509,748	\$ 142,177	\$ 207,760	\$ 716	\$ 4,303	\$ 403,347	\$ 15,210	\$ 1,291,340

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

GRANTS ASSISTANCE FUND

Combining Balance Sheet
September 30, 2009

	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	106,892	-	396,762	-	48,898
Prepayments	-	1,980	7,756	11,328	1,985
Advances	-	257,527	-	4,259	1,900
Due from other funds	<u>182,384</u>	<u>365,758</u>	<u>-</u>	<u>276,508</u>	<u>-</u>
	<u>\$ 289,276</u>	<u>\$ 625,265</u>	<u>\$ 404,518</u>	<u>\$ 292,095</u>	<u>\$ 52,783</u>
<u>LIABILITIES AND FUND BALANCES</u>					
Liabilities:					
Accounts payable	\$ 27,565	\$ 145,130	\$ 4,491	\$ 3,076	\$ 7,383
Other liabilities and accruals	73,943	47,770	17,631	6,766	5,041
Due to other funds	-	-	382,396	-	16,141
Deferred revenues	<u>-</u>	<u>91,207</u>	<u>-</u>	<u>185,027</u>	<u>24,218</u>
Total liabilities	<u>101,508</u>	<u>284,107</u>	<u>404,518</u>	<u>194,869</u>	<u>52,783</u>
Fund balances:					
Reserved for:					
Related assets	-	-	-	-	-
Continuing appropriations	-	-	-	-	-
Encumbrances	81,903	470,942	90,232	32,631	13,986
Unreserved (deficits)	<u>105,865</u>	<u>(129,784)</u>	<u>(90,232)</u>	<u>64,595</u>	<u>(13,986)</u>
Total fund balances	<u>187,768</u>	<u>341,158</u>	<u>-</u>	<u>97,226</u>	<u>-</u>
Total liabilities and fund balances	<u>\$ 289,276</u>	<u>\$ 625,265</u>	<u>\$ 404,518</u>	<u>\$ 292,095</u>	<u>\$ 52,783</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

GRANTS ASSISTANCE FUND

Combining Balance Sheet, Continued
September 30, 2009

	<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	-	135,383	-	-	-
Prepayments		9,291	-		-
Advances	-	78,805	-	-	-
Due from other funds	<u>72,930</u>	<u>-</u>	<u>81,902</u>	<u>4,024</u>	<u>116,699</u>
	<u>\$ 72,930</u>	<u>\$ 223,479</u>	<u>\$ 81,902</u>	<u>\$ 804,024</u>	<u>\$ 216,699</u>
 <u>LIABILITIES AND FUND BALANCES</u>					
Liabilities:					
Accounts payable	\$ 6,062	\$ 25,409	\$ 19,104	\$ 35,482	\$ 1,715
Other liabilities and accruals	-	16,359	3,829	-	282
Due to other funds	-	133,118	-	-	-
Deferred revenues	<u>-</u>	<u>48,593</u>	<u>58,969</u>	<u>-</u>	<u>62,493</u>
Total liabilities	<u>6,062</u>	<u>223,479</u>	<u>81,902</u>	<u>35,482</u>	<u>64,490</u>
Fund balances:					
Reserved for:					
Related assets	-	-	-	800,000	100,000
Continuing appropriations	-	-	-	-	196,399
Encumbrances	66,786	202,375	14,048	-	1,150
Unreserved (deficits)	<u>82</u>	<u>(202,375)</u>	<u>(14,048)</u>	<u>(31,458)</u>	<u>(145,340)</u>
Total fund balances	<u>66,868</u>	<u>-</u>	<u>-</u>	<u>768,542</u>	<u>152,209</u>
Total liabilities and fund balances	<u>\$ 72,930</u>	<u>\$ 223,479</u>	<u>\$ 81,902</u>	<u>\$ 804,024</u>	<u>\$ 216,699</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

GRANTS ASSISTANCE FUND

Combining Balance Sheet, Continued
September 30, 2009

	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	-	-	-	-	-	687,935
Prepayments	-	-	-	-	-	32,340
Advances	-	-	-	-	-	342,491
Due from other funds	<u>19,867</u>	<u>143,729</u>	<u>-</u>	<u>153</u>	<u>8,880</u>	<u>1,272,834</u>
	<u>\$ 19,867</u>	<u>\$ 143,729</u>	<u>\$ -</u>	<u>\$ 153</u>	<u>\$ 8,880</u>	<u>\$ 3,235,600</u>
<u>LIABILITIES AND FUND BALANCES</u>						
Liabilities:						
Accounts payable	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 275,417
Other liabilities and accruals	-	-	-	-	-	171,621
Due to other funds	-	-	-	-	-	531,655
Deferred revenues	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>470,507</u>
Total liabilities	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,449,200</u>
Fund balances:						
Reserved for:						
Related assets	-	-	-	-	-	900,000
Continuing appropriations	-	-	-	-	-	196,399
Encumbrances	-	-	-	-	-	974,053
Unreserved (deficits)	<u>19,867</u>	<u>143,729</u>	<u>-</u>	<u>153</u>	<u>8,880</u>	<u>(284,052)</u>
Total fund balances	<u>19,867</u>	<u>143,729</u>	<u>-</u>	<u>153</u>	<u>8,880</u>	<u>1,786,400</u>
Total liabilities and fund balances	<u>\$ 19,867</u>	<u>\$ 143,729</u>	<u>\$ -</u>	<u>\$ 153</u>	<u>\$ 8,880</u>	<u>\$ 3,235,600</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, 2009

	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	\$ 2,689,074	\$ 2,772,812	\$ 734,506	\$ 123,598	\$ 219,658
Federal contributions	-	-	-	-	-
Other grants	-	-	-	-	-
Interest income	-	-	-	-	-
	<u>2,689,074</u>	<u>2,772,812</u>	<u>734,506</u>	<u>123,598</u>	<u>219,658</u>
Expenditures by function:					
Current:					
General government	-	-	-	375,168	-
Economic development	-	-	734,506	-	256,472
Education	2,501,306	-	-	-	-
Health services	-	2,479,624	-	-	-
Environment protection and sanitation	-	-	-	-	-
Boards, commissions, and other	-	-	-	-	-
	<u>2,501,306</u>	<u>2,479,624</u>	<u>734,506</u>	<u>375,168</u>	<u>256,472</u>
Total expenditures	<u>2,501,306</u>	<u>2,479,624</u>	<u>734,506</u>	<u>375,168</u>	<u>256,472</u>
Net change in fund balances	187,768	293,188	-	(251,570)	(36,814)
Fund balances at the beginning of the year	<u>-</u>	<u>47,970</u>	<u>-</u>	<u>348,796</u>	<u>36,814</u>
Fund balances at the end of the year	<u>\$ 187,768</u>	<u>\$ 341,158</u>	<u>\$ -</u>	<u>\$ 97,226</u>	<u>\$ -</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, 2009

	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	\$ 632,385	\$ 1,498,866	\$ -	\$ -	\$ -
Federal contributions	-	-	153,394	-	-
Other grants	-	-	-	-	55,591
Interest income	-	-	-	6,581	-
	<u>632,385</u>	<u>1,498,866</u>	<u>153,394</u>	<u>6,581</u>	<u>55,591</u>
Expenditures by function:					
Current:					
General government	674,517	-	51,179	-	(3,272)
Economic development	-	-	-	58,963	740
Education	-	1,498,866	-	-	34,059
Health services	-	-	20,510	-	12,634
Environment protection and sanitation	-	-	-	-	11,430
Boards, commissions, and other	-	-	81,705	-	-
	<u>674,517</u>	<u>1,498,866</u>	<u>153,394</u>	<u>58,963</u>	<u>55,591</u>
Total expenditures	<u>674,517</u>	<u>1,498,866</u>	<u>153,394</u>	<u>58,963</u>	<u>55,591</u>
Net change in fund balances	(42,132)	-	-	(52,382)	-
Fund balances at the beginning of the year	<u>109,000</u>	<u>-</u>	<u>-</u>	<u>820,924</u>	<u>152,209</u>
Fund balances at the end of the year	<u>\$ 66,868</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 768,542</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, 2009

	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	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 8,670,899
Federal contributions	-	-	-	-	-	153,394
Other grants	-	-	-	-	-	55,591
Interest income	-	-	-	-	-	6,581
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>8,886,465</u>
Expenditures by function:						
Current:						
General government	-	-	-	-	-	1,097,592
Economic development	-	-	-	-	-	1,050,681
Education	-	-	-	(153)	-	4,034,078
Health services	-	(488)	-	-	-	2,512,280
Environment protection and sanitation	-	-	-	-	-	11,430
Boards, commissions, and other	-	-	-	-	-	81,705
	<u>-</u>	<u>(488)</u>	<u>-</u>	<u>(153)</u>	<u>-</u>	<u>8,787,766</u>
Total expenditures	<u>-</u>	<u>(488)</u>	<u>-</u>	<u>(153)</u>	<u>-</u>	<u>8,787,766</u>
Net change in fund balances	-	488	-	153	-	98,699
Fund balances at the beginning of the year	<u>19,867</u>	<u>143,241</u>	<u>-</u>	<u>-</u>	<u>8,880</u>	<u>1,687,701</u>
Fund balances at the end of the year	<u>\$ 19,867</u>	<u>\$ 143,729</u>	<u>\$ -</u>	<u>\$ 153</u>	<u>\$ 8,880</u>	<u>\$ 1,786,400</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, 2009

	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	\$ 2,689,074	\$ 2,772,812	\$ 734,506	\$ 123,598	\$ 219,658
Federal contributions	-	-	-	-	-
Other grants	-	-	-	-	-
Interest income	-	-	-	-	-
	<u>2,689,074</u>	<u>2,772,812</u>	<u>734,506</u>	<u>123,598</u>	<u>219,658</u>
Expenditures by account:					
Salaries and wages:					
Regular	1,340,728	773,841	296,480	115,639	115,121
Overtime	524	110,753	12,696	-	1,038
Fringe benefits	163,543	94,045	37,579	7,861	16,722
Other personnel costs	-	-	2,175	-	-
Travel and transportation	24,477	168,257	77,194	37,895	7,695
Communications	18,955	3,125	13,369	8,530	2,241
Dues, membership, and subscriptions	-	821	-	-	-
Food stuffs	2,094	36,846	800	1,034	4,512
Port charges	102	464	-	-	-
Capital outlays	39,751	-	-	-	-
Office supplies and materials	379,608	78,204	41,393	9,092	19,522
POL	41,760	9,823	12,842	2,516	19,337
Printing and reproduction	1,509	14,662	240	1,815	573
Rental services	1,060	340	4,329	302	210
Repairs and maintenance	20,086	5,746	663	50	-
Utilities	85,732	150,918	20,507	4,669	4,585
Medical referral	-	19,358	-	-	-
Medical supplies	-	456,153	-	-	-
Contractual services	70,528	382,502	141,180	44,355	52,143
Professional services	-	-	13,380	14,319	-
Retirement contributions	622	4,250	-	-	140
Scholarships and allowances	199,258	2,540	-	-	700
Training	-	15,756	43,671	85,022	8,313
Leased housing, buildings and land	63,045	18,150	9,068	19,470	1,855
Equipment	45,351	140,785	5,541	25,901	-
Miscellaneous	2,573	(7,715)	1,399	(3,302)	1,765
Total expenditures	<u>2,501,306</u>	<u>2,479,624</u>	<u>734,506</u>	<u>375,168</u>	<u>256,472</u>
Net change in fund balances	187,768	293,188	-	(251,570)	(36,814)
Fund balances at the beginning of the year	-	47,970	-	348,796	36,814
Fund balances at the end of the year	<u>\$ 187,768</u>	<u>\$ 341,158</u>	<u>\$ -</u>	<u>\$ 97,226</u>	<u>\$ -</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, 2009

	Section 211(a)(6) Infrastructure	Section 211(a)(7) Supplemental Education	U.S. Federal Grants	Compact Capital Projects	Foreign Assistance
Revenues:					
Compact funding	\$ 632,385	\$ 1,498,866	\$ -	\$ -	\$ -
Federal contributions	-	-	153,394	-	-
Other grants	-	-	-	-	55,591
Interest income	-	-	-	6,581	-
	<u>632,385</u>	<u>1,498,866</u>	<u>153,394</u>	<u>6,581</u>	<u>55,591</u>
Expenditures by account:					
Salaries and wages:					
Regular	-	201,387	65,219	-	5,278
Overtime	-	-	4,454	-	-
Fringe benefits	-	25,461	5,363	-	386
Other personnel costs	-	-	-	-	(3,250)
Travel and transportation	-	102,962	8,672	-	5,468
Communications	-	9,387	1,450	-	-
Dues, membership, and subscriptions	-	-	-	-	-
Food stuffs	-	4,942	-	-	2,520
Port charges	-	283	-	-	-
Capital outlays	-	-	-	-	-
Office supplies and materials	75,991	165,185	16,847	-	7,629
POL	22,438	15,311	902	-	-
Printing and reproduction	-	400	18	-	6,425
Rental services	-	600	-	-	45
Repairs and maintenance	-	9,387	-	-	-
Utilities	25	17,095	1,536	-	1,000
Medical referral	-	-	-	-	-
Medical supplies	-	-	-	-	-
Contractual services	576,063	463,371	-	58,963	24,298
Professional services	-	-	-	-	-
Retirement contributions	-	36,384	3,059	-	5,800
Scholarships and allowances	-	167,210	-	-	-
Training	-	200,079	-	-	-
Leased housing, buildings and land	-	11,486	8,497	-	-
Equipment	-	61,045	36,000	-	-
Miscellaneous	-	6,891	1,377	-	(8)
Total expenditures	<u>674,517</u>	<u>1,498,866</u>	<u>153,394</u>	<u>58,963</u>	<u>55,591</u>
Net change in fund balances	(42,132)	-	-	(52,382)	-
Fund balances at the beginning of the year	109,000	-	-	820,924	152,209
Fund balances at the end of the year	<u>\$ 66,868</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 768,542</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, 2009

	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	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 8,670,899
Federal contributions	-	-	-	-	-	153,394
Other grants	-	-	-	-	-	55,591
Interest income	-	-	-	-	-	6,581
	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>8,886,465</u>
Expenditures by account:						
Salaries and wages:						
Regular	-	-	-	-	-	2,913,693
Overtime	-	-	-	-	-	129,465
Fringe benefits	-	-	-	-	-	350,960
Other personnel costs	-	-	-	-	-	(1,075)
Travel and transportation	-	-	-	-	-	432,620
Communications	-	-	-	-	-	57,057
Dues, membership, and subscriptions	-	-	-	-	-	821
Food stuffs	-	-	-	-	-	52,748
Port charges	-	-	-	-	-	849
Capital outlays	-	-	-	-	-	39,751
Office supplies and materials	-	-	-	-	-	793,471
POL	-	-	-	-	-	124,929
Printing and reproduction	-	-	-	-	-	25,642
Rental services	-	-	-	-	-	6,886
Repairs and maintenance	-	-	-	-	-	35,932
Utilities	-	-	-	-	-	286,067
Medical referral	-	-	-	-	-	19,358
Medical supplies	-	-	-	-	-	456,153
Contractual services	-	-	-	-	-	1,813,403
Professional services	-	-	-	-	-	27,699
Retirement contributions	-	-	-	-	-	50,255
Scholarships and allowances	-	-	-	-	-	369,708
Training	-	-	-	-	-	352,841
Leased housing, buildings and land	-	-	-	-	-	131,571
Equipment	-	(488)	-	-	-	314,135
Miscellaneous	-	-	-	(153)	-	2,827
Total expenditures	<u>-</u>	<u>(488)</u>	<u>-</u>	<u>(153)</u>	<u>-</u>	<u>8,787,766</u>
Net change in fund balances	-	488	-	153	-	98,699
Fund balances at the beginning of the year	19,867	143,241	-	-	8,880	1,687,701
Fund balances at the end of the year	<u>\$ 19,867</u>	<u>\$ 143,729</u>	<u>\$ -</u>	<u>\$ 153</u>	<u>\$ 8,880</u>	<u>\$ 1,786,400</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 OF FINANCIAL STATEMENTS 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, 2009, which collectively comprise the State of Kosrae's basic financial statements and have issued our report thereon dated June 23, 2010. 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 73 through 75) as items 2009-01 and 2009-02 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.

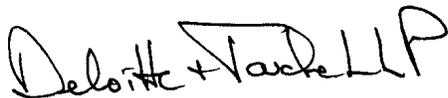
Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose 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 management, the Honorable Members of the Kosrae State Legislature, federal awarding agencies, pass-through entities, the cognizant audit and other federal agencies, and others within the entity 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 23, 2010

**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, 2009. 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 73 through 75). 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, the State of Kosrae'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, 2009. 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 federal program (CFDA # 15.875) for the year ended September 30, 2009.

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.

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.

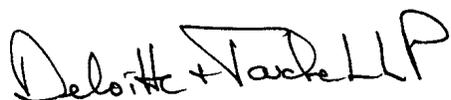
A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control.

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

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, 2009, and have issued our report thereon dated June 23, 2010. 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 69 and 70) 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 management, the Honorable Members of the Kosrae State Legislature, federal awarding agencies, pass-through entities, cognizant audit and other federal agencies, and others within the entity and is not intended to be and should not be used by anyone other than these specified parties.



June 23, 2010

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Summary Schedule of Expenditures of Federal Awards, by Grantor
Year Ended September 30, 2009

Agency/Program	Expenditures
U.S. Department of Agriculture	\$ 81,705
U.S. Department of the Interior	8,630,601
U.S. Department of Health and Human Services	<u>20,510</u>
GRAND TOTAL	<u><u>\$ 8,732,816</u></u>

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

U.S. Department of Agriculture:	
Rural Self-Help TA	10.420

Reconciliation to the basic financial statements:	
Grants Assistance Fund	\$ 8,787,766
Add:	
Other miscellaneous credits	641
Less:	
Foreign Assistance Fund	<u>(55,591)</u>
	<u><u>\$ 8,732,816</u></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, 2009

Agency/Program	CFDA#	Expenditures
U.S. DEPARTMENT OF AGRICULTURE		
Rural Self-Help TA	10.420	\$ <u>81,705</u>
Total U.S. Department of Agriculture		\$ <u><u>81,705</u></u>
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES		
Cancer Prevention and Control Program (See Note)	93 Unknown	\$ 12,655
Breast and Cervical Cancer	93 Unknown	<u>7,855</u>
Total U.S. Department of Health and Human Services		\$ <u><u>20,510</u></u>
U.S. DEPARTMENT OF THE INTERIOR		
Economic, Social and Political Development of the Territories:	15.875	
Compact Health and Medical 216(a)(2)		\$ -
Compact Special Block Grant		-
Compact Capital Projects 211(b)		58,963
Compact II Capacity Building Sector		375,168
Compact II Education Sector		2,501,306
Compact II Environment Sector		256,472
Compact II Health Sector		2,479,624
Compact II Private Sector		734,506
Compact II Infrastructure Sector		674,517
Supplemental Education Grant Sector		1,498,866
Technical Assistance:		
Road Maintenance Equipment		<u>51,179</u>
Total U.S. Department of the Interior		\$ <u><u>8,630,601</u></u>
GRAND TOTAL		\$ <u><u>8,732,816</u></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, 2009

(1) Scope of Review

The Government of the State of Kosrae 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 Health and Human Services
- U.S. Department of the Interior

(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, the State's reporting entity is defined in Note 1A to its September 30, 2009 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 the State, as defined above, for the year ended September 30, 2009.

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, 2009

<u>Grantor</u> <u>Program Title</u>	<u>CFDA No.</u>	2009 <u>Fiscal Year</u> <u>Expenditures</u>
<u>U.S. Department of the Interior</u> Compact of Free Association: Compact Sector Grants	15.875	\$ <u>8,520,459</u>
Total U.S. Federal program expenditures		\$ <u>8,732,816</u>
% of total U.S. Federal 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, 2009

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 are not considered to be material weakness(es)? | 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 are not considered to be material weakness(es)? | None reported | | | | |
| 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? | No | | | | |
| 9. | The State's major programs were as follows: | | | | | |
| | <table border="0" style="margin-left: 20px;"> <tr> <td style="text-align: right;"><u>CFDA Number</u></td> <td><u>Federal Program</u></td> </tr> <tr> <td style="text-align: right;">15.875</td> <td>U.S. Department of the Interior – Compact of Free Association –Sector Grants</td> </tr> </table> | <u>CFDA Number</u> | <u>Federal Program</u> | 15.875 | U.S. Department of the Interior – Compact of Free Association –Sector Grants | |
| <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>
2009-01	Fixed Assets
2009-02	Equity Investments

Part III - Federal Award Findings and Questioned Cost Section

No matters are reportable.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2009

Financial Statements Findings Section

Finding No.: 2009-01
Area: Fixed Assets

Criteria:

1. In accordance with Financial Management Regulation 5.2, State property should be reported and assigned a property tag number to each item upon receipt.
2. In accordance with 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.

Conditions:

1. Not all property was assigned a tag number upon receipt.

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.

Prior Year Status:

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

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:

The copy of the Kosrae State Fixed Assets maintenance plan prepared by the Department of T & I was earlier provided to you. IN addition, we have enclosed a copy of the memorandum to the Supply Officer concerning the tagging of fixed assets which we labeled as Exhibit 1; to address the other concern in the report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2009

Finding No.: 2009-02
Area: Equity Investments

Criteria:

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

Condition:

Unaudited financial statements were not submitted for Kosrae Sea Ventures, Inc. (KSVI) and SEMO in support of State equity investments. No financial statements for Pacific Tuna Industries were furnished in support of the State's 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 the State.

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 have referred the matter to the Attorney General for possible recovery of any remaining interest in the residual assets of these investments. In the case of KSVI, we will also pursue the matter with the FSM National Government.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Unresolved Prior Years' Findings and Questioned Costs
Year Ended September 30, 2009

The following is a summary of unresolved questioned costs of the State of Kosrae as of September 30, 2009:

	Questioned Costs Set Forth in Prior Audit Reports <u>2008</u>	Questioned Costs Resolved in Fiscal Year <u>2009</u>	Questioned Costs at <u>September 30, 2009</u>
Unresolved Questioned Costs FY 2006	\$ 413,357	\$ 413,357	\$ -
Unresolved Questioned Costs FY 2007	<u>50,000</u>	<u>50,000</u>	<u>-</u>
	\$ <u>463,357</u>	\$ <u>463,357</u>	-
Unresolved Questioned Costs FY 2009			<u>-</u>
Total outstanding questioned costs at September 30, 2009			\$ <u><u>-</u></u>

The prior year status of findings is contained in the accompanying Schedule of Findings and Questioned Costs (pages 73 through 75).

Questioned Cost resolution through the FSM National Government for costs aggregating \$427,185 occurred through correspondence dated February 4, 2010 from the Secretary of Finance.

The remaining FY 2006 questioned costs of \$36,172 were resolved through application of the two-year rule.