

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

YEAR ENDED SEPTEMBER 30, 2008

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

YEAR ENDED SEPTEMBER 30, 2008

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FEDERATED STATES OF MICRONESIA**

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**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

YEAR ENDED SEPTEMBER 30, 2008

INDEPENDENT AUDITORS' REPORT

Honorable John Ehsa
Governor, State of Pohnpei
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 Pohnpei (the State) as of and for the year ended September 30, 2008, which collectively comprise the State's basic financial statements as set forth in Section II of the foregoing table of contents. These financial statements are the responsibility of the management of the State. Our responsibility is to express an opinion on the respective financial statements based on our audit. We did not audit the financial statements of the Pohnpei Transportation Authority, the Small Business Guarantee and Finance Corporation, and the Pohnpei Economic Development Authority, which represent 6%, 2%, and 8%, respectively, of the assets, net assets, and revenues of the State's discretely presented component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion expressed herein, insofar as it relates to the amounts included for the Pohnpei Transportation Authority, the Small Business Guarantee and Finance Corporation, and the Pohnpei Economic Development Authority, is based solely on the reports of the other auditors.

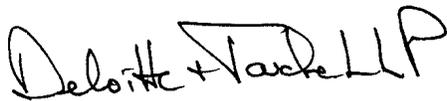
We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and 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 and the reports of the other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audit and the reports of other auditors, such financial statements, as set forth in Section II of the foregoing table of contents, 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 Pohnpei as of September 30, 2008, and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis, on pages 3 through 10, as well as the Schedule of Revenues, Expenditures, and Changes in Unreserved Fund Balance - 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, is 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 16, 2009, on our consideration of the State's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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

June 16, 2009

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2008

This section of Pohnpei State's financial report presents our Management's Discussion and Analysis (MD&A) for the fiscal year ended September 30, 2008. This MD&A is prepared in compliance with the GASB-34 requirement. Readers are requested to read this MD&A in conjunction with the State's financial statements, which follow this section.

FINANCIAL HIGHLIGHTS

- The Pohnpei State's primary government's total net assets for this year are \$41,546,159. This represents a deterioration in net assets of \$9,343,754. No significant changes in tax or employment bases appeared to impact this change. This change in revenues was due to investment losses whereas the change in expenditures related to a one-time payment to a component unit.
- The net change in governmental fund balance is a decrease of \$7,552,799. The total revenues reported are \$26,154,264 and loan proceeds of \$93,916 with total expenditures of \$33,642,046 and special items, net of \$666,067.
- Actual revenues for the general fund were \$698,757 lower than budgeted revenues. The total expenditures, budgetary basis showed an unfavorable variance of \$418,598. The general fund reported an unreserved fund balance of \$4,770,195 for the fiscal year.

OVERVIEW OF THE FINANCIAL STATEMENTS

This annual report consists of four parts-management's discussion and analysis (this section), the basic financial statements, required supplementary information and the notes to the financial statements.

The basic financial statements include two kinds of statements that present different views of the State:

Government-Wide Financial Statements

The government-wide statements report information about State of Pohnpei as a whole using accounting methods similar to those used by private-sector companies. The statement of net assets includes all of the government's assets and liabilities. All of the current year's revenues and expenses are accounted for in the statement of activities regardless of when cash is received or paid.

The two government-wide statements report State of Pohnpei's net assets and how they have changed. Net assets - the difference between State of Pohnpei's assets and liabilities - is one way to measure State of Pohnpei's financial health or position.

- Over time, increases or decreases in State of Pohnpei's net assets are an indicator of whether its financial health is improving or deteriorating, respectively.
- To assess the overall health of State of Pohnpei, additional non-financial factors such as changes in State of Pohnpei's tax base, the condition of State of Pohnpei's roads and infrastructure, and the quality of services need to be considered.

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

- Primary government - this grouping comprises governmental activities, which includes most of State of Pohnpei's basic services such as education, public safety, health, finance, judiciary, and general administration. Local sourced tax revenues and other federal grants finance most activities of the primary government. The government-wide financial statements of the State consist of its governmental activities, which include public works, health, education and general administration.

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FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2008

Sales taxes, revenue sharing, federal grants and Compact II/Sector grants are the major sources of these activities. Compact II/Sector grants replace the Compact I funding in fiscal year 2004.

- Discretely presented component units - State of Pohnpei includes numerous other entities in its report. Although legally separate, these "component units" are important because State of Pohnpei is financially accountable for them.

Fund Financial Statements

The fund financial statements provide more detailed information about the State's significant funds. The State uses fund accounting to comply with financial related legal requirements.

- Governmental funds. Most of the State's basic services are included in governmental funds' which focus on how cash and other financial assets that can readily be converted to cash flow in and out and the balances left at year-end that are available for spending. Unlike the government-wide financial statements, the governmental funds statements focus on the short-term financial requirements of the State. Because this information does not encompass the additional long-term focus of the government wide statements, we provide reconciliation at the bottom of the governmental funds statement, to explain the relationship between them. The State maintains individual governmental funds, which are categorized as major and non-major. The major fund includes the General Fund. The other major funds are consisting of Grant Assistance Fund, and the Compact Trust Fund.

FINANCIAL ANALYSIS OF THE STATE AS A WHOLE (GOVERNMENT-WIDE)

The following is a summary of the State's net assets as of September 30:

	Governmental Activities	
	2008	2007
Current and other assets	\$ 14,843,133	\$ 18,339,039
Capital assets	24,587,296	26,643,421
Other non-current assets	<u>11,439,348</u>	<u>15,500,553</u>
Total assets	<u>50,869,777</u>	<u>60,483,013</u>
Current liabilities	3,117,562	3,080,549
Long-term debt and other liabilities	<u>6,206,056</u>	<u>6,512,551</u>
Total liabilities	<u>9,323,618</u>	<u>9,593,100</u>
Net Assets:		
Invested in capital assets, net of related debt	24,587,296	26,643,421
Restricted	18,263,750	20,505,171
Unrestricted	<u>(1,304,887)</u>	<u>3,741,321</u>
Total net assets	\$ <u>41,546,159</u>	\$ <u>50,889,913</u>

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2008

Changes in net assets. The State's Statement of Changes in Net Assets for the fiscal year ended September 30 follows:

	Governmental Activities	
	2008	2007
Revenues		
Program revenues:		
Charges for services	\$ 1,430,435	\$ 780,806
Operating grants and contributions	217,008	5,208,456
Compact related	17,117,576	17,343,833
Capital grants and contributions	858,571	94,790
General revenues:		
Taxes	7,668,422	7,717,751
Investment earnings (loss)	(1,172,700)	1,722,264
Other	<u>34,951</u>	<u>192,547</u>
Total revenues	<u>26,154,263</u>	<u>33,060,447</u>
Expenses:		
General Government	6,602,599	6,049,172
Education	12,129,132	12,323,283
Health services	7,173,315	6,549,571
Land and natural resources	451,151	284,944
Public works and transportation	877,940	2,393,364
Public safety	1,274,314	1,141,190
Boards, commissions and other appropriations	<u>7,655,633</u>	<u>4,782,295</u>
Total expenses	<u>36,164,084</u>	<u>33,523,819</u>
Special item:		
Reduction of estimated legal claims	825,000	-
Write off of receivables	<u>(158,933)</u>	<u>3,434,713</u>
Change in net assets	\$ <u>(9,343,754)</u>	\$ <u>(3,898,085)</u>

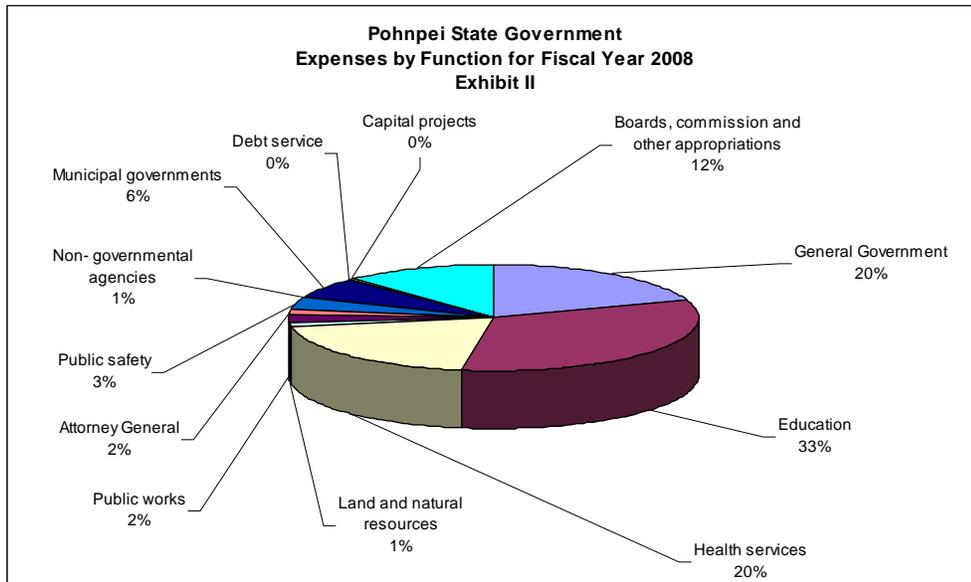
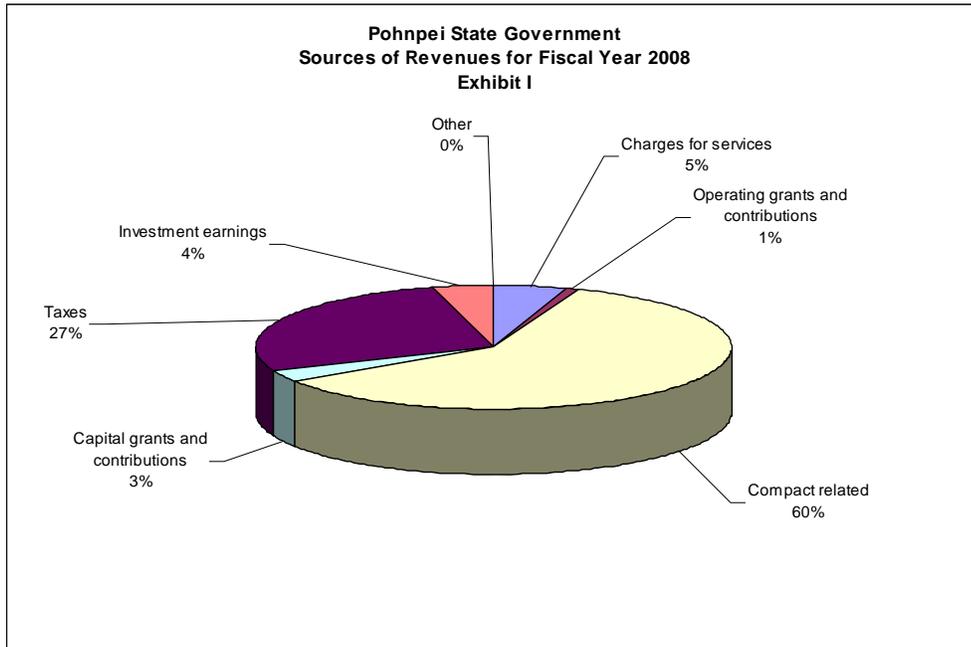
Key elements of the decrease in net assets are as follows:

- Revenues decreased in the current year by \$6,906,184 due primarily to a decrease in operating grants and contributions of \$4,991,448 and a decrease in general revenues of \$3,101,889. This decrease was primarily the result of a reduction in the corpus of the Compact Trust Fund and the State's other investment portfolios as a result of a decrease in fair market value of investments impacted by the slump in global financial markets.
- Expenses increased in the current year by \$2,640,265 due primarily to a one-off payment to a State component unit.

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FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2008

Exhibit I below, showed that 60% of the State's revenues were derived from Compact II while 27% came from taxes and licenses. The least source of revenues is other revenue. For expenses, the State encompass a range of services. Exhibit II illustrated that education represented 33% of the State's total expenses while health represented 20%.



**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2008

FINANCIAL ANALYSIS OF THE STATE'S GOVERNMENTAL FUNDS

The State's governmental fund changes in fund balances for the year ended September 30, 2008 are shown below.

Changes in Fund Balances

	<u>General Fund</u>	<u>Other Funds</u>	<u>Total</u>
Revenues:			
Taxes	\$ 7,668,421	\$ 614,037	\$ 8,282,458
Compact	-	17,976,147	17,976,147
Other	<u>(1,026,436)</u>	<u>922,095</u>	<u>(104,341)</u>
Total revenues	<u>6,641,985</u>	<u>19,512,279</u>	<u>26,154,264</u>
Expenditures	<u>12,467,053</u>	<u>21,174,993</u>	<u>33,642,046</u>
Loan proceeds	-	<u>(93,916)</u>	<u>(93,916)</u>
Transfers (in) out	<u>(605,750)</u>	<u>605,750</u>	-
Special item	<u>158,933</u>	-	<u>158,933</u>
Net change in fund balance	\$ <u>(5,378,251)</u>	\$ <u>(2,174,548)</u>	\$ <u>(7,552,799)</u>

General Fund

The revenues decreased by \$3,112,783 compared from fiscal year 2007 which caused mainly by loss on investments. The total expenditures without write-offs, however, also increased by \$3,681,229 or 41.90% more than last year. Subsidy to Pohnpei Transportation Authority and decrease in funding for private sector grant for fiscal year 2008 were absorbed and funded by the general fund; hence explained the increase in expenditures.

Grant Assistance Fund

As mentioned in the preceding paragraph, Compact II/Sector Grants were the major sources of Pohnpei State's operating grants for fiscal year 2008. The total revenues amounted to \$20,494,657 while total expenditures are in the amount of \$19,667,390, which is discussed below:

- The education sector grant that shall support and improve the educational system of the Federated States of Micronesia, including, without limitation, the systems for primary, secondary, and post-secondary education. The total revenues are \$7,767,901 against total expenditures of \$7,766,921.
- The health sector grant that shall support and improve the delivery of preventive, curative and environmental care, and develop the human and material resources necessary for the Federated States of Micronesia to perform these services. The total funding equals the total expenditures in the amount of \$5,535,158.
- The sector grant for private sector development shall support the efforts of the Federated of Micronesia to attract new foreign investment and increase indigenous business activity. Priorities will be in advancing the private development of fisheries, tourism and agriculture; employing new telecommunications technologies; and analyzing and developing new systems, laws, and policies to foster private sector development, to facilitate investment by potential private investors, and develop business and entrepreneurial skills. The total of \$128,098 was received and expended for this activity.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2008

- The sector for capacity building shall support the efforts of the Federated States of Micronesia to build effective, accountable and transparent national and local government and other public sector institutions and systems. The total grant revenues and expenditures are \$669,174.
- The environment sector shall support the efforts of the Federated States of Micronesia to protect the Nation's land and marine environment and to conserve and achieve sustainable use of its natural resources. The total revenue is \$447,972 while total expenditures are \$474,722 due to the revenue accrual.
- Public Infrastructure grant shall give priority to primary and secondary education capital projects and programs that directly affect health and safety including water and wastewater projects, solid waste disposal projects and health care facilities. The total funding is \$858,575 though the total amount expended is \$221,618.
- The Supplemental Education Grant (SEG) is considered the seventh-sector grant. SEG has been offered in lieu of grants that were formerly available from various federal agencies. The federal programs that were incorporated into SEG are Territories & Freely Associated States Education Grant (T&FASEG), Adult Education & Family Literacy, Workforce Investment Act, Pacific Vocational Education Improvement Program and Early Childhood Program (formerly Head Start). For the year, the total expenditures incurred were \$2,570,249.

Another major source of funding under the Grant Assistance Fund is the US Federal Grants, which supported \$2,228,626 expenditures of the State.

Compact Trust Fund

The Compact Trust Fund has a total fund balance of \$8,011,327, all of which is reserved for the funding of future operations of the State commencing in October 2023. The net decrease in fund balance during the current year of \$1,852,006 reflected the slump in global financial markets that occurred during fiscal year 2008.

GENERAL FUND BUDGETARY HIGHLIGHTS

During the year, the State revised its budget several times in the aggregate amount of \$1,112,519 to accommodate supplemental funding for departments and offices requiring increases in appropriations to avoid budget overruns. These matters are not believed to have a significant effect on future services. The State conforms to the most appropriate measures of utilizing its net assets due to the current global economic crisis.

The net decrease in the State's general fund unreserved fund balance of \$5,253,029 comes mainly from loss on investments and increase in expenditures.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

The State's capital assets at the end of fiscal years 2008 and 2007 consist basically of equipment, buildings, roads and bridges. The summary of capital assets at the end of September 30 is shown below:

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2008

	<u>Governmental Activities</u>	
	<u>2008</u>	<u>2007</u>
Buildings	\$ 6,250,479	\$ 6,250,479
Infrastructure	52,341,781	52,341,781
Machinery	<u>6,961,139</u>	<u>6,787,737</u>
Total	\$ <u>65,553,399</u>	\$ <u>65,379,997</u>

See Note 5 to the financial statements for more information about the State's capital assets. No significant capital asset additions occurred during the year ended September 30, 2008. Additionally, the State is not engaged in significant capital expenditure commitments as of September 30, 2008.

Long-Term Debt

At September 30 the State had long-term debt as shown below:

	<u>Governmental Activities</u>	
	<u>2008</u>	<u>2007</u>
ADB loans	\$ <u>5,039,571</u>	\$ <u>4,521,067</u>

Increase in long-term debt is caused by foreign currency losses. Note 7 to the financial statements presents more information about the State's long-term obligations, including debt.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS

Funding for the operations of most of the government services in fiscal year 2009 will still come from the Compact II.

Fiscal year 2009 is the sixth year of the implementation of the economic assistance under the Compact II/ Sector Grant. Sector funding replaces the funding sources from the old Compact I. Under the Compact II/Sector grant, the annual budget approved by JEMCO for fiscal year 2009 is as follows:

- For education sector grant, which continues to be the funding priority, the annual budget is \$7,643,352.
- The health sector grant's budget is \$ 6,149,401.
- The sector grant funding for private sector development is \$ 142,754.
- The capacity building sector grant budget for fiscal year 2009 is \$ 511,869.
- The environment sector grant is \$ 404,195.
- The cumulative grants for the Public Infrastructure from fiscal years 2005 through 2009 is more than \$29,000,000. Priority projects are education, health related and private sector development. It is also required that 5% of the total grant be allocated to the Infrastructure Maintenance fund for the maintenance of the existing and new projects. Local matching of the same amount is required.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Management's Discussion and Analysis
September 30, 2008

- In the case of the Supplemental Education Grant (SEG), the total funding for fiscal year 2009 is \$ 2,559,218. The programs covered in the funding are Early Childhood Education, Education Improvement Programs, Workforce Development/Skill Training, Vocational Education and Staff Development. The grant award was signed on October 07, 2008.

For fiscal year 2009, the locally generated revenues and the revenue shares from the National Government are projected at a range of \$7,000,000 or less due to the implementation of FSM Public law no 14-90. FSM Public law no. 14-90 allows taxpayers to deduct the wages and benefits paid to their employees from the taxable revenues; hence reducing the amount of gross revenue taxes. In fiscal year 2008; increase in the FSM revenue sharing was more than \$100,000. For Pohnpei State; decrease in collection of taxes was more than \$150,000 due to the decrease of outstanding penalties and interest. The Department of Treasury and Administration will however continue to intensify its collection effort to raise more revenues in the ensuing years. In addition, the final carry-over balances from the Compact II may be authorized to be used to fund other operations of the government.

FINANCIAL CONTACT

This financial report is designed to provide all interested users with a general overview of the State of Pohnpei's finances. If you have questions about this report or need additional financial information, please contact the Office of the Director of Treasury and Administration, P.O. Box 1567 Kolonia, Pohnpei FM 96941.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

Statement of Net Assets
September 30, 2008

	Primary Government	Component Units
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 1,316,963	\$ 2,319,897
Investments	7,370,813	673,030
Receivables, net of allowance for uncollectibles	4,473,490	2,646,988
Advances	43,121	-
Inventories	30,392	1,246,411
Other current assets	-	12,031
Restricted assets:		
Cash and cash equivalents	608,354	339,608
Total current assets	13,843,133	7,237,965
Noncurrent assets:		
Capital assets, net of accumulated depreciation	24,587,296	33,155,527
Investments	1,000,000	1,448,498
Other	-	571,560
Restricted assets:		
Investments	11,439,348	-
Total noncurrent assets	37,026,644	35,175,585
Total assets	\$ 50,869,777	\$ 42,413,550
LIABILITIES		
Current liabilities:		
Current portion of long-term obligations	\$ 140,000	\$ 261,780
Notes payable	-	100,000
Accounts payable	1,018,969	1,109,094
Current portion of compensated absences payable	237,438	-
Due to primary government	-	1,509,722
Other liabilities and accruals	1,315,297	580,085
Deferred revenues	405,858	259,339
Total current liabilities	3,117,562	3,820,020
Noncurrent liabilities:		
Long-term obligations, net of current portion	4,899,571	3,605,597
Compensated absences payable, net of current portion	681,485	-
Due to primary government	-	2,450,000
Other noncurrent liabilities	625,000	-
Total noncurrent liabilities	6,206,056	6,055,597
Total liabilities	9,323,618	9,875,617
Contingencies and commitments		
NET ASSETS		
Invested in capital assets, net of related debt	24,587,296	27,326,757
Restricted for:		
Nonexpendable:		
Future operations	8,011,328	-
Expendable:		
Compact related	2,935,975	-
Capital projects	228,452	-
Debt service	3,428,021	-
Other purposes	3,659,974	2,122,649
Unrestricted	(1,304,887)	3,088,527
Total net assets	41,546,159	32,537,933
Total liabilities and net assets	\$ 50,869,777	\$ 42,413,550

See accompanying notes to basic financial statements.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

Statement of Activities
Year Ended September 30, 2008

Functions/Programs	Program Revenues				Net (Expenses) Revenues and Changes in Net Assets	
	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Primary Government	Component Units
Primary government:						
Governmental activities:						
General government	\$ 6,602,599	\$ 939,799	\$ 1,615,776	\$ -	\$ (4,047,024)	\$ -
Land and natural resources	451,151	-	-	-	(451,151)	-
Education	12,129,132	-	11,628,354	-	(500,778)	-
Health services	7,173,315	-	6,391,953	-	(781,362)	-
Public safety	1,274,314	-	-	-	(1,274,314)	-
Attorney-general	662,501	-	-	-	(662,501)	-
Public works and transportation	877,940	-	-	-	(877,940)	-
Payments to non-governmental agencies	184,342	-	-	-	(184,342)	-
Boards, commissions and others	3,105,751	-	111,313	-	(2,994,438)	-
Municipal governments	2,179,490	-	-	-	(2,179,490)	-
Debt service	126,524	-	(560,807)	-	(687,331)	-
Future operations	-	-	(1,852,005)	-	(1,852,005)	-
Capital projects	85,847	490,636	-	858,571	1,263,360	-
Payments to PTA	1,311,178	-	-	-	(1,311,178)	-
Total primary government	\$ 36,164,084	\$ 1,430,435	\$ 17,334,584	\$ 858,571	(16,540,494)	-
Component units:						
Pohnpei Utilities Corporation	\$ 16,238,431	\$ 13,597,235	\$ -	\$ -	-	(2,641,196)
Pohnpei Port Authority	2,185,015	1,590,364	-	348,626	-	(246,025)
Pohnpei Fisheries Corporation	274,618	22,796	-	-	-	(251,822)
Pohnpei Transportation Authority	1,497,366	1,055,361	-	-	-	(442,005)
Small Business Guarantee and Finance Corporation	141,646	27,261	-	-	-	(114,385)
Pohnpei Economic Development Authority	391,563	140,863	-	-	-	(250,700)
Pohnpei State Housing Authority	164,669	173,352	-	-	-	8,683
Total component units	\$ 20,893,308	\$ 16,607,232	\$ -	\$ 348,626	-	(3,937,450)
General revenues:						
Taxes:						
Revenue sharing					5,514,736	-
Excise taxes					2,153,686	-
Unrestricted investment earnings (loss)					(1,172,700)	-
Other					34,951	275,131
Total general revenues					6,530,673	275,131
Special item:						
Reduction of estimated legal claims					825,000	-
Write-off of receivables					(158,933)	-
Change in net assets					(9,343,754)	(3,662,319)
Net assets at the beginning of the year					50,889,913	36,200,252
Net assets at the end of the year					\$ 41,546,159	\$ 32,537,933

See accompanying notes to basic financial statements.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

Balance Sheet
Governmental Funds
September 30, 2008

		Special Revenue	Permanent	Other Governmental Funds	Total
	General	Grants Assistance	Compact Trust		
ASSETS					
Cash and cash equivalents	\$ 1,316,963	\$ -	\$ -	\$ -	\$ 1,316,963
Investments	4,259,544	4,111,269	-	-	8,370,813
Receivables, net:					
Taxes	1,638,028	1,189,777	-	-	2,827,805
Other	1,629,616	5,223	-	10,846	1,645,685
Due from other funds	4,069,576	2,052,411	-	4,573,374	10,695,361
Advances	20,778	22,343	-	-	43,121
Inventories	-	-	-	30,392	30,392
Restricted assets:					
Cash and cash equivalents	45,581	562,773	-	-	608,354
Investments	-	-	8,011,327	3,428,021	11,439,348
Total assets	<u>\$ 12,980,086</u>	<u>\$ 7,943,796</u>	<u>\$ 8,011,327</u>	<u>\$ 8,042,633</u>	<u>\$ 36,977,842</u>
LIABILITIES AND FUND BALANCES					
Liabilities:					
Accounts payable	\$ 125,490	\$ 831,337	\$ -	\$ 62,142	\$ 1,018,969
Other liabilities and accruals	1,221,927	92,647	-	723	1,315,297
Deferred revenues	-	405,858	-	-	405,858
Due to other funds	6,625,785	3,626,341	-	443,235	10,695,361
Total liabilities	<u>7,973,202</u>	<u>4,956,183</u>	<u>-</u>	<u>506,100</u>	<u>13,435,485</u>
Fund balances:					
Reserved for:					
Related assets	-	1,565,060	8,011,327	30,392	9,606,779
Encumbrances	23,052	437,863	-	84,325	545,240
Continuing appropriations	213,637	50,050	-	624,913	888,600
Debt service	-	-	-	3,428,021	3,428,021
Unreserved:					
General fund	4,770,195	-	-	-	4,770,195
Special revenue funds	-	934,640	-	3,114,621	4,049,261
Debt service funds	-	-	-	206,904	206,904
Capital projects funds	-	-	-	47,357	47,357
Total fund balances	<u>5,006,884</u>	<u>2,987,613</u>	<u>8,011,327</u>	<u>7,536,533</u>	<u>23,542,357</u>
Total liabilities and fund balances	<u>\$ 12,980,086</u>	<u>\$ 7,943,796</u>	<u>\$ 8,011,327</u>	<u>\$ 8,042,633</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

24,587,296

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:

Loans payable	(5,039,571)
Compensated absences payable	(918,923)
Claims and judgments payable	<u>(625,000)</u>

(6,583,494)

Net assets of governmental activities

\$ 41,546,159

See accompanying notes to basic financial statements.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

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

	General	Special Revenue	Permanent	Other	Total
		Grants Assistance	Compact Trust	Governmental Funds	
Revenues:					
Compact funding	\$ -	\$ 17,976,147	\$ -	\$ -	\$ 17,976,147
Net increase in the fair value of investments	(1,172,700)	42,002	(1,852,006)	(560,807)	(3,543,511)
CFSM grants	-	61,551	-	-	61,551
Federal contributions	-	2,228,626	-	-	2,228,626
FSM revenue sharing	5,514,736	-	-	-	5,514,736
State taxes	2,153,685	-	-	614,037	2,767,722
Fees and charges	122,206	-	-	816,398	938,604
Other	24,058	186,331	-	-	210,389
Total revenues	6,641,985	20,494,657	(1,852,006)	869,628	26,154,264
Expenditures:					
Current:					
General government	3,653,704	1,452,776	-	717,695	5,824,175
Land and natural resources	470,812	-	-	-	470,812
Education	301,132	12,679,456	-	-	12,980,588
Health services	269,630	5,535,158	-	437,537	6,242,325
Public safety	1,239,129	-	-	-	1,239,129
Office of the Attorney-General	657,501	-	-	-	657,501
Public works	877,940	-	-	-	877,940
Payments to non-governmental agencies	184,342	-	-	-	184,342
Boards, commissions and other	1,322,195	-	-	-	1,322,195
Grants to local governments	2,179,490	-	-	-	2,179,490
Pohnpei Transportation Authority	1,311,178	-	-	-	1,311,178
Debt service	-	-	-	266,524	266,524
Capital projects	-	-	-	85,847	85,847
Total expenditures	12,467,053	19,667,390	-	1,507,603	33,642,046
Excess (deficiency) of revenues over (under) expenditures	(5,825,068)	827,267	(1,852,006)	(637,975)	(7,487,782)
Other financing sources (uses):					
Loan proceeds	-	-	-	93,916	93,916
Operating transfers in	605,750	-	-	-	605,750
Operating transfers out	-	(605,750)	-	-	(605,750)
Other financing sources (uses), net	605,750	(605,750)	-	93,916	93,916
Special item:					
Write-off of receivables	(158,933)	-	-	-	(158,933)
Net change in fund balances	(5,378,251)	221,517	(1,852,006)	(544,059)	(7,552,799)
Fund balances at the beginning of the year	10,385,135	2,766,096	9,863,333	8,080,592	31,095,156
Fund balances at the end of the year	\$ 5,006,884	\$ 2,987,613	\$ 8,011,327	\$ 7,536,533	\$ 23,542,357

See accompanying notes to basic financial statements.

**STATE OF POHNPEI
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, 2008

Amounts reported for governmental activities in the statement of activities on page 12 are different than the net change in fund balances because:

Net change in fund balances - total governmental funds from page 14	\$ (7,552,799)
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. This is the amount by which depreciation exceeded capital outlays in the current period	(2,056,125)
Some expenses reported in the statement of activities do not require the use of current financial resources and therefore, are not reported as expenditures in governmental funds. These expenses include accrued annual leave and claims and judgments payable or recoveries of prior accruals that are reported in the statement of activities, but not in funds	<u>265,170</u>
Change in net assets of governmental activities as presented on page 12.	\$ <u>(9,343,754)</u>

See accompanying notes to basic financial statements.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

Combining Statement of Net Assets
Component Units
September 30, 2008

	Pohnpei Utilities Corporation	Pohnpei Port Authority	Pohnpei Fisheries Corporation	Pohnpei Transportation Authority	Small Business Guarantee and Finance Corporation	Pohnpei Economic Development Authority	Pohnpei State Housing Authority	Total
ASSETS								
Current assets:								
Cash and cash equivalents	\$ 198,407	\$ 1,862,731	\$ 154,381	\$ -	\$ 40,609	\$ 31,768	\$ 32,001	\$ 2,319,897
Investments	173,030	-	-	-	-	500,000	-	673,030
Receivables, net:								
General	1,866,390	197,695	2,713	195,005	1,363	4,475	317,067	2,584,708
Other	23,698	20,166	-	-	-	688	17,728	62,280
Inventories	1,219,377	-	-	26,509	-	525	-	1,246,411
Other current assets	-	11,960	-	-	-	-	71	12,031
Restricted assets:								
Cash and cash equivalents	-	-	-	-	339,608	-	-	339,608
Total current assets	<u>3,480,902</u>	<u>2,092,552</u>	<u>157,094</u>	<u>221,514</u>	<u>381,580</u>	<u>537,456</u>	<u>366,867</u>	<u>7,237,965</u>
Noncurrent assets:								
Capital assets, net of accumulated depreciation	26,257,924	6,796,983	1,591	50,179	2,200	36,269	10,381	33,155,527
Investments	516,621	-	-	-	931,877	-	-	1,448,498
Other	-	199,752	-	-	371,808	-	-	571,560
Total noncurrent assets	<u>26,774,545</u>	<u>6,996,735</u>	<u>1,591</u>	<u>50,179</u>	<u>1,305,885</u>	<u>36,269</u>	<u>10,381</u>	<u>35,175,585</u>
Total assets	<u>\$30,255,447</u>	<u>\$ 9,089,287</u>	<u>\$ 158,685</u>	<u>\$ 271,693</u>	<u>\$ 1,687,465</u>	<u>\$ 573,725</u>	<u>\$ 377,248</u>	<u>\$42,413,550</u>
LIABILITIES								
Current liabilities:								
Current portion of long-term debt	\$ 199,694	\$ -	\$ 62,086	\$ -	\$ -	\$ -	\$ -	\$ 261,780
Notes payable	100,000	-	-	-	-	-	-	100,000
Accounts payable	435,915	204,150	70,527	63,935	-	334,567	-	1,109,094
Due to primary government	-	-	-	1,318,722	-	191,000	-	1,509,722
Other liabilities and accruals	274,269	145,125	-	-	9,582	119,628	31,481	580,085
Deferred revenue	190,074	-	66,667	2,598	-	-	-	259,339
Total current liabilities	<u>1,199,952</u>	<u>349,275</u>	<u>199,280</u>	<u>1,385,255</u>	<u>9,582</u>	<u>645,195</u>	<u>31,481</u>	<u>3,820,020</u>
Noncurrent liabilities:								
Due to primary government	-	-	2,450,000	-	-	-	-	2,450,000
Noncurrent portion of long-term debt	3,550,597	-	55,000	-	-	-	-	3,605,597
Total liabilities	<u>4,750,549</u>	<u>349,275</u>	<u>2,704,280</u>	<u>1,385,255</u>	<u>9,582</u>	<u>645,195</u>	<u>31,481</u>	<u>9,875,617</u>
NET ASSETS								
Invested in capital assets, net of related debt	22,879,154	6,796,983	(2,448,409)	50,179	2,200	36,269	10,381	27,326,757
Restricted	143,970	-	-	-	1,643,293	-	335,386	2,122,649
Unrestricted	2,481,774	1,943,029	(97,186)	(1,163,741)	32,390	(107,739)	-	3,088,527
Total net assets	<u>25,504,898</u>	<u>8,740,012</u>	<u>(2,545,595)</u>	<u>(1,113,562)</u>	<u>1,677,883</u>	<u>(71,470)</u>	<u>345,767</u>	<u>32,537,933</u>
	<u>\$30,255,447</u>	<u>\$ 9,089,287</u>	<u>\$ 158,685</u>	<u>\$ 271,693</u>	<u>\$ 1,687,465</u>	<u>\$ 573,725</u>	<u>\$ 377,248</u>	<u>\$42,413,550</u>

See accompanying notes to basic financial statements.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

Combining Statement of Revenues, Expenses, and Changes in Net Assets
Component Units
Year Ended September 30, 2008

	Pohnpei Utilities Corporation	Pohnpei Port Authority	Pohnpei Fisheries Corporation	Pohnpei Transportation Authority	Small Business Guarantee and Finance Corporation	Pohnpei Economic Development Authority	Pohnpei State Housing Authority	Total
Operating revenues:								
Charges for services	\$ -	\$ 1,590,364	\$ 22,796	\$ 1,055,361	\$ 27,261	\$ 140,863	\$ 173,352	\$ 3,009,997
Sales	<u>13,597,235</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>13,597,235</u>
Total operating revenues	<u>13,597,235</u>	<u>1,590,364</u>	<u>22,796</u>	<u>1,055,361</u>	<u>27,261</u>	<u>140,863</u>	<u>173,352</u>	<u>16,607,232</u>
Operating expenses:								
Cost of services	13,043,549	1,715,027	1,658	1,465,299	-	186,421	159,202	16,571,156
Administration costs	1,089,952	-	221	-	138,235	203,896	-	1,432,304
Depreciation and amortization	<u>2,104,930</u>	<u>469,988</u>	<u>272,739</u>	<u>32,067</u>	<u>3,411</u>	<u>1,246</u>	<u>5,467</u>	<u>2,889,848</u>
Total operating expenses	<u>16,238,431</u>	<u>2,185,015</u>	<u>274,618</u>	<u>1,497,366</u>	<u>141,646</u>	<u>391,563</u>	<u>164,669</u>	<u>20,893,308</u>
Operating income (loss)	<u>(2,641,196)</u>	<u>(594,651)</u>	<u>(251,822)</u>	<u>(442,005)</u>	<u>(114,385)</u>	<u>(250,700)</u>	<u>8,683</u>	<u>(4,286,076)</u>
Nonoperating revenues (expenses):								
Contributions from the primary government	-	-	-	-	-	-	97,344	97,344
Interest income (expense)	(128,931)	29,814	(6,822)	-	18,973	-	-	(86,966)
Other	<u>-</u>	<u>-</u>	<u>100,000</u>	<u>-</u>	<u>54,839</u>	<u>109,914</u>	<u>-</u>	<u>264,753</u>
Total nonoperating revenues (expenses), net	<u>(128,931)</u>	<u>29,814</u>	<u>93,178</u>	<u>-</u>	<u>73,812</u>	<u>109,914</u>	<u>97,344</u>	<u>275,131</u>
Capital contributions	<u>-</u>	<u>348,626</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>348,626</u>
Change in net assets	(2,770,127)	(216,211)	(158,644)	(442,005)	(40,573)	(140,786)	106,027	(3,662,319)
Net assets at the beginning of the year	<u>28,275,025</u>	<u>8,956,223</u>	<u>(2,386,951)</u>	<u>(671,557)</u>	<u>1,718,456</u>	<u>69,316</u>	<u>239,740</u>	<u>36,200,252</u>
Net assets at the end of the year	<u>\$25,504,898</u>	<u>\$ 8,740,012</u>	<u>\$ (2,545,595)</u>	<u>\$ (1,113,562)</u>	<u>\$ 1,677,883</u>	<u>\$ (71,470)</u>	<u>\$ 345,767</u>	<u>\$32,537,933</u>

See accompanying notes to basic financial statements.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2008

(1) Summary of Significant Accounting Policies

The accompanying financial statements of the State of Pohnpei (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, Kosrae and Yap. The State is a constitutional government comprised of three branches: the Legislative Branch, consisting of 23 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 net assets and results of operations of the following legally separate entities are presented as part of the State's operations:

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

i. Discretely Presented Component Units

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

Pohnpei Utilities Corporation (PUC): PUC was created by Pohnpei State Public Law (PSPL) No. 2L-179-91 and is responsible for providing electrical, water and sewer services to the people of Pohnpei through the operation of the electric power, water and sewer systems. PUC is governed by a seven-member Board of Directors appointed by the Governor with the advice and consent of the Legislature.

Pohnpei Port Authority (PPA): PPA was created by PSPL No. 2L-224-91 and is responsible for overseeing the use and maintenance of the State's sea and air ports. PPA is governed by a seven-member Board of Directors, consisting of representatives of the State appointed by the Governor with the advice and consent of the Legislature.

Pohnpei Fisheries Corporation (PFC): PFC was created by PSPL No. 3L-28-93 and is responsible for the operation and management of the fish processing plant, boats owned by the plant and the cold storage facility. PFC is governed by a seven-member Board of Directors, consisting of representatives of the State appointed by the Governor with the advice and consent of the Legislature.

Pohnpei Transportation Authority (PTA): PTA was created by PSPL No. 169-69 and is responsible for promotion, development, and improving transportation facilities of the State. PTA is governed by a seven-member Board of Directors, consisting of representatives of the State appointed by the Governor with the advice and consent of the Legislature.

Small Business Guarantee and Finance Corporation (SBGFC): SBGFC was created by PSPL No. 3L-86-95 to provide, promote, develop and widen in both scope and services reach various alternative modes of financing for small enterprises, including, but not limited to, direct and indirect project lending, venture capital, financial leasing, secondary mortgage and rediscounting of loan papers to small businesses. SBGFC is governed by a seven-member Board of Directors, consisting of four representatives of the State and three representatives from the private sector appointed by the Governor with the advice and consent of the Legislature.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

i. Discretely Presented Component Units, Continued

Pohnpei Economic Development Authority (PEDA): PEDA was created by PSPL No. 4L-159-78 for the purpose of promoting economic development through expansion of agriculture, marine resources, tourism, industry, energy development, banking, transportation and community development in Pohnpei. PEDA is also designated to succeed the Ponape District Fishing Authority as the sole entity to promote, develop, and support commercial utilization of living marine resources as provided in Public Law No. 7-110 of the Trust Territory Code. PEDA is governed by a seven-member Board of Developers appointed by the Governor with the advice and consent of the Legislature.

Pohnpei State Housing Authority (PSHA): PSHA was created by PSPL No. 2L-81-88 for the purpose of facilitating, through low-interest loans, the construction of safe and sanitary residential housing for low income families of the State, and for monitoring the Housing Preservation Grant (HPG) loan funds extended by United States Department of Agriculture Rural Development. PSHA is governed by a five-member Board of Directors appointed by the Governor with the advice and consent of the Legislature.

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.

P.O. Box 370
Kolonia, Pohnpei, FSM 96941

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.

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.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

B. Government-Wide Financial Statements, Continued

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

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

The government-wide Statement of Net Assets reports \$18,263,750 of restricted net assets, of which \$3,659,974 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.

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 governmental 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.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting

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. 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. 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.

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

The State reports the following Governmental Fund fund types:

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.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

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. Debt Service Funds

These funds account for the accumulation of resources for the retirement of long-term debt.

iv. Capital Projects Funds

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

v. Permanent Funds

These funds account 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:

Grants Assistance Fund, a Governmental Fund Type - Special Revenue Fund. This fund accounts for all financial transactions of U.S. federally assisted funds, including United States Congress appropriations under United States Public Law 99-239, as amended, Title II, Article I, Section 211(a) and approved by FSM Congress to support and improve the education, health, private sector development, public sector capacity building, and environment sectors of the Federated States of Micronesia.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

Compact Trust Fund, a Governmental Fund Type - Permanent Fund. This fund accounts for United States Congress appropriations under United States Public Law 99-239, as amended, Title II, Article I, Section 215 and approved by FSM Congress 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. Earnings from funds invested would not be available for distribution until October 2023.

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

Cash and cash equivalents include cash held in demand accounts as well as short-term investments with maturity dates 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.

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 in the State's governmental funds primarily consist of taxes and federal revenues. 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.

Amounts due from other governments include those funds which are earned and have yet to be reimbursed by the FSM National Government in its role as the primary grant recipient of U.S. federal assistance programs, Congress of the Federated States of Micronesia public project grants, U.S. Department of the Interior capital project grants through the Trust Territory Government and amounts due to the State under the FSM tax revenue sharing program.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

I. Inventories and Prepaid Items

Inventories of materials and supplies are determined by physical count and are valued at the lower of cost (principally average cost) or market. Certain payments made to vendors or persons for services reflect costs applicable to future accounting periods and are recorded as prepaid items in both government-wide and fund financial statements.

J. Interfund Receivables/Payables

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

These balances result from time lags 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. Restricted Assets

Certain assets of the primary government are classified as restricted assets because their use is completely restricted through enabling legislation and loan agreements. As of September 30, 2008, investments of \$8,011,327 recorded in the Compact Trust Fund are restricted in that they are not available to be used in current operations. In addition, investments of \$3,428,021 recorded in the other governmental funds are restricted for future repayment of the Early Retirement Program loan. Furthermore, cash and cash equivalents were restricted for the following uses:

Deposit with a local bank restricted for the purchase of medical supplies for the State hospital. \$ 45,581

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 Pohnpei State Housing Authority, the trustee of the Loan Guarantee Escrow Account. 562,773

\$ 608,354

L. Capital Assets

Capital assets, which include property, plant, equipment and infrastructure assets (e.g. roads, bridges, ramps and other similar items), are reported in the governmental activity column of the government-wide financial statements. Such assets, whether purchased or constructed, are recorded at historical cost or estimated historical cost. Donated capital assets are recorded at fair market value at the date of donation.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

L. Capital Assets, Continued

The State currently holds no title to land. Machinery and equipment, other than vehicles and boats, are capitalized when the cost of individual items exceed \$50,000. Vehicles and boats, along with significant repair and maintenance qualifying as a betterment of such, are capitalized regardless of cost and depreciated. Building and infrastructure projects, along with significant improvements or reconstruction qualifying as a betterment of such, are capitalized when the cost of individual items or projects exceed \$100,000. The costs of normal maintenance and repairs that do not add to the value of the capital asset or materially extend capital asset lives are not capitalized. Additionally, as of fiscal year 2004, the State chose to capitalize assets acquired with U.S. federal funds that have an acquisition cost of \$5,000 or more.

Capital assets of the primary government and the 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	40-50 years
Infrastructure	25-50 years
Facilities	3 - 40 years
Machinery and equipment	3 - 25 years
Furniture and fixtures	3 - 10 years

M. Interfund/Intrafund Transactions

As a general rule, the effect of interfund activity has been eliminated in the government-wide financial 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.

N. 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 and fiduciary fund financial statements. A liability for these amounts is reported in governmental funds only if they have matured, for example, as a result of employee resignations and retirements. Annual leave accumulates at the rate of 4 hours biweekly, if less than 3 years of service, 6 hours biweekly, if between 3 and 10 years of service, and 8 hours biweekly if over 10 years of service, limited to 45 working days.

O. 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.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

O. Fund Equity, Continued

The unreserved fund balances for the governmental funds represent the amount available for budgeting future operations. The reserve for related assets as of September 30, 2008, is represented by the following assets:

	<u>General</u>	<u>Grant Assistance</u>	<u>Compact Trust</u>	<u>Other Governmental Funds</u>	<u>Total</u>
Inventories	\$ -	\$ -	\$ -	\$ 30,392	\$ 30,392
Restricted assets:					
Cash and cash equivalents	-	565,060	-	-	565,060
Investments	-	1,000,000	8,011,327	-	9,011,327
	<u>\$ -</u>	<u>\$ 1,565,060</u>	<u>\$ 8,011,327</u>	<u>\$ 30,392</u>	<u>\$ 9,606,779</u>

P. 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. No losses have occurred as a result of these risks in any of the past three fiscal years.

Q. New Accounting Standards

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

In June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Post employment Benefits Other Than Pensions*. GASB Statement No. 45 establishes standards for the measurement, recognition, and display of other post employment benefits expense/expenditures and related liabilities, note disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employers. The provisions of this statement are effective for periods beginning after December 15, 2007. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the State.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

Q. New Accounting Standards, Continued

In December 2006, GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. GASB Statement No. 49 provides guidance and consistency under which a governmental entity would be required to report a liability related to pollution remediation. The provisions of this statement are effective for periods beginning after December 15, 2007. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the State.

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

In November 2007, GASB issued Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*. GASB Statement No. 52 improves the quality of financial reporting by requiring endowments to report their land and other real estate investments at fair value, creating consistency in reporting among similar entities that exist to invest resources for the purpose of generating income. The provisions of this statement are effective for periods beginning after June 15, 2008. Management does not believe 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*. GASB Statement No. 53 is intended to improve how state and local governments report information about derivative instruments - financial arrangements used by governments to manage specific risks or make investments - in their financial statements. The provisions of this statement are effective for periods beginning after June 15, 2009. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the State.

R. Estimates

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

S. Deferred Revenues

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

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

T. 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.

U. Reclassifications

Due to the provisions of GASB Statement No. 34 *Basic Financial Statements – and Management's Discussion and Analysis – For State and Local Governments*, major funds presented in a previous year may not be major funds presented in the current year. Concurrently, major funds presented in the current year may not be major funds presented in the previous year.

(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 State pools cash resources of its various funds in order to facilitate the management of cash. Unless otherwise required by law, interest income received on pooled cash accrues to the General Fund. Cash and cash equivalents applicable to a particular fund are readily identifiable. The State has invested the majority of its excess Compact Funds in a pooled investment fund which is managed under the control of the Federated Development Authority, an entity comprised of the FSM National Government and its four component states. Investment income originating from the pool accrues to the General Fund.

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

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

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2008

(2) Deposits and Investments, Continued

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

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

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

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 POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2008

(2) Deposits and Investments, Continued

A. Deposits, Continued

As of September 30, 2008, the carrying amount of the primary government's total cash and cash equivalents were \$1,925,317 and the corresponding bank balances were \$3,811,722, which are maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2008, bank deposits in the amount of \$200,000 were FDIC insured. The State does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Accordingly, 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, 2008, the State's investments at fair value are as follows:

Fixed income securities:	
Domestic fixed income	\$ <u>3,903,582</u>
Other investments:	
Domestic equities	4,789,482
Cash management account	<u>10,117,097</u>
	<u>14,906,579</u>
	\$ <u>18,810,161</u>

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2008

(2) Deposits and Investments, Continued

B. Investments, Continued

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

<u>Investment</u>	<u>Credit Rating</u>	<u>Investment Maturities (In Years)</u>				<u>Total</u>
		<u>Current</u>	<u>1-5</u>	<u>6-10</u>	<u>Over</u>	
U.S. treasury obligations	AAA	\$101,514	\$ 524,687	\$284,802	\$ 146,121	\$1,057,124
U.S. government agency obligations:						
California Water Sewer	AAA	-	-	-	119,570	119,570
Federal Farm Credit Bank Bonds	AAA	-	57,539	-	-	57,539
Federal Home Loan Bank Bonds	AAA	11,481	44,035	-	-	55,516
Federal Home Loan Mortgage Assn	AAA	-	65,410	20,322	471,449	557,181
Federal National Mortgage Assn	AAA	-	26,091	11,395	169,886	207,372
Government National Mortgage Assn	AAA	-	-	-	710,443	710,443
Government National Mortgage Corp	AAA	-	-	-	6,651	6,651
Housing Urban Development US	AAA	-	11,431	-	-	11,431
Sonoma County Pension	AAA	-	-	-	45,334	45,334
Tennessee Valley Auth Bonds	AAA	32,198	-	-	8,891	41,089
Corporate notes and bonds	A1	-	136,489	62,187	-	198,676
Corporate notes and bonds	A2	23,776	89,435	121,118	21,620	255,949
Corporate notes and bonds	A3	-	-	-	9,240	9,240
Corporate notes and bonds	AA1	-	41,514	-	-	41,514
Corporate notes and bonds	AA2	-	14,422	-	27,740	42,162
Corporate notes and bonds	AA3	3,311	78,337	54,418	17,563	153,629
Corporate notes and bonds	AAA	4,185	-	-	-	4,185
Corporate notes and bonds	B2	-	3,467	-	-	3,467
Corporate notes and bonds	BA1	-	33,697	-	-	33,697
Corporate notes and bonds	BAA1	-	22,460	104,475	7,144	134,079
Corporate notes and bonds	BAA2	-	42,639	49,361	5,309	97,309
Corporate notes and bonds	BAA3	7,941	-	12,083	-	20,024
Corporate notes and bonds	N/A	-	-	-	40,401	40,401
Grand Total		<u>\$184,406</u>	<u>\$1,191,653</u>	<u>\$720,161</u>	<u>\$1,807,362</u>	<u>\$3,903,582</u>

As of September 30, 2008, the Grants Assistance Fund holds 19% of the shares of the Pacific Islands Development Bank, which is carried at a cost of \$1,000,000 as the market value of these shares is difficult to assess since they are not publicly traded. Additionally, the State acquired an interest in an airline during fiscal year 2004 and recorded an impairment of such investment in the same period. Financial statements from the investee are not currently available.

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, 2008.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2008

(2) Deposits and Investments, Continued

B. Investments, Continued

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. As of September 30, 2008, the State did not hold an investment in any one issuer that represented more than 5% of the State's total investments.

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.

(3) Receivables

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

	<u>General</u>	<u>Grants Assistance</u>	<u>Compact Trust</u>	<u>Other Governmental Funds</u>	<u>Total</u>
Receivables:					
Taxes	\$1,665,506	\$1,735,699	\$ -	\$ -	\$ 3,401,205
Other	<u>3,792,637</u>	<u>5,223</u>	<u>-</u>	<u>584,724</u>	<u>4,382,584</u>
	5,458,143	1,740,922	-	584,724	7,783,789
Less: allowance for uncollectibles	<u>(2,190,499)</u>	<u>(545,922)</u>	<u>-</u>	<u>(573,878)</u>	<u>(3,310,299)</u>
	<u>\$3,267,644</u>	<u>\$1,195,000</u>	<u>\$ -</u>	<u>\$ 10,846</u>	<u>\$ 4,473,490</u>

Receivables of the primary government are primarily due from businesses and individuals residing in the FSM. The State establishes an allowance for doubtful accounts receivable based on the credit risk of specific customers, historical trends and other information. During the year ended September 30, 2008, the State reevaluated the allowance for doubtful debts and determined that an additional provision was required for receivables within the General Fund in the amount of \$158,933. Accordingly, such has been reflected as a special item within the accompanying financial statements.

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

	<u>Pohnpei Utilities Corporation</u>	<u>Pohnpei Port Authority</u>	<u>Pohnpei Fisheries Corporation</u>	<u>Pohnpei Transportation Authority</u>	<u>Small Business Guarantee and Finance Corporation</u>	<u>Pohnpei Economic Development Authority</u>	<u>Pohnpei State Housing Authority</u>	<u>Total</u>
Receivables:								
General	\$4,284,082	\$1,365,550	\$ 182,628	\$ 971,606	\$ 1,046	\$ 354,510	\$ 6,263,869	\$13,423,291
Other	<u>129,749</u>	<u>20,166</u>	<u>9,007</u>	<u>92</u>	<u>317</u>	<u>688</u>	<u>17,728</u>	<u>177,747</u>
	4,413,831	1,385,716	191,635	971,698	1,363	355,198	6,281,597	13,601,038
Less: allowance for uncollectibles	<u>(2,523,743)</u>	<u>(1,167,855)</u>	<u>(188,922)</u>	<u>(776,693)</u>	<u>-</u>	<u>(350,035)</u>	<u>(5,946,802)</u>	<u>(10,954,050)</u>
	<u>\$1,890,088</u>	<u>\$ 217,861</u>	<u>\$ 2,713</u>	<u>\$ 195,005</u>	<u>\$ 1,363</u>	<u>\$ 5,163</u>	<u>\$ 334,795</u>	<u>\$ 2,646,988</u>

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2008

(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.

(4) Interfund Receivables and Payables

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

Receivable Fund	Payable Fund	Amount
General	Grants Assistance	\$ 3,626,341
General	Nonmajor governmental funds	443,235
Grants Assistance	General	2,052,411
Nonmajor governmental fund	General	<u>4,573,374</u>
		<u>\$ 10,695,361</u>

Receivables and payables between funds reflected as due to/from primary government in the statement of net assets at September 30, 2008, are summarized as follows:

<u>Discretely Presented Component Units</u>	<u>Due From</u>	<u>Due To</u>
Pohnpei Fisheries Corporation: Grants Assistance Fund	\$ <u> -</u>	\$ <u>2,450,000</u>

(5) Fixed Assets

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

	Balance October <u>1, 2007</u>	<u>Additions</u>	<u>Retirements</u>	Balance September <u>30, 2008</u>
Governmental activities:				
Capital assets, being depreciated:				
Buildings	\$ 6,250,479	\$ -	\$ -	\$ 6,250,479
Machinery, equipment and others	6,787,737	248,032	(74,630)	6,961,139
Infrastructure	<u>52,341,781</u>	<u>-</u>	<u>-</u>	<u>52,341,781</u>
Total capital assets, being depreciated	<u>65,379,997</u>	<u>248,032</u>	<u>(74,630)</u>	<u>65,553,399</u>
Less accumulated depreciation for:				
Buildings	(1,816,797)	(125,009)	-	(1,941,806)
Machinery, equipment and others	(5,709,684)	(449,284)	74,630	(6,084,338)
Infrastructure	<u>(31,210,095)</u>	<u>(1,729,864)</u>	<u>-</u>	<u>(32,939,959)</u>
	<u>(38,736,576)</u>	<u>(2,304,157)</u>	<u>74,630</u>	<u>(40,966,103)</u>
Governmental activities capital assets, net	<u>\$ 26,643,421</u>	<u>\$ (2,056,125)</u>	<u>\$ -</u>	<u>\$ 24,587,296</u>

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2008

(5) Fixed Assets, Continued

Depreciation expense was charged to functions/programs of the primary government's governmental activities as follows:

General government	\$ 63,607
Department of Land and Natural Resources	11,290
Education	279,430
Health services	126,088
Public safety	35,185
Boards and commissions	1,783,557
Judiciary	<u>5,000</u>
	<u>\$ 2,304,157</u>

(6) Short-Term Debt

Discretely Presented Component Units

Notes payable by the discretely presented component units consist of the following at September 30, 2008:

Pohnpei Utilities Corporation (PUC)

Notes payable drawn on a bank line of credit of \$100,000 (line expiry December 7, 2008), interest at time certificate of deposit (TCD) rate plus 2% (6.10% at September 30, 2008), collateralized by TCD. \$ 100,000

Changes in notes payable for the year ended September 30, 2008, are as follows:

	Outstanding September 30, <u>2007</u>	<u>Increases</u>	<u>Decreases</u>	Outstanding September 30, <u>2008</u>	Due Within <u>One Year</u>
Notes to a bank	\$ 398,000	\$ 475,122	\$ (773,122)	\$ 100,000	\$ 100,000
Note to an investment company	<u>476,825</u>	-	<u>(476,825)</u>	-	-
	<u>\$ 874,825</u>	<u>\$ 475,122</u>	<u>\$ (1,249,947)</u>	<u>\$ 100,000</u>	<u>\$ 100,000</u>

(7) Long-Term Obligations

Primary Government

Asian Development Bank (ADB) Early Retirement Program Loan

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 (ADB Loan No. 1520) is funded by a \$4,200,000 loan from the ADB through the FSM National Government. The activities of the ERS Program are recorded in the General Fund. As of September 30, 2008, the carrying value of the loan increased to \$4,723,972 due to foreign exchange losses passed through from the FSM National Government.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2008

(7) Long-Term Obligations, Continued

Primary Government

Asian Development Bank (ADB) Early Retirement Program Loan, Continued

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 appropriated funds into the ERS Trust Account. As of September 30, 2008, \$3,428,021 has been deposited to the Trust Account, which is restricted for the repayment of this debt.

Asian Development Bank (ADB) Private Sector Development Program Loan

The State entered into an agreement with the Federated States of Micronesia National Government (FSM) to borrow a portion of the proceeds of the FSM Program Loan with ADB, for the purpose of promoting private sector development in Pohnpei, with interest at 1 to 1.5%.

As of September 30, 2008, an immaterial amount of drawdowns was received. The principal payments shall be made in 32 equal semi-annual payments beginning on May 15, 2011 and the last payment in November 15, 2026. As at September 30, 2008, total amount disbursed to the State under this program loan (ADB Loan No. 1874 and 1873) is \$414,983. However, as of September 30, 2008, the carrying value of the loan increased due to foreign exchange losses. The State has recorded at the government-wide level the amount of its allocable share of these exchange losses. Dialogue with the FSM National Government will continue, and any reductions of these losses will be recorded in fiscal year 2009 upon resolution.

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

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2009	\$ 84,874	\$ 51,347	\$ 136,220
2010	129,649	55,377	185,027
2011	129,649	53,857	183,506
2012	129,649	52,336	181,986
2013 – 2017	777,897	288,570	1,066,466
2018 – 2022	1,128,586	175,497	1,304,083
2023 – 2027	1,070,203	112,509	1,182,712
2028 – 2032	875,515	59,813	935,328
2033 – 2037	<u>713,548</u>	<u>67,791</u>	<u>789,339</u>
	<u>\$5,039,571</u>	<u>\$857,096</u>	<u>\$5,956,667</u>

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2008

(7) Long-Term Obligations, Continued

Primary Government, Continued

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

	Balance October 1, 2007	Additions	Reductions	Balance September 30, 2008	Due Within One Year
Loans payable:					
ADB loans	\$ 4,521,067	\$ 93,916	\$ 140,000	\$ 4,474,983	\$ 140,000
ADB loans (foreign exchange)	<u> -</u>	<u>564,588</u>	<u> -</u>	<u>564,588</u>	<u> -</u>
	<u>4,521,067</u>	<u>658,504</u>	<u>140,000</u>	<u>5,039,571</u>	<u>140,000</u>
Other:					
Compensated absences	877,597	146,199	104,873	918,923	237,438
Claims and litigation payable	<u>1,450,000</u>	<u> -</u>	<u>825,000</u>	<u>625,000</u>	<u> -</u>
	<u>2,322,367</u>	<u>146,199</u>	<u>929,873</u>	<u>1,543,923</u>	<u>237,438</u>
	<u>\$ 6,843,434</u>	<u>\$ 804,703</u>	<u>\$ 1,069,873</u>	<u>\$ 6,583,494</u>	<u>\$ 377,438</u>

The reduction of \$825,000 in claims and litigation payable has been recorded as a special item based on a reassessment of related claims and litigation.

Discretely Presented Component Units

A summary of long-term debt as of September 30, 2008, is as follows:

Pohnpei Utilities Corporation (PUC)

Amount drawn on a note payable to the State of Pohnpei, facilitated by an Asian Development Bank loan to the FSM, due in semi-annual installments of \$33,500 commencing February 28, 2007. The State of Pohnpei has not imposed collateralization on PUC and has waived its rights to receive 6.82% in interest. The loan agreement includes a 1% service charge to be added to the principal until installment payments commence. This service charge may be paid by PUC or by the State of Pohnpei. \$ 2,022,848

Loan payable to United States Department of Agriculture, Rural Utilities Service, due in monthly installments of \$2,654 commencing October 28, 2006. The loan is collateralized by a revenue bond. The loan bears a fixed interest rate of 4.5%. 565,803

Loan payable to FSM Development Bank, 5 year term, interest at 9%, collateralized by a \$150,000 time certificate of deposit. Pursuant to a loan agreement dated October 26, 2001, PUC is required to make monthly payments of both principal and interest in the amount \$10,379. A member of the PUC Board is also a member of management of the FSM Development Bank. 388,518

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2008

(7) Long-Term Obligations, Continued

Discretely Presented Component Units, Continued

Pohnpei Utilities Corporation (PUC), Continued

Loan payable to Bank of the Federated States of Micronesia (BoFSM), 5 year term, interest at 9%, collateralized by one unit of diesel power comprehensive generator plant, two units of Daihatsu model 12D532 engines, building and materials, and existing and future receivables. Monthly principal and interest installments of \$9,794 commencing September 15, 2008. First payment was made in October 2008.

773,122

\$ 3,750,291

Pohnpei Fisheries Corporation (PFC)

Notes payable to Pohnpei Economic Development Corporation, uncollateralized and without interest, due in equal monthly installments beginning April 30, 1998 of \$20,000.

\$ 40,000

Notes payable to Federated States of Micronesia Development Bank (FSMDB), collateralized by the existing assets of the Corporation, due in monthly installments of \$4,655, with 9% interest and a term of 4 years beginning June 2004, ending May 2007.

62,086

Notes payable to FSM National Government for amounts received under a conditional grant award, interest at 9% with no specified repayment term.

15,000

\$ 117,086

Annual debt service requirements to maturity for principal and interest of discretely presented component units are as follows:

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2009	\$ 316,780	\$ 151,026	\$ 467,806
2010	211,477	129,449	340,926
2011	226,999	113,927	340,926
2012	203,032	97,449	300,481
2013	596,227	84,105	680,332
2014 – 2018	297,029	197,211	494,240
2019 – 2023	321,160	173,080	494,240
2024 – 2028	348,782	145,458	494,240
2029 – 2033	380,645	113,595	494,240
2034 – 2038	417,677	76,563	494,240
2039 – 2043	461,035	33,205	494,240
2044	86,534	806	87,340
	<u>\$3,867,377</u>	<u>\$ 1,315,874</u>	<u>\$5,183,251</u>

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2008

(7) Long-Term Obligations, Continued

Discretely Presented Component Units, Continued

Pohnpei Fisheries Corporation (PFC), Continued

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

	Balance October 1, <u>2007</u>	<u>Additions</u>	<u>Reductions</u>	Balance September 30, 2008	Due Within <u>One Year</u>
Loans payable	\$ 3,286,074	\$ 773,122	\$(191,819)	\$ 3,867,377	\$ 261,780
Other:					
Due to primary government	<u>2,450,000</u>	-	-	<u>2,450,000</u>	-
	<u>\$ 5,736,074</u>	<u>\$ 773,122</u>	<u>\$(191,819)</u>	<u>\$ 6,317,377</u>	<u>\$ 261,780</u>

(8) Contingencies and Commitments

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.

Insurance Coverage

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

Federal Grants

The State participates in a number of federally assisted grant programs. These programs are subject to financial and compliance audits to ascertain if Federal laws and guidelines have been followed.

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 Guarantees

As discussed in Note 1K, if after exhaustive efforts between Pohnpei State Housing Authority and Rural Development (parties to the MOU) have failed to collect from the defaulted borrowers, the State may be ultimately responsible for various USDA Rural Development loans. As of March 28, 2007, the State was notified that various loans in the program may be in default. No provision for any liability that may result from this matter has been provided for within the accompanying financial statements.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2008

(8) Contingencies and Commitments, Continued

Other, Continued

Litigation

The State is party to several legal proceedings arising from governmental operations. Claims are filed with the State's Attorney General. Approved claims are usually paid under general appropriations to the affected government agency. The State Attorney General is of the opinion that the probable outcome of suits existing at September 30, 2008, is not predictable but could have a material impact on the accompanying financial statements. Such impact has currently been estimated to approximate \$625,000.

Other

The State Legislature has authorized various Compact Infrastructure and Infrastructure Maintenance projects. However, the State Legislature has required that additional approvals be provided by that body prior to these projects being expended. As a result, no continuing appropriation has been recorded or will be recorded for these authorizations until such time as the additional requirements have been satisfied.

State law mandates that 30% of fishing fines be shared with applicable municipalities. Given the lack of certain legal clarifications, no specific dollar amount can be determined to be recorded as either a continuing appropriation or as a liability due to the municipalities.

(9) Continuing Appropriations

Continuing appropriations as of September 30, 2008, are summarized as follows:

Major Governmental Funds

General Fund:

Each fiscal year, the Pohnpei State Legislature appropriates funds for various programs, municipal projects and other projects which are available until fully expended or project completion. \$ 213,637

Grants Assistance Fund:

Each fiscal year, the Pohnpei State Legislature appropriates funds for capital projects and economic development projects. \$ 50,050

Nonmajor Governmental Funds

Each fiscal year, the Pohnpei State Legislature appropriates funds for various programs and other projects. \$ 477,614

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2008

(10) Self-Insurance Fund - Component Units

In accordance with section 2(5) of State Law 3L-41-93, an amendment was made to the original enabling legislation for Pohnpei Utilities Corporation (PUC) establishing a self-insurance fund to defray costs of any unforeseen accidents or disasters. The funds are accumulated in a restricted self-insurance fund, held by a trustee, in the name of PUC. No other insurance is maintained by PUC.

Pohnpei Port Authority and Pohnpei Fisheries Corporation purchase insurance to cover workmen's compensation and life insurance risks. Both entities are substantially self-insured for all other risks. Management of both entities are of the opinion that no material losses have been sustained as a result of this practice.

Pohnpei Transportation Authority does not purchase commercial insurance covering potential risks. Management of this entity represents that no material losses have been sustained as a result of this practice during the last three years.

(11) FSM Development Bank Loan Funds

Compact Capital Account funds in an aggregate amount of \$1.7 million were transferred to the control of the FSM Development Bank (FSMDB) (a component unit of the FSM National Government) to be loaned out to borrowers from Pohnpei State mainly for economic development projects. The loan fund is administered by FSMDB in a Trust capacity. All loan decisions are made by management of the State. These loans are not controlled by the State and are not currently recorded in the accompanying financial statements. As of December 31, 2007 (FSMDB fiscal year end), the outstanding fund balance aggregated \$719,915.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

YEAR ENDED SEPTEMBER 30, 2008

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

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

	Budgeted Amounts		Actual - Budgetary	Variance with Final Budget -
	Original	Final	Basis (see Note 1)	
Revenues:				
FSM revenue sharing	\$ 4,600,000	\$ 4,600,000	\$ 5,514,736	\$ 914,736
State taxes	2,315,000	2,315,000	2,153,511	(161,489)
Net change in the fair value of investments	300,000	300,000	(1,172,700)	(1,472,700)
Other	137,000	137,000	157,696	20,696
Total revenues	7,352,000	7,352,000	6,653,243	(698,757)
Expenditures:				
Current:				
General government	3,719,500	3,827,465	3,616,404	211,061
Department of Land and Natural Resources	450,228	499,375	454,265	45,110
Department of Education	417,616	419,934	301,129	118,805
Department of Health Services	380,000	530,000	270,018	259,982
Department of Public Safety	1,274,893	1,308,150	1,238,025	70,125
Office of the Attorney-General	329,102	694,902	649,336	45,566
Other appropriations	1,938,853	2,282,202	2,156,911	125,291
Payments to Non-governmental Agencies	132,280	192,963	176,333	16,630
Payment to PTA	-	-	1,311,178	(1,311,178)
Grants to local governments	2,179,500	2,179,500	2,179,490	10
Total expenditures	10,821,972	11,934,491	12,353,089	(418,598)
Excess (deficiency) of revenues over expenditures	(3,469,972)	(4,582,491)	(5,699,846)	(1,117,355)
Other financing uses:				
Operating transfers out	-	-	605,750	605,750
Special item:				
Write-off of receivables	-	-	(158,933)	(158,933)
Net change in unreserved fund balance	(3,469,972)	(4,582,491)	(5,253,029)	(670,538)
Other changes in unreserved fund balance:				
Decrease in reserve for related assets	-	-	949,559	949,559
Increase in reserve for continuing appropriations	-	-	74,892	74,892
Unreserved fund balance at the beginning of the year	8,998,773	8,998,773	8,998,773	-
Unreserved fund balance at the end of the year	\$ 5,528,801	\$ 4,416,282	\$ 4,770,195	\$ 353,913

See accompanying notes to required supplementary information - budgetary reporting.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

(1) Budgetary Information

The Governor presents to the Pohnpei 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 Pohnpei State Legislature reviews and approves these estimates making changes, as it deems appropriate. The Appropriation Committee of the Pohnpei State Legislature, during the regular session of the Pohnpei State Legislature, holds public hearings at which time Departments and Offices are required to justify their budget estimates. During the regular session of the Pohnpei State Legislature, an appropriation bill, as required by the Constitution, is introduced and budget estimates are then legally enacted by the Pohnpei State Legislature.

Formal budget integration is employed as a management control device during the year for all funds. The Pohnpei 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.

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

Net change in fund balance	\$ (5,378,251)
Decrease in reserve for encumbrances	<u>125,222</u>
Net change in unreserved fund balance	\$ <u>(5,253,029)</u>

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

<u>Program Area</u>	<u>Excess</u>
Department of Treasury and Administration	\$180,908
Department of Education-Director's Office	\$ 533
Division of Police and Security	\$193,414
Public Land and Trust	\$ 8,790
Foreign Investment Board	\$ 69,929

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

(2) Reconciliation – GAAP and Budgetary Bases of Accounting, Continued

<u>Program Area</u>	<u>Excess</u>
ALMS	\$ 23,712
Small Business Guarantee and Finance Corporation	\$ 119,000
Pohnpei Housing Authority	\$ 4,660
Pohnpei Economics Development Authority	\$ 76,684
Pohnpei Public Library	\$ 52,463

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

OTHER SUPPLEMENTARY INFORMATION

YEAR ENDED SEPTEMBER 30, 2008

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

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

	General	Special	Permanent	Other	Total
		Revenue	Compact	Governmental	
		Grants	Trust	Funds	
		Assistance			
Expenditures:					
Salaries and wages	\$ 5,951,977	\$ 12,017,860	\$ -	\$ 82,107	\$ 18,051,944
Grants and subsidies	2,507,039	-	-	-	2,507,039
Contractual services	521,641	964,176	-	531,946	2,017,763
Utilities	330,389	729,831	-	33,999	1,094,219
Supplies and materials	262,090	879,641	-	133,366	1,275,097
Books and library materials	-	476,860	-	-	476,860
Instructional materials	-	35,869	-	-	35,869
POL	333,824	232,377	-	26,999	593,200
Medical supplies	-	1,229,999	-	387,293	1,617,292
Scholarship and training	-	387,429	-	-	387,429
Capital outlay	155,125	312,316	-	21,750	489,191
Noncapitalized equipment and furniture	-	138,849	-	2,307	141,156
Travel	276,230	674,874	-	19,124	970,228
Grants and subsidies	-	68,250	-	-	68,250
Communications	110,283	127,339	-	5,705	243,327
Medical referral	105,114	351,527	-	-	456,641
Repairs and maintenance	40,185	65,644	-	2,666	108,495
Printing and reproduction	-	49,220	-	1,405	50,625
Freight	2,486	40,492	-	6,980	49,958
Rentals	10,797	27,809	-	2,328	40,934
Import tax	1,577	27,910	-	688	30,175
Official and housing allowance	192,108	92,145	-	4,080	288,333
Insurance	63,880	2,484	-	-	66,364
Food stuffs	100,109	418,690	-	1,309	520,108
Principal and interest payments	-	-	-	141,926	141,926
Non-payroll compensation	-	228,261	-	-	228,261
Employee training	-	29,163	-	-	29,163
Court settlements	16,500	-	-	-	16,500
Subsidy to PTA	1,311,178	-	-	-	1,311,178
Other	174,521	58,375	-	101,625	334,521
	<u>\$ 12,467,053</u>	<u>\$ 19,667,390</u>	<u>\$ -</u>	<u>\$ 1,507,603</u>	<u>\$ 33,642,046</u>

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

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

	<u>2008</u>	<u>2007</u>
Revenues:		
FSM revenue sharing	\$ 5,514,736	\$ 5,405,136
State taxes:		
Sales tax	2,027,223	2,005,680
Hotel tax	67,788	60,809
Tax penalties	58,674	246,126
	<u>2,153,685</u>	<u>2,312,615</u>
Net increase in the fair value of investments	<u>(1,172,700)</u>	<u>1,722,264</u>
Other revenues	<u>146,264</u>	<u>314,753</u>
Total revenues	<u>6,641,985</u>	<u>9,754,768</u>
Expenditures:		
Current:		
General government:		
Governor and staff	734,774	630,482
Department of Treasury and Administration	616,497	499,854
Judiciary Branch	609,420	569,483
Legislative Branch	1,693,013	1,643,476
	<u>3,653,704</u>	<u>3,343,295</u>
Department of Land and Natural Resources:		
Office of the Director	39,273	83,172
Division of Public Land	-	51,379
Division of Forestry & Marine Conservation	151,682	-
Division of Historic Preservation	57,200	-
Parks and Recreation	42,342	-
Zoning Commission	1,000	-
Division of Surveying and Mapping	179,315	154,407
	<u>470,812</u>	<u>288,958</u>
Department of Education:		
Division of Pre-School and Primary Education	189,355	2,805
Post-secondary education	111,777	55,341
	<u>301,132</u>	<u>58,146</u>
Department of Health:		
Medical services	229,242	-
Medical referral	40,388	-
	<u>269,630</u>	<u>-</u>
Department of Public Safety:		
Office of the Director	127,071	90,756
Division of Police and Security	844,986	759,276
Division of Correction and Rehabilitation	251,196	250,216
Police Commission	11,105	-
Division of Search and Rescue	4,771	7,419
	<u>1,239,129</u>	<u>1,107,667</u>
Office of the Attorney-General	<u>657,501</u>	<u>264,849</u>
Boards, Commissions and Other:		
Economic Affairs	354,831	2,354
Social Affairs	212,071	183,424
Transportation and Infrastructure	877,940	591,199
Environmental Protection Agency	-	13,750
Foreign Investment Board	74,145	57,655
Election Commissioner	195,280	67,498
Pohnpei Public Broadcasting Corporation	132,256	142,122
Public Land and Trustees	8,790	-
Pohnpei State Housing Authority	125,424	93,231
Pohnpei Ethics Commission	23,714	-
Pohnpei Economic Development Authority	76,684	24,535
Small Business Guarantee and Finance Corporation	119,000	82,530
Pohnpei Transportation Authority	1,311,178	-
Other	-	36,353
	<u>3,511,313</u>	<u>1,294,651</u>

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

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

	2008	2007
Expenditures, continued:		
Payments to Non-governmental Agencies:		
Pohnpei Public Library	52,463	52,463
Micronesian Legal Services Corporation	38,280	38,280
USDA Rural Development	93,599	103,953
	184,342	194,696
Grants to local governments	2,179,490	2,233,562
Total expenditures	12,467,053	8,785,824
Excess (deficiency) of revenues over (under) expenditures	(5,825,068)	968,944
Other financing uses:		
Operating transfers out/in	605,750	(420,951)
Special item:		
Write-off of receivables	(158,933)	(984,713)
Net change in fund balance	(5,378,251)	(436,720)
Fund balance at the beginning of the year	10,385,135	10,821,855
Fund balance at the end of the year	\$ 5,006,884	\$ 10,385,135

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

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

	Budgeted Amounts		Actual Amounts	Variance
	Original	Final		
Revenues:				
FSM revenue sharing:	\$ 4,600,000	\$ 4,600,000	\$ 5,514,736	\$ 914,736
State taxes:				
Sales tax	2,315,000	2,315,000	2,153,511	(161,489)
	2,315,000	2,315,000	2,153,511	(161,489)
Net change in the fair value of investments	300,000	300,000	(1,172,700)	(1,472,700)
Other	137,000	137,000	157,696	20,696
Total revenues	7,352,000	7,352,000	6,653,243	(698,757)
Expenditures:				
Current:				
General government:				
Governor and staff	658,514	769,352	731,958	37,394
Department of Treasury and Administration	584,605	615,259	628,280	(13,021)
Judiciary Branch	685,936	680,936	576,736	104,200
Legislative Branch	1,790,445	1,761,918	1,679,430	82,488
	3,719,500	3,827,465	3,616,404	211,061
Department of Land and Natural Resources:				
Office of the Director	44,556	45,619	38,904	6,715
Division of Forestry & Marine Conservation	150,899	152,748	134,870	17,878
Division of Surveying and Mapping	182,261	182,690	180,167	2,523
Division of Historic Preservation	71,512	117,049	99,592	17,457
Public Land Office	-	269	(268)	537
Land Use Planning & Zoning Commission	1,000	1,000	1,000	-
	450,228	499,375	454,265	45,110
Department of Education:				
Director's office	-	-	533	(533)
Division of Pre-School and Primary Education	267,616	269,934	188,822	81,112
Secondary Education and Special Education	150,000	150,000	111,774	38,226
	417,616	419,934	301,129	118,805
Department of Health Services:				
COM Nursing	60,000	60,000	-	60,000
Division of Medical Services	160,000	160,000	91,291	68,709
Hemodialysis	-	75,000	69,021	5,979
Division of Dental Services	40,000	40,000	-	40,000
Division of Public Health	120,000	120,000	69,318	50,682
Medical Referral	-	75,000	40,388	34,612
	380,000	530,000	270,018	259,982
Department of Public Safety:				
Office of the Director	103,380	134,004	131,934	2,070
Division of Search and Rescue	-	5,000	4,771	229
Police Commission	-	27,080	6,762	20,318
Division of Police and Security	901,144	869,596	1,094,558	(224,962)
Division of Correction and Rehabilitation	270,369	272,470	-	272,470
	1,274,893	1,308,150	1,238,025	70,125
Office of the Attorney-General	329,102	694,902	649,336	45,566

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

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

	Budgeted Amounts		Actual Amounts	Variance
	Original	Final		
Expenditures, continued:				
Boards, Commissions and Other:				
Economic Affairs	375,367	385,367	359,016	26,351
Social Affairs	231,615	231,615	211,333	20,282
Transportation and Infrastructure	842,221	869,722	854,544	15,178
Public Land and Trustee	-	-	8,790	(8,790)
Foreign Investment Board	-	78,848	69,929	8,919
ALMS	-	24,062	23,712	350
Pohnpei Public Broadcasting Corporation	164,684	170,418	126,752	43,666
Election Commissioner	209,895	211,584	187,420	24,164
Small Business Guarantee and Finance Corporation	-	119,000	119,000	-
Pohnpei Housing Authority	115,071	115,071	119,731	(4,660)
Pohnpei Economics Development Authority	-	76,515	76,684	(169)
Pohnpei Transportation Authority	-	-	1,311,178	(1,311,178)
	<u>1,938,853</u>	<u>2,282,202</u>	<u>3,468,089</u>	<u>(1,185,887)</u>
Payments to Non-Governmental Agencies:				
Pohnpei Public Library	-	52,463	52,463	-
Micronesian Legal Services Corporation	38,280	38,280	38,280	-
USDA Rural Development	94,000	102,220	85,590	16,630
	<u>132,280</u>	<u>192,963</u>	<u>176,333</u>	<u>16,630</u>
Grants to local governments	<u>2,179,500</u>	<u>2,179,500</u>	<u>2,179,490</u>	<u>10</u>
Total expenditures	<u>10,821,972</u>	<u>11,934,491</u>	<u>12,353,089</u>	<u>(418,598)</u>
Deficiency of revenues under expenditures	<u>(3,469,972)</u>	<u>(4,582,491)</u>	<u>(5,699,846)</u>	<u>(1,117,355)</u>
Other financing uses:				
Operating transfers out	-	-	605,750	605,750
Special item:				
Write-off of receivables	-	-	(158,933)	(158,933)
Net change in unreserved fund balance	<u>(3,469,972)</u>	<u>(4,582,491)</u>	<u>(5,253,029)</u>	<u>(670,538)</u>
Other changes in unreserved fund balance:				
Decrease in reserve for related assets	-	-	949,559	949,559
Increase in reserve for continuing appropriations	-	-	74,892	74,892
Unreserved fund balance at the beginning of the year	<u>8,998,773</u>	<u>8,998,773</u>	<u>8,998,773</u>	<u>-</u>
Unreserved fund balance at the end of the year	<u>\$ 5,528,801</u>	<u>\$ 4,416,282</u>	<u>\$ 4,770,195</u>	<u>\$ 353,913</u>

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

Combined Balance Sheet
Nonmajor Governmental Funds
September 30, 2008

	Other Special Revenue	Other Debt Service	Health and Education Projects	Total
<u>ASSETS</u>				
Receivables, net:				
Other	\$ 10,846	\$ -	\$ -	\$ 10,846
Due from other funds	4,137,361	206,793	229,220	4,573,374
Inventories	30,392	-	-	30,392
Restricted assets:				
Investments	-	3,428,021	-	3,428,021
Total assets	\$ 4,178,599	\$ 3,634,814	\$ 229,220	\$ 8,042,633
<u>LIABILITIES AND FUND BALANCES</u>				
Liabilities:				
Accounts payable	\$ 61,485	\$ (111)	\$ 768	\$ 62,142
Other liabilities and accruals	723	-	-	723
Due to other funds	443,235	-	-	443,235
Total liabilities	505,443	(111)	768	506,100
Fund balances:				
Reserved for:				
Related assets	30,392	-	-	30,392
Encumbrances	80,529	-	3,796	84,325
Continuing appropriations	447,614	-	177,299	624,913
Debt service	-	3,428,021	-	3,428,021
Unreserved:				
Special revenue funds	3,114,621	-	-	3,114,621
Debt service fund	-	206,904	-	206,904
Capital projects funds	-	-	47,357	47,357
Total fund balances	3,673,156	3,634,925	228,452	7,536,533
Total liabilities and fund balances	\$ 4,178,599	\$ 3,634,814	\$ 229,220	\$ 8,042,633

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

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

	<u>Other Special Revenue</u>	<u>Other Debt Service</u>	<u>Health and Education Projects</u>	<u>Total</u>
Revenues:				
Net decrease in fair value of investments	\$ -	\$ (560,807)	\$ -	\$ (560,807)
Sales tax	614,037	-	-	614,037
Fees and charges	816,398	-	-	816,398
Total revenues	<u>1,430,435</u>	<u>(560,807)</u>	<u>-</u>	<u>869,628</u>
Expenditures by function:				
Current:				
General government	717,695	-	-	717,695
Health services	437,537	-	-	437,537
Debt service	-	266,524	-	266,524
Capital projects	-	-	85,847	85,847
Total expenditures	<u>1,155,232</u>	<u>266,524</u>	<u>85,847</u>	<u>1,507,603</u>
Excess (deficiency) of revenues over (under) expenditures	<u>275,203</u>	<u>(827,331)</u>	<u>(85,847)</u>	<u>(637,975)</u>
Other financing sources:				
Loan proceeds	-	93,916	-	93,916
Net change in fund balances	275,203	(733,415)	(85,847)	(544,059)
Fund balances at the beginning of the year	<u>3,397,953</u>	<u>4,368,340</u>	<u>314,299</u>	<u>8,080,592</u>
Fund balances at the end of the year	<u>\$ 3,673,156</u>	<u>\$ 3,634,925</u>	<u>\$ 228,452</u>	<u>\$ 7,536,533</u>

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

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

	Other Special Revenue	Other Debt Service	Health and Education Projects	Total
Revenues:				
Net decrease in fair value of investments	\$ -	\$ (560,807)	\$ -	\$ (560,807)
Sales tax	614,037	-	-	614,037
Fees and charges	816,398	-	-	816,398
Total revenues	1,430,435	(560,807)	-	869,628
Expenditures by account:				
Salaries and wages	55,262	-	26,845	82,107
Contractual services	495,896	-	36,050	531,946
Utilities	32,979	-	1,020	33,999
Supplies and materials	119,501	1,106	12,759	133,366
POL	24,486	-	2,513	26,999
Medical supplies	387,293	-	-	387,293
Capital outlay	18,955	2,795	-	21,750
Noncapitalized equipment and furniture	-	-	2,307	2,307
Travel	-	19,124	-	19,124
Communications	5,705	-	-	5,705
Repairs and maintenance	2,006	-	660	2,666
Printing and reproduction	152	-	1,253	1,405
Freight	6,980	-	-	6,980
Rent	10	-	2,318	2,328
Import tax	566	-	122	688
Official and housing allowance	4,080	-	-	4,080
Food stuffs	1,309	-	-	1,309
Principal and interest payments	-	141,926	-	141,926
Other	52	101,573	-	101,625
Total expenditures	1,155,232	266,524	85,847	1,507,603
Excess (deficiency) of revenues over (under) expenditures	275,203	(827,331)	(85,847)	(637,975)
Other financing sources:				
Loan proceeds	-	93,916	-	93,916
Net change in fund balances	275,203	(733,415)	(85,847)	(544,059)
Fund balances at the beginning of the year	3,397,953	4,368,340	314,299	8,080,592
Fund balances at the end of the year	\$ 3,673,156	\$ 3,634,925	\$ 228,452	\$ 7,536,533

See Accompanying Independent Auditors' Report.

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

Combining Balance Sheet
 September 30, 2008

	Agriculture Revolving	SVAP Revolving	Airport Operations	Recycling Revolving	Pave Road Maintenance	Medical Supplies Revolving	Health Care Premiums
<u>ASSETS</u>							
Receivables:							
Other	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 10,846
Due from other funds	7,633	67	22,273	22,899	1,529,917	7,861	1,338,604
Inventories	30,392	-	-	-	-	-	-
Total assets	<u>\$ 38,025</u>	<u>\$ 67</u>	<u>\$ 22,273</u>	<u>\$ 22,899</u>	<u>\$ 1,529,917</u>	<u>\$ 7,861</u>	<u>\$ 1,349,450</u>
<u>LIABILITIES AND FUND BALANCES (DEFICITS)</u>							
Liabilities:							
Accounts payable	\$ 1,103	\$ -	\$ -	\$ -	\$ -	\$ 57,730	\$ -
Other liabilities and accruals	(2)	-	-	-	2	-	(2)
Due to other funds	-	-	-	-	-	-	-
Total liabilities	<u>1,101</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>2</u>	<u>57,730</u>	<u>(2)</u>
Fund balances (deficits):							
Reserved for:							
Related assets	30,392	-	-	-	-	-	-
Encumbrances	5,731	-	-	-	59,074	11,697	-
Continuing appropriations	-	-	-	-	447,614	-	-
Unreserved (deficit)	801	67	22,273	22,899	1,023,227	(61,566)	1,349,452
Total fund balances (deficits)	<u>36,924</u>	<u>67</u>	<u>22,273</u>	<u>22,899</u>	<u>1,529,915</u>	<u>(49,869)</u>	<u>1,349,452</u>
Total liabilities and fund balances (deficits)	<u>\$ 38,025</u>	<u>\$ 67</u>	<u>\$ 22,273</u>	<u>\$ 22,899</u>	<u>\$ 1,529,917</u>	<u>\$ 7,861</u>	<u>\$ 1,349,450</u>

See Accompanying Independent Auditors' Report.

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

Combining Balance Sheet, Continued
 September 30, 2008

	V6AH Revolving	Environmental Quality	Early Retirement	Special Police Fee	Fishing Fines	Infrastructure Maintenance	Public Lands Trust	Total
ASSETS								
Receivables:								
Other	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 10,846
Due from other funds	13,183	29,866	-	76,930	885,563	-	202,565	4,137,361
Inventories	-	-	-	-	-	-	-	30,392
Total assets	<u>\$ 13,183</u>	<u>\$ 29,866</u>	<u>\$ -</u>	<u>\$ 76,930</u>	<u>\$ 885,563</u>	<u>\$ -</u>	<u>\$ 202,565</u>	<u>\$ 4,178,599</u>
LIABILITIES AND FUND BALANCES (DEFICITS)								
Liabilities:								
Accounts payable	\$ -	\$ -	\$ -	\$ -	\$ 452	\$ -	\$ 2,200	\$ 61,485
Other liabilities and accruals	-	-	-	(1)	1	-	725	723
Due to other funds	-	-	-	-	-	443,235	-	443,235
Total liabilities	<u>-</u>	<u>-</u>	<u>-</u>	<u>(1)</u>	<u>453</u>	<u>443,235</u>	<u>2,925</u>	<u>505,443</u>
Fund balances (deficits):								
Reserved for:								
Related assets	-	-	-	-	-	-	-	30,392
Encumbrances	-	-	-	1,892	2,135	-	-	80,529
Continuing appropriations	-	-	-	-	-	-	-	447,614
Unreserved (deficit)	13,183	29,866	-	75,039	882,975	(443,235)	199,640	3,114,621
Total fund balances (deficits)	<u>13,183</u>	<u>29,866</u>	<u>-</u>	<u>76,931</u>	<u>885,110</u>	<u>(443,235)</u>	<u>199,640</u>	<u>3,673,156</u>
Total liabilities and fund balances (deficits)	<u>\$ 13,183</u>	<u>\$ 29,866</u>	<u>\$ -</u>	<u>\$ 76,930</u>	<u>\$ 885,563</u>	<u>\$ -</u>	<u>\$ 202,565</u>	<u>\$ 4,178,599</u>

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

NONMAJOR GOVERNMENTAL FUNDS
SPECIAL REVENUE FUNDS

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

	Agriculture Revolving	SVAP Revolving	Airport Operations	Recycling Revolving	Pave Road Maintenance	Medical Supplies Revolving	Health Care Premiums
Revenues:							
Sales tax	\$ -	\$ -	\$ -	\$ -	\$ 490,636	\$ -	\$ 123,401
Fees and charges	59,081	-	-	-	-	398,785	-
Total revenues	<u>59,081</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>490,636</u>	<u>398,785</u>	<u>123,401</u>
Expenditures by function:							
Current:							
General government	63,344	-	-	-	34,101	-	-
Health services	-	-	-	-	-	437,537	-
Total expenditures	<u>63,344</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>34,101</u>	<u>437,537</u>	<u>-</u>
Net change in fund balances (deficits)	(4,263)	-	-	-	456,535	(38,752)	123,401
Fund balances (deficits) at the beginning of the year	<u>41,187</u>	<u>67</u>	<u>22,273</u>	<u>22,899</u>	<u>1,073,380</u>	<u>(11,117)</u>	<u>1,226,051</u>
Fund balances (deficits) at the end of the year	<u>\$ 36,924</u>	<u>\$ 67</u>	<u>\$ 22,273</u>	<u>\$ 22,899</u>	<u>\$ 1,529,915</u>	<u>\$ (49,869)</u>	<u>\$ 1,349,452</u>

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

NONMAJOR GOVERNMENTAL FUNDS
SPECIAL REVENUE FUNDS

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

	V6AH Revolving	Environmental Quality	Early Retirement	Special Police Fee	Fishing Fines	Infrastructure Maintenance	Public Lands Trust	Total
Revenues:								
Sales tax	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 614,037
Fees and charges	26,005	50,300	-	46,054	200,000	-	36,173	816,398
Total revenues	<u>26,005</u>	<u>50,300</u>	<u>-</u>	<u>46,054</u>	<u>200,000</u>	<u>-</u>	<u>36,173</u>	<u>1,430,435</u>
Expenditures by function:								
Current:								
General government	11,282	20,636	-	31,235	20,886	443,235	92,976	717,695
Health services	-	-	-	-	-	-	-	437,537
Total expenditures	<u>11,282</u>	<u>20,636</u>	<u>-</u>	<u>31,235</u>	<u>20,886</u>	<u>443,235</u>	<u>92,976</u>	<u>1,155,232</u>
Net change in fund balances (deficits)	14,723	29,664	-	14,819	179,114	(443,235)	(56,803)	275,203
Fund balances (deficits) at the beginning of the year	<u>(1,540)</u>	<u>202</u>	<u>-</u>	<u>62,112</u>	<u>705,996</u>	<u>-</u>	<u>256,443</u>	<u>3,397,953</u>
Fund balances (deficits) at the end of the year	<u>\$ 13,183</u>	<u>\$ 29,866</u>	<u>\$ -</u>	<u>\$ 76,931</u>	<u>\$ 885,110</u>	<u>\$ (443,235)</u>	<u>\$ 199,640</u>	<u>\$ 3,673,156</u>

See Accompanying Independent Auditors' Report.

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

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

	Agriculture Revolving	SVAP Revolving	Airport Operations	Recycling Revolving	Pave Road Maintenance	Medical Supplies Revolving	Health Care Premiums
Revenues:							
Sales tax	\$ -	\$ -	\$ -	\$ -	\$ 490,636	\$ -	\$ 123,401
Fees and charges	59,081	-	-	-	-	398,785	-
Total revenues	<u>59,081</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>490,636</u>	<u>398,785</u>	<u>123,401</u>
Expenditures by account:							
Salaries and wages	-	-	-	-	-	-	-
Contractual services	-	-	-	-	34,101	-	-
Utilities	-	-	-	-	-	-	-
Supplies and materials	53,811	-	-	-	-	48,491	-
POL	3,000	-	-	-	-	-	-
Medical supplies	-	-	-	-	-	387,293	-
Capital outlay	-	-	-	-	-	-	-
Communications	-	-	-	-	-	-	-
Repairs and maintenance	620	-	-	-	-	-	-
Printing and reproduction	48	-	-	-	-	-	-
Freight	5,252	-	-	-	-	1,728	-
Rentals	-	-	-	-	-	-	-
Import tax	566	-	-	-	-	-	-
Official and housing allowance	-	-	-	-	-	-	-
Food stuffs	20	-	-	-	-	-	-
Other	27	-	-	-	-	25	-
Total expenditures	<u>63,344</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>34,101</u>	<u>437,537</u>	<u>-</u>
Net change in fund balances (deficits)	(4,263)	-	-	-	456,535	(38,752)	123,401
Fund balances (deficits) at the beginning of the year	<u>41,187</u>	<u>67</u>	<u>22,273</u>	<u>22,899</u>	<u>1,073,380</u>	<u>(11,117)</u>	<u>1,226,051</u>
Fund balances (deficits) at the end of the year	<u>\$ 36,924</u>	<u>\$ 67</u>	<u>\$ 22,273</u>	<u>\$ 22,899</u>	<u>\$ 1,529,915</u>	<u>\$ (49,869)</u>	<u>\$ 1,349,452</u>

See Accompanying Independent Auditors' Report.

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

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

	V6AH Revolving	Environmental Quality	Early Retirement	Special Police Fee	Fishing Fines	Infrastructure Maintenance	Public Lands Trust	Total
Revenues:								
Sales tax	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 614,037
Fees and charges	26,005	50,300	-	46,054	200,000	-	36,173	816,398
Total revenues	26,005	50,300	-	46,054	200,000	-	36,173	1,430,435
Expenditures by function:								
Salaries and wages	-	6,076	-	-	-	-	49,186	55,262
Contractual services	-	14,560	-	-	-	443,235	4,000	495,896
Utilities	7,500	-	-	464	-	-	25,015	32,979
Supplies and materials	1,280	-	-	11,086	-	-	4,833	119,501
POL	-	-	-	400	20,886	-	200	24,486
Medical supplies	-	-	-	-	-	-	-	387,293
Capital outlay	-	-	-	18,955	-	-	-	18,955
Communications	2,502	-	-	-	-	-	3,203	5,705
Repairs and maintenance	-	-	-	330	-	-	1,056	2,006
Printing and reproduction	-	-	-	-	-	-	104	152
Freight	-	-	-	-	-	-	-	6,980
Rentals	-	-	-	-	-	-	10	10
Import tax	-	-	-	-	-	-	-	566
Official and housing allowance	-	-	-	-	-	-	4,080	4,080
Food stuffs	-	-	-	-	-	-	1,289	1,309
Other	-	-	-	-	-	-	-	52
Total expenditures	11,282	20,636	-	31,235	20,886	443,235	92,976	1,155,232
Net change in fund balances (deficits)	14,723	29,664	-	14,819	179,114	(443,235)	(56,803)	275,203
Fund balances (deficits) at the beginning of the year	(1,540)	202	-	62,112	705,996	-	256,443	3,397,953
Fund balances (deficits) at the end of the year	\$ 13,183	\$ 29,866	\$ -	\$ 76,931	\$ 885,110	\$ (443,235)	\$ 199,640	\$ 3,673,156

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

GRANTS ASSISTANCE FUNDS

Combining Balance Sheet
September 30, 2008

	Section 211(a)(1) Education Sector	Section 211(a)(2) Health Sector	Section 211(a)(3) Private Sector Development	Section 211(a)(4) Capacity Building	Section 211(a)(5) Environment	Section 211(a)(1) Supplemental Education	Section Infrastructure Maintenance	Section 221(b) Special Block Grant	Compact I Other Grants	U.S. Federal Grants	Non-U.S. Grants	CFSM Grants	Compact I Capital Grant	Total
ASSETS														
Investment	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 223,856	\$ 1,195,801	\$ -	\$ -	\$ -	\$ 2,691,612	\$ 4,111,269
Grants receivable from FSM, net	21,874	-	-	43,959	98,912	206,816	-	-	-	793,897	-	24,319	-	1,189,777
Other receivable	-	-	-	-	-	-	-	-	-	-	-	3,928	1,295	5,223
Due from other funds	644,054	395,709	74,224	-	-	-	858,575	-	-	-	79,849	-	-	2,052,411
Advances	-	813	8,971	7,049	-	2,553	-	-	-	1,802	-	1,155	-	22,343
Restricted cash	-	-	-	-	-	-	-	-	-	-	-	-	562,773	562,773
	<u>\$ 665,928</u>	<u>\$ 396,522</u>	<u>\$ 83,195</u>	<u>\$ 51,008</u>	<u>\$ 98,912</u>	<u>\$ 209,369</u>	<u>\$ 858,575</u>	<u>\$ 223,856</u>	<u>\$ 1,195,801</u>	<u>\$ 795,699</u>	<u>\$ 79,849</u>	<u>\$ 29,402</u>	<u>\$ 3,255,680</u>	<u>\$ 7,943,796</u>
LIABILITIES AND FUND BALANCES														
Liabilities:														
Accounts payable	\$ 612,579	\$ 67,454	\$ 6,686	\$ 13,012	\$ 20,623	\$ 85,246	\$ -	\$ 100	\$ 1,475	\$ 22,545	\$ 665	\$ 942	\$ 10	\$ 831,337
Other liabilities and accruals	46,233	21,550	331	1,068	3,000	10,042	-	-	-	9,995	64	361	-	92,644
Deferred revenue	-	302,731	75,641	-	-	-	-	-	-	-	27,486	-	-	405,858
Due to other funds	-	-	-	35,744	101,475	110,313	-	179,768	1,111,701	763,159	-	28,100	1,296,084	3,626,344
Total liabilities	<u>658,812</u>	<u>391,735</u>	<u>82,658</u>	<u>49,824</u>	<u>125,098</u>	<u>205,601</u>	<u>-</u>	<u>179,868</u>	<u>1,113,176</u>	<u>795,699</u>	<u>28,215</u>	<u>29,403</u>	<u>1,296,094</u>	<u>4,956,183</u>
Fund balances:														
Reserved for:														
Related assets	-	-	-	-	-	-	-	-	-	-	-	-	1,565,060	1,565,060
Encumbrances	130,858	104,304	952	21,036	5,081	96,766	-	-	9,487	64,332	352	4,695	-	437,863
Continuing appropriation	-	-	-	-	-	-	-	-	50,000	-	-	-	50	50,050
Unreserved	<u>(123,742)</u>	<u>(99,517)</u>	<u>(415)</u>	<u>(19,852)</u>	<u>(31,267)</u>	<u>(92,998)</u>	<u>858,575</u>	<u>43,988</u>	<u>23,138</u>	<u>(64,332)</u>	<u>51,282</u>	<u>(4,696)</u>	<u>394,476</u>	<u>934,640</u>
Total fund balances (deficit)	<u>7,116</u>	<u>4,787</u>	<u>537</u>	<u>1,184</u>	<u>(26,186)</u>	<u>3,768</u>	<u>858,575</u>	<u>43,988</u>	<u>82,625</u>	<u>-</u>	<u>51,634</u>	<u>(1)</u>	<u>1,959,586</u>	<u>2,987,613</u>
Total liabilities and fund balances	<u>\$ 665,928</u>	<u>\$ 396,522</u>	<u>\$ 83,195</u>	<u>\$ 51,008</u>	<u>\$ 98,912</u>	<u>\$ 209,369</u>	<u>\$ 858,575</u>	<u>\$ 223,856</u>	<u>\$ 1,195,801</u>	<u>\$ 795,699</u>	<u>\$ 79,849</u>	<u>\$ 29,402</u>	<u>\$ 3,255,680</u>	<u>\$ 7,943,796</u>

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

GRANTS ASSISTANCE FUNDS

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

	Section 211(a)(1) Education Sector	Section 211(a)(2) Health Sector	Section 211(a)(3) Private Sector Development	Section 211(a)(4) Capacity Building	Section 211(a)(5) Environment	Section 211(a)(1) Supplemental Education	Infrastructure Maintenance	Section 221(b) Special Block Grant	Compact I Other Grants	U.S. Federal Grants	Non-U.S. Grants	CFSM Grants	Compact I Capital Grant	Total
Revenues:														
Compact funding	\$ 7,766,921	\$ 5,535,158	\$ 128,098	\$ 669,174	\$ 447,972	\$ 2,570,249	\$ 858,575	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 17,976,147
CFSM grants	-	-	-	-	-	-	-	-	-	-	-	61,551	-	61,551
Federal contribution	-	-	-	-	-	-	-	-	-	2,228,626	-	-	-	2,228,626
Other	980	-	-	-	-	3,034	-	-	-	-	171,059	-	11,258	186,331
Investment income	-	-	-	-	-	-	-	-	42,002	-	-	-	-	42,002
	<u>7,767,901</u>	<u>5,535,158</u>	<u>128,098</u>	<u>669,174</u>	<u>447,972</u>	<u>2,573,283</u>	<u>858,575</u>	<u>-</u>	<u>42,002</u>	<u>2,228,626</u>	<u>171,059</u>	<u>61,551</u>	<u>11,258</u>	<u>20,494,657</u>
Expenditures by function:														
Current:														
General government	-	-	128,098	669,174	474,722	-	-	-	850	-	119,425	61,551	(1,044)	1,452,776
Education	7,766,921	-	-	-	-	2,570,249	-	(6,750)	120,410	2,228,626	-	-	-	12,679,456
Health services	-	5,535,158	-	-	-	-	-	-	-	-	-	-	-	5,535,158
Total expenditures	<u>7,766,921</u>	<u>5,535,158</u>	<u>128,098</u>	<u>669,174</u>	<u>474,722</u>	<u>2,570,249</u>	<u>-</u>	<u>(6,750)</u>	<u>121,260</u>	<u>2,228,626</u>	<u>119,425</u>	<u>61,551</u>	<u>(1,044)</u>	<u>19,667,390</u>
Excess (deficiency) of revenue over (under) expenditures	980	-	-	-	(26,750)	3,034	858,575	6,750	(79,258)	-	51,634	-	12,302	827,267
Other financing sources (uses):														
Operating transfers	-	-	-	-	-	-	-	-	-	-	-	-	(605,750)	(605,750)
Net change in fund balances	980	-	-	-	(26,750)	3,034	858,575	6,750	(79,258)	-	51,634	-	(593,448)	221,517
Fund balances (deficit) at the beginning of the year	<u>6,136</u>	<u>4,787</u>	<u>537</u>	<u>1,184</u>	<u>564</u>	<u>734</u>	<u>-</u>	<u>37,238</u>	<u>161,883</u>	<u>-</u>	<u>-</u>	<u>(1)</u>	<u>2,553,034</u>	<u>2,766,096</u>
Fund balances (deficit) at the end of the year	<u>\$ 7,116</u>	<u>\$ 4,787</u>	<u>\$ 537</u>	<u>\$ 1,184</u>	<u>\$ (26,186)</u>	<u>\$ 3,768</u>	<u>\$ 858,575</u>	<u>\$ 43,988</u>	<u>\$ 82,625</u>	<u>\$ -</u>	<u>\$ 51,634</u>	<u>\$ (1)</u>	<u>\$ 1,959,586</u>	<u>\$ 2,987,613</u>

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

GRANTS ASSISTANCE FUNDS

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

	Section 211(a)(1) Education Sector	Section 211(a)(2) Health Sector	Section 211(a)(3) Private Sector Development	Section 211(a)(4) Capacity Building	Section 211(a)(5) Environment	Section 211(a)(1) Supplemental Education	Infrastructure Maintenance	Section 221(b) Special Block Grant	Compact I Other Grants	U.S. Federal Grants	Non-U.S. Grants	CFSM Grants	Compact I Capital Grant	Total
Revenues:														
Compact funding	\$ 7,766,921	\$ 5,535,158	\$ 128,098	\$ 669,174	\$ 447,972	\$ 2,570,249	\$ 858,575	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 17,976,147
CFSM grants	-	-	-	-	-	-	-	-	-	-	-	61,551	-	61,551
Federal contribution	-	-	-	-	-	-	-	-	2,228,626	-	-	-	-	2,228,626
Other	980	-	-	-	-	3,034	-	-	-	-	171,059	-	11,258	186,331
Investment income	-	-	-	-	-	-	-	-	42,002	-	-	-	-	42,002
	<u>7,767,901</u>	<u>5,535,158</u>	<u>128,098</u>	<u>669,174</u>	<u>447,972</u>	<u>2,573,283</u>	<u>858,575</u>	<u>-</u>	<u>42,002</u>	<u>2,228,626</u>	<u>171,059</u>	<u>61,551</u>	<u>11,258</u>	<u>20,494,657</u>
Expenditures by account:														
Salaries and wages	5,878,476	2,573,173	51,662	425,920	256,339	1,343,470	-	-	-	1,433,179	27,876	27,765	-	12,017,860
Contractual services	39,949	373,563	2,320	21,209	142,446	264,766	-	-	15,268	103,755	900	-	-	964,176
Utilities	134,459	507,591	3,500	14,945	9,880	16,743	-	-	850	23,565	17,298	1,000	-	729,831
Supplies and materials	251,621	87,876	6,763	26,671	28,376	268,429	-	-	-	173,882	33,413	2,600	10	879,641
Books and library materials	476,860	-	-	-	-	-	-	-	-	-	-	-	-	476,860
Instructional materials	32,419	-	-	-	-	3,450	-	-	-	-	-	-	-	35,869
POL	88,151	20,295	5,580	3,058	8,381	30,313	-	-	-	68,716	4,344	3,539	-	232,377
Medical supplies	-	1,217,240	-	-	-	-	-	-	-	12,759	-	-	-	1,229,999
Scholarship and training	327,183	-	-	-	-	(53,414)	-	(6,750)	120,410	-	-	-	-	387,429
Capital outlay	47,255	41,724	1,675	4,711	16,873	99,163	-	-	-	92,845	-	8,070	-	312,316
Capital maintenance	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Noncapitalized equipment and furniture	78,538	5,650	2,791	3,655	1,582	28,386	-	-	-	16,589	-	1,658	-	138,849
Travel	2,488	149,126	27,064	144,986	431	129,771	-	-	-	216,230	2,699	3,133	(1,054)	674,874
Grants and subsidies	68,250	-	-	-	-	-	-	-	-	-	-	-	-	68,250
Communications	51,739	13,769	6,621	5,599	3,017	36,669	-	-	-	9,925	-	-	-	127,339
Medical referral	-	366,795	-	-	-	-	-	-	(15,268)	-	-	-	-	351,527
Repairs and maintenance	19,217	3,067	-	2,513	5,706	15,260	-	-	-	18,650	507	724	-	65,644
Printing and reproduction	1,774	5,608	15,706	3,247	315	11,688	-	-	-	10,014	868	-	-	49,220
Freight	22,874	4,116	130	2,364	331	9,693	-	-	-	984	-	-	-	40,492
Rentals	27	117	2,838	497	-	13,424	-	-	-	10,212	594	100	-	27,809
Import tax	-	14,795	-	367	486	11,224	-	-	-	1,038	-	-	-	27,910
Official and housing allowance	400	67,040	-	-	500	180	-	-	-	21,610	2,415	-	-	92,145
Insurance	-	2,484	-	-	-	-	-	-	-	-	-	-	-	2,484
Food stuffs	244,853	79,502	30	1,023	59	74,501	-	-	-	2,886	2,874	12,962	-	418,690
Non-payroll compensation	-	-	-	-	-	222,161	-	-	-	5,810	290	-	-	228,261
Employee training	-	-	-	-	-	29,163	-	-	-	-	-	-	-	29,163
Other	388	1,627	1,418	8,409	-	15,209	-	-	-	5,977	25,347	-	-	58,375
Total expenditures	<u>7,766,921</u>	<u>5,535,158</u>	<u>128,098</u>	<u>669,174</u>	<u>474,722</u>	<u>2,570,249</u>	<u>-</u>	<u>(6,750)</u>	<u>121,260</u>	<u>2,228,626</u>	<u>119,425</u>	<u>61,551</u>	<u>(1,044)</u>	<u>19,667,390</u>
Excess (deficiency) of revenue over (under) expenditures	980	-	-	-	(26,750)	3,034	858,575	6,750	(79,258)	-	51,634	-	12,302	827,267
Other financing sources (uses):														
Operating transfers	-	-	-	-	-	-	-	-	-	-	-	-	(605,750)	(605,750)
Net change in fund balances	980	-	-	-	(26,750)	3,034	858,575	6,750	(79,258)	-	51,634	-	(593,448)	221,517
Fund balances (deficit) at the beginning of the year	6,136	4,787	537	1,184	564	734	-	37,238	161,883	-	-	(1)	2,553,034	2,766,096
Fund balances (deficit) at the end of the year	\$ 7,116	\$ 4,787	\$ 537	\$ 1,184	\$ (26,186)	\$ 3,768	\$ 858,575	\$ 43,988	\$ 82,625	\$ -	\$ 51,634	\$ (1)	\$ 1,959,586	\$ 2,987,613

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

Honorable John Ehsa
Governor, State of Pohnpei
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 Pohnpei as of and for the year ended September 30, 2008, which collectively comprise the State of Pohnpei's basic financial statements and have issued our report thereon dated June 16, 2009. Our report was modified to include a reference to other auditors. 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. Other auditors audited the financial statements of the Pohnpei Transportation Authority, the Small Business Guarantee and Finance Corporation, and the Pohnpei Economic Development Authority, as described in our report on the State of Pohnpei's financial statements. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors.

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 Pohnpei Utilities Corporation, the Pohnpei Port Authority, the Pohnpei Fisheries Corporation and the Pohnpei State Housing Authority, 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 Pohnpei's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the State of Pohnpei's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the State of Pohnpei'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 a certain deficiency in internal control over financial reporting that we consider to be a significant deficiency.

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 accounting principles generally accepted in the United States of America 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 deficiency described in the accompanying Schedule of Findings and Questioned Costs (pages 78 through 81) as item 2008-2 to be a significant deficiency in internal control over financial reporting.

A *material weakness* is a significant deficiency, or a 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.

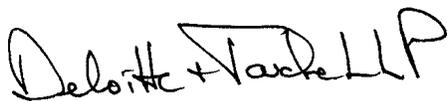
Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, do not we believe that the significant deficiency described above is a material weakness.

The State's response to the finding identified in our audit is described in the accompanying Schedule of Findings and Questioned Costs. We did not audit the State's response and, accordingly, we express no opinion on it.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State of Pohnpei'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 that are required to be reported under *Government Auditing Standards*.

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



June 16, 2009

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND INTERNAL
CONTROL OVER COMPLIANCE APPLICABLE TO EACH MAJOR FEDERAL AWARD
PROGRAM AND ON THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**

Honorable John Ehsa
Governor, State of Pohnpei
Federated States of Micronesia:

Compliance

We have audited the compliance of the State of Pohnpei with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended September 30, 2008. The State of Pohnpei's major federal programs are identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs (pages 78 through 81). 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 Pohnpei's management. Our responsibility is to express an opinion on the State of Pohnpei's compliance based on our audit.

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

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; 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 Pohnpei'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 Pohnpei's compliance with those requirements.

In our opinion, the State of Pohnpei complied, in all material respects, with the requirements referred to above that are applicable to its Compact of Free Association Sector Grants major program (CFDA # 15.875) and its Special Education - Grants to States major program (CFDA # 84.027) for the year ended September 30, 2008. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying Schedule of Findings and Questioned Costs as items 2008-1 and 2008-2.

Internal Control Over Compliance

The management of the State of Pohnpei 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 Pohnpei's internal control over compliance with the 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 Pohnpei's internal control over compliance.

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

A *control deficiency* in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs as items 2008-1 and 2008-2 to be significant deficiencies.

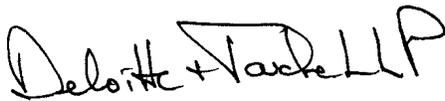
A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. We did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

The State'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's responses and, accordingly, we express no opinion on them.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Pohnpei as of and for the year ended September 30, 2008, and have issued our report thereon dated June 16, 2009. Our report was modified to include reference to other auditors. Our audit was performed for the purpose of forming opinions on the financial statements that collectively comprise the State of Pohnpei's basic financial statements. The accompanying schedule of expenditures of federal awards (pages 69 through 75) is presented for purposes 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 Pohnpei. 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, in relation to the basic financial statements taken as a whole.

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

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

June 16, 2009

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

Agency/Program	Expenditures
U.S. Department of Agriculture	\$ 44,307
U.S. Department of the Interior	17,391,785
U.S. Department of Homeland Security	16,004
U.S. Department of Education	1,177,523
U.S. Department of Health and Human Services	856,795
GRAND TOTAL	\$ 19,486,414
<u>Note:</u> All awards are received in a subgrantee capacity through the FSM National Government, except for the following, which are received directly from the grantor agency:	
Direct from the U.S. Department of Health and Human Services:	
Consolidated Health Centers (Community Health Centers, Migrant Health Centers, Health Care for the Homeless, Public Housing Primary Care and School Based Health Centers)	93.224 \$ <u>210,076</u>
Direct from University of Hawaii:	
CCPI Cancer Program	93.999 \$ <u>27,878</u>
Total Direct Grants	\$ 237,954
Reconciliation to the basic financial statements:	
Grants Assistance Fund	\$ 19,667,390
Less:	
Non-U.S. Grants	(119,425)
CFSM Grants	(61,551)
	\$ 19,486,414

See accompanying notes to schedule of expenditures of federal awards.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

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

<u>Agency/Program</u>	<u>CFDA#</u>	<u>Expenditures</u>
U.S. DEPARTMENT OF AGRICULTURE		
Cooperative Forestry Assistance	10.664	\$ <u>44,307</u>
U.S. DEPARTMENT OF AGRICULTURE TOTAL		\$ <u><u>44,307</u></u>

See accompanying notes to schedule of expenditures of federal awards.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA

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

Agency/Program	CFDA#	Expenditures
U.S. DEPARTMENT OF THE INTERIOR		
Economic, Social and Political Development of the Territories:	15.875	
Compact Capital Improvement Projects		\$ (1,044)
Compact Health and Medical Grants		121,260
Compact Special Block Grants		(6,750)
Compact II Education Sector		7,766,921
Compact II Health Sector		5,535,158
Compact II Private Sector		128,098
Compact II Capacity Building Sector		669,174
Compact II Environment Sector		474,722
Compact II Supplemental Education		2,570,249
Technical Assistance:		
Survey and Mapping		46,275
PPA Runway Mower Unit		1
Historic Preservation Fund Grants-In-Aid	15.904	<u>87,721</u>
U.S. DEPARTMENT OF THE INTERIOR TOTAL		<u>\$ 17,391,785</u>

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

Agency/Program	CFDA#	Expenditures
U.S. DEPARTMENT OF LABOR		
WIA Adult Program	17.258	\$ -
WIA Dislocated Worker	17.260	-
U.S. DEPARTMENT OF LABOR TOTAL		\$ -

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

<u>Agency/Program</u>	<u>CFDA#</u>	<u>Expenditures</u>
U.S. DEPARTMENT OF HOMELAND SECURITY		
Disaster Assistance	83.516	<u>16,004</u>
U.S. DEPARTMENT OF HOMELAND SECURITY		<u>\$ 16,004</u>

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

<u>Agency/Program</u>	<u>CFDA#</u>	<u>Expenditures</u>
U.S. DEPARTMENT OF EDUCATION		
Special Education - Grants to States	84.027	\$ 1,178,866
Vocation Education-Basic Grants to the States	84.048B	<u>(1,343)</u>
U.S. DEPARTMENT OF EDUCATION TOTAL		<u>\$ 1,177,523</u>

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

Agency/Program	CFDA#	Expenditures
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES		
Maternal and Child Health Federal Consolidated Programs	93.110	\$ 520
Project Grants and Cooperative Agreements for Tuberculosis		
Control Programs	93.116	44,820
Sexual Violence/Rape Prevention	93.126	17,621
Family Planning - Services	93.217	103,746
Consolidated Health Centers	93.224	210,076
Immunization Grants	93.268	90,634
CDC & Prevention-Investigations & Technical Assistance	93.283	25,780
Comprehensive Cancer Control	93.283	58,862
HIV Care	93.917	1,498
HIV Prevention Activities-Health Department Based	93.940	40,323
Block Grants for Prevention and Treatment of Substance Abuse	93.959	119,706
Preventive Health Services - Sexually Transmitted Diseases Control Grants	93.977	6,682
Cooperative Agreements for State-Based Diabetes Control		
Programs and Evaluation of Surveillance Systems	93.988	8,493
Preventive Health and Health Services Block Grant	93.991	980
Maternal and Child Health Services Block Grant to the States	93.994	99,176
CCPI Cancer Program	93.999	27,878
		<u>856,795</u>
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES TOTAL		\$ <u>856,795</u>
		<u>19,486,414</u>
GRAND TOTAL		\$ <u>19,486,414</u>

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

1. Scope

The State of Pohnpei is one of the four States of the Federated States of Micronesia. 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 Single Audit.

A. Programs Subject to Single Audit

Schedules of expenditures of federal awards are presented for each federal program related to the following agencies:

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

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. 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, 2008 basic financial statements; and 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, 2008.

C. Subgrantees

Certain program funds are passed through the State to subgrantee organizations. The Schedule of Expenditures of Federal Awards does not contain separate schedules disclosing how the subgrantee outside of the State's control utilizes these funds.

D. Indirect Cost Allocation

The State does not receive any indirect cost allocation and does not charge indirect costs against federal programs.

E. 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.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Programs Selected For
Audit in Accordance with OMB Circular A-133
Year Ended September 30, 2008

<u>Grantor</u> <u>Program Title</u>	<u>CFDA No.</u>	2008 <u>Fiscal Year</u> <u>Expenditures</u>
<u>U.S. Department of the Interior</u>		
Compact of Free Association Compact II Sector Grants	15.875	
Compact II Education Sector		\$ 7,766,921
Compact II Health Sector		5,535,158
Compact II Private Sector		128,098
Compact II Capacity Building Sector		669,174
Compact II Environment Sector		474,722
Compact II Supplemental Education		<u>2,570,249</u>
Total Major Programs Under CFDA #15.875		<u>17,144,322</u>
 <u>U.S. Department of Education</u>		
Special Education – Grants to States	84.027	<u>1,178,866</u>
Total U.S. Federal program expenditures selected		\$ <u>18,323,188</u>
Total U.S. Federal program expenditures		\$ <u>19,486,414</u>
% of total U.S. Federal expenditures covered by major programs		<u>94%</u>

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

Part I - Summary of Auditors' Results Section

Financial Statements

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

Federal Awards

- | | |
|---|---------------------|
| Internal control over major programs: | |
| 5. Material weakness(es) identified? | No |
| 6. Significant deficiency(ies) identified that is not considered to be a material weakness? | Yes |
| 7. Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB Circular A-133? | Yes |
| 8. Type of auditors' report issued on compliance for major programs | Unqualified |
| 9. The State's major programs were as follows: | |
| <u>Name of Federal Program or Cluster</u> | <u>CFDA Numbers</u> |
| U.S. Department of the Interior - Compact of Free Association Compact II Sector Grants | 15.875 |
| U.S. Department of Education – Special Education – Grants to State | 84.027 |
| 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 |

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

Part II – Financial Statements Findings Section

<u>Finding #</u>	<u>Finding</u>
2008-2	Maintenance of Fixed Assets

Part III - Federal Award Findings and Questioned Cost Section

<u>Finding #</u>	<u>CFDA #</u>	<u>Finding</u>	<u>Questioned Costs</u>
2008-1	15.875	Procurement	\$0
2008-2	15.875/84.027	Maintenance of Fixed Assets	\$0

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

Finding No.: 2008-1
 CFDA No.: 15.875
 Grantor Agency: U.S. Department of the Interior
 Grant #: Compact II Sector Grants
 Program Name: Pohnpei State Government
 Requirement: Procurement
 Questioned Costs: \$0

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

Condition:

CFDA 15.875 Compact Sector Grants: For 4 (2%) of 80 non-payroll expenditures tested (\$191,678 of the aggregate amount of \$2,058,976 tested), there was insufficient documentation to support competitive procurement requirements.

<u>Transaction No</u>	<u>Ref2</u>	<u>Amount</u>	<u>Account</u>
29516	split	\$ 24,258	11 82 60
30894	split	8,098	11 82 60
30894	split	16,035	11 82 60
30895	split	<u>15,771</u>	11 82 60
		<u>\$ 64,162</u>	

Cause: There appears to be a lack of controls over ensuring compliance with applicable State and federal procurement standards.

Effect: Noncompliance results from this condition due to insufficient competitive procurement documentation. However, no questioned costs result from this matter as the State has subsequently reimbursed this fund for the subject expenditures.

Recommendation: We recommend that Pohnpei State Government comply with State and federal procurement program requirements and strengthen its internal controls to ensure that adequate competitive procurement documentation is on file. If exceptions to procurement policies occur, they should be approved and be documented in file on a contemporaneous basis.

Auditee Response: We agree to this finding and we have subsequently implemented corrective actions that we believe will resolve such finding in the future.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

Finding No.: 2008-2
CFDA No.: 15.875
Grantor Agency: U.S. Department of the Interior
Program Name: Compact Sector Grants
Requirement: Compliance: Maintenance of Fixed Assets
Questioned Cost: \$0

CFDA No.: 84.027
Grantor Agency: U.S. Department of Education
Grant No.: H0278030002
Program Name: Special Education
Requirement: Compliance: Maintenance of Fixed Assets
Questioned Cost: \$0

Criteria: Management should periodically review asset maintenance activities to ensure compliance with program objectives and requirements.

Condition: No documented procedures are in currently in place to ensure that fixed assets are periodically reviewed for asset maintenance.

Cause: There appears to be a weakness in internal controls over ensuring that fixed assets are periodically maintained.

Effect: The expected life of fixed assets may be lessened. However, no questioned costs result from this finding as no specific instances came to our attention in fiscal year 2008 of unnecessary expenditures that occurred due to this condition.

Prior Year Status: Noncompliance with maintenance of fixed assets was reported as a finding in the fiscal years 2006-2007 single audits.

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

Auditee Response: We agree with the finding, however, corrective action was implemented in FY09.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

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

	Questioned Costs Set Forth in Prior Audit Report <u>2007</u>	Questioned Costs Resolved in Fiscal Year <u>2008</u>	Questioned Costs at <u>September 30, 2008</u>
Questioned Costs FY 08	\$ <u>-</u>	\$ <u>-</u>	\$ <u>-</u>

Unresolved prior year findings are set forth in the accompanying schedule of findings and questioned costs.