

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

YEAR ENDED SEPTEMBER 30, 2008

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

YEAR ENDED SEPTEMBER 30, 2008

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NATIONAL GOVERNMENT**

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**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

YEAR ENDED SEPTEMBER 30, 2008

INDEPENDENT AUDITORS' REPORT

Honorable Emmanuel Mori
President
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 Federated States of Micronesia (FSM) National Government as of and for the year ended September 30, 2008, which collectively comprise the FSM National Government'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 FSM National Government. Our responsibility is to express an opinion on the respective financial statements based on our audit.

Except as discussed in the following paragraphs, 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 FSM National Government'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 that our audit provides a reasonable basis for our opinions.

During the year ended September 30, 2007, because of inadequacies in the accounting records, we were unable to form an opinion regarding the amount at which receivables, advances, amounts due to the FSM State Governments and deferred revenues are recorded for the governmental activities; the amount at which receivables, advances and amounts due to the FSM State Governments are recorded for the General Fund; the amount at which receivables and amounts due to the FSM State Governments are recorded for the Grants Assistance Fund; and the amount at which deferred revenues are recorded for the aggregate remaining fund information. Although the FSM National Government was able to reconcile these accounts as of September 30, 2008, the aforementioned amounts entered into the determination of the revenues and expenditures/expenses for the governmental activities, the General Fund, the Grants Assistance Fund, and the aggregate remaining fund information for the year ended September 30, 2008.

The financial statements of the National Fisheries Corporation, a component unit of the FSM National Government, have historically consolidated its investment in Micronesia Longline Fishing Company, a 97%-owned corporation, and its investment in Yap Fishing Corporation, Yap Fresh Tuna, Inc., Chuuk Fresh Tuna, Inc., and Kosrae Sea Venture, Inc., all 50%-owned corporations. Due to the lack of either audited or unaudited financial statements of Micronesia Longline Fishing Company, Yap Fishing Corporation, Yap Fresh Tuna, Inc., Chuuk Fresh Tuna, Inc., and Kosrae Sea Venture, Inc., the amount by which this departure would affect investments, net assets, and expenses of the aggregate discretely presented component units is not reasonably determinable.

The financial statements of the National Fisheries Corporation and the FSM Petroleum Corporation have not been audited, and we were not engaged to audit these financial statements as part of our audit of the FSM National Government's basic financial statements. The financial activities of the National Fisheries Corporation and the FSM Petroleum Corporation included in the FSM National Government's basic financial statements as a discretely presented component units and represent collectively 11%, 30% and 39% of the assets, liabilities and operating revenues, respectively, of the FSM National Government's aggregate discretely presented component units.

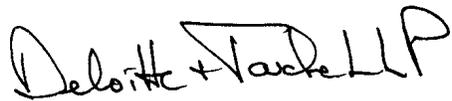
In our opinion, except for the effects on the financial statements of such adjustments, if any, as might have been determined to be necessary had receivables, advances, amounts due to the FSM State Governments and deferred revenues for the governmental activities; receivables, advances and amounts due to the FSM State Governments for the General Fund; receivables and amounts due to the FSM State Governments for the Grants Assistance Fund; and deferred revenues for the aggregate remaining fund information been adequately recorded at September 30, 2007 and their effect on revenues and expenditures/expenses for governmental activities, the General Fund, the Grants Assistance Fund, and the aggregate remaining fund information for the year ended September 30, 2008, been determined, as discussed in the third paragraph above, the lack of audited financial statements of Micronesia Longline Fishing Company, Yap Fishing Corporation, Yap Fresh Tuna, Inc., Chuuk Fresh Tuna, Inc., and Kosrae Sea Venture, Inc., as discussed in the fourth paragraph above, and the lack of audited financial statements of the National Fisheries Corporation and the FSM Petroleum Corporation, as discussed in the fifth paragraph above, 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 FSM National Government as of September 30, 2008, and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 11 to the financial statements, the beginning net assets of the governmental activities within the accompanying financial statements has been restated to correct a misstatement.

The Management's Discussion and Analysis, on pages 4 through 11, as well as the Schedule of Revenues, Expenditures, and Changes in Deficit - Budget and Actual - General Fund and notes thereto, as set forth in Section III of the foregoing table of contents, are not a required part of the basic financial statements but are supplementary information required by GASB. This supplementary information is the responsibility of the management of the FSM National Government. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

Our audit was conducted for the purpose of forming an opinion on the FSM National Government's respective financial statements that collectively comprise the FSM National Government'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 FSM National Government, are presented for purposes of additional analysis and are not a required part of the basic financial statements of the FSM National Government. Such additional information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, except for the effects of the matter discussed in the third paragraph above, 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 30, 2009, on our consideration of the FSM National Government'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, slightly stylized font.

June 30, 2009

FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT

Management's Discussion and Analysis
September 30, 2008

This discussion and analysis of the FSM National Government's financial performance provides an overview of the financial activities of the FSM National Government for the year ended September 30, 2008 and of the financial position of the FSM National Government at September 30, 2008. This report is to be read in conjunction with the financial statements of the FSM National Government which begin on page 12. Fiscal Year 2008 comparative information has been provided where appropriate.

FINANCIAL HIGHLIGHTS

- For the fiscal year ended September 30, 2008, FSM National Government has total net assets of \$82,581,293 (FY07 as restated \$79,508,249). The increase is primarily due to recording of infrastructure and construction in progress for airport improvement projects and infrastructure projects in the Government-wide financial statements.
- During the year, FSM National Government expenses for governmental activities were \$52,077,160 (FY07 as restated \$44,456,443) and were funded by program revenues of \$27,454,162 (FY07 \$29,655,526) and were further funded with taxes and other general revenues (excluding special items) that totaled \$30,151,961 (FY07 \$29,996,855).
- During the year, FSM National Government wrote-off its old receivable balances of \$2,455,919 (FY07 \$944,533).
- During the year, FSM National Government transferred the fund balance from the original compact to the general fund of \$3,337,255.
- The net change in governmental funds decreased by \$2,380,466 (FY07 increased by \$5,094,492). Total revenues reported are \$57,393,217 with total expenditures of \$60,950,213. Total loan proceeds from ADB Loan are \$3,632,449.
- At September 30, 2008, the General Fund reported an unreserved surplus of \$1,266,267 (FY07 \$6,124,246). Of the total unreserved surplus, \$1,096,344 came from the excess of revenue against the projected/budgeted amounts, and the remaining \$169,923 came from the unexpended appropriations in the budgetary expenditures, net of operating transfers in and out, write-off of old receivable balances and other changes in unreserved fund balance. The summary and details of these amounts can be found on page 55 and pages 61 to 63 respectively.

OVERVIEW OF THE FINANCIAL STATEMENTS

This Financial Statements for the Year Ended September 30, 2008 consists of four parts - management's discussion and analysis (this section), the basic financial statements, required supplementary information, and notes to financial statements.

The basic financial statements include two kinds of statements that present different views of the National Government.

The Government-Wide Financial Statements

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

The Statement of Net Assets includes all of the Government's assets and liabilities. The difference between the two is called net assets. Overtime, increases or decreases in the Government's net assets serve as an indicator to measure the Government's financial position.

FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT

Management's Discussion and Analysis
September 30, 2008

The Statement of Activities, on the other hand, accounts for the National Government's current year's revenues and expenses regardless of when cash is received or paid.

The Statement of Net Assets and the Statement of Activities are divided into three activities:

- **Governmental Activities** - Most of the FSM National Government's basic services are reported here. These include the services provided by the Executive Branch such as office of the president, health and social affairs, education, foreign affairs, transportation, communication and infrastructure, resources and development, finance and administration, justice, office of the public defender, SBOC office, environment and emergency management and national archives, cultural and historic preservation; the Judicial Branch; the Legislative Branch; other National Government programs; Boards and Commissions; and other legislative appropriations. These services are funded by Compact of Association funds, US Federal grants, FSM tax revenues, licenses, fees and investment earnings.
- **Components Units** – The FSM National Government has eight (8) component units namely, College of Micronesia - FSM, National Fisheries Corporation, FSM Telecommunications Corporation, FSM Development Bank, FSM Social Security Administration, the FSM Coconut Development Authority, FSM Petroleum Corporation and the Mi Care Plan. These components units are entities which are legally separate from the FSM National Government, but are financially accountable to the FSM National Government, or whose relationships with the FSM National Government is such that exclusion would cause the FSM National Government's basic financial statements to be misleading or incomplete.

Fund Financial Statements

The analysis of the FSM National Government's major funds begins on page 14. The Fund Financial Statements provide detailed information about the most significant funds - not the FSM National Government as a whole. Some funds are required to be established by FSM law. However, the FSM National Government establishes many other funds to help control and manage funds provided for particular purposes to see that expenditures meet the legal requirements for using certain taxes, grants, and other grant funds received from outsiders. The FSM National Government has two kinds of funds - government and fiduciary – each using different accounting approaches.

- **Government funds** - Most of the National Government's basic services are reported in governmental funds, which focus on how money flows into and out of those funds and the balances left at year-end that are available for spending. These funds are reported using an accounting method called modified accrual accounting, which measures cash and all other financial assets that can readily be converted to cash. The government fund statements provide a detailed short-term view of the National Government general operations and the basic services it provides. Government fund information helps determine whether there are more or fewer financial resources that can be spent in the near future to finance the National Government's program. We describe the relationship (or differences) between governmental activities (reported in the Statement of Net Assets and the Statement of Activities) and governmental funds in reconciliation at the bottom of the page 14.
- **Fiduciary funds** - These funds are used to account for assets held by a Government unit in a trustee capacity for individuals, private organizations, and other governmental resources. This fund is used to account for operations that are financed and operated in a manner similar to private business enterprises where the intent is that costs (expenses, including amortization and depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges.

FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT

Management's Discussion and Analysis
September 30, 2008

THE NATIONAL GOVERNMENT AS A WHOLE

Net assets may serve overtime as a useful indicator of government's financial position. At the end of FY08, National Government assets exceeded liabilities by \$82,581,293. Of the total net assets, \$68,420,087 is restricted as to purposes for which they may be used. National Government uses these capital assets to provide services to its citizens; consequently, these assets are not available for future spending. Although National Government investments in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other source, since the capital assets themselves cannot be used to liquidate these liabilities.

Table 1 shows the schedule of National Government's net assets as of September 30, 2008.

Table 1 – Net Assets

	<u>Governmental Activities</u>	
	(As Restated)	
	<u>2008</u>	<u>2007</u>
Current assets	\$ 50,931,484	\$ 49,967,094
Other assets	49,991,788	43,905,103
Capital assets	<u>53,442,653</u>	<u>42,869,797</u>
Total assets	<u>154,365,925</u>	<u>136,741,994</u>
Current liabilities	20,840,426	15,543,229
Other liabilities	<u>50,944,206</u>	<u>41,690,516</u>
Total liabilities	<u>71,784,632</u>	<u>57,233,745</u>
Net Assets:		
Invested in cap assets net of related debt	53,442,653	42,869,797
Restricted	14,977,434	13,096,830
Unrestricted	<u>14,161,206</u>	<u>23,541,622</u>
Net assets	<u>\$82,581,293</u>	<u>\$79,508,249</u>

At the end of FY08, the FSM National Government unrestricted assets show a surplus of \$14,161,206 compared to \$23,541,622 at the end of FY07.

FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT

Management's Discussion and Analysis
September 30, 2008

Table 2 shows the changes in Net Assets of the National Government as of September 30, 2008.

Table 2
Changes in Net Assets

Governmental Activities

	<u>2008</u>	(As Restated) <u>2007</u>
Revenues:		
Program Revenues:		
Charges for services	\$ 2,984,956	\$ 1,628,040
Operating grants and contributions	11,612,635	14,750,180
Capital grants and contributions	12,856,571	13,277,306
General Revenues:		
Income tax	3,621,662	2,398,611
Fishing rights fees	17,045,395	15,005,147
Fuel	118,465	137,348
Import	4,136,704	4,186,072
Gross receipt	3,385,961	3,842,247
Corporate tax	34,318	-
Unrestricted investment (losses) earnings	(2,011,414)	3,115,689
Grants	1,066,088	-
Other	<u>2,754,782</u>	<u>1,311,741</u>
Total revenue	<u>57,606,123</u>	<u>59,652,381</u>
Expenditures:		
Executive	36,724,346	27,039,360
Judicial	1,172,123	955,439
Legislative	3,003,016	3,221,718
Office of Public Auditor	1,753,854	806,761
Other Nat'l. Govt. Program	2,594,413	4,878,679
Boards and commissions	1,166,179	1,864,426
Other appropriations	-	3,932,825
Future operations	203,269	-
Payments to component units	1,338,198	1,248,428
Capital projects	3,777,474	37,255
Debt service	<u>344,288</u>	<u>466,552</u>
Total expenditures	<u>52,077,160</u>	<u>44,451,443</u>
Excess before special items	5,528,963	15,200,938
Special items	<u>(2,455,919)</u>	<u>(944,533)</u>
Change in net assets	3,073,044	14,256,405
Net assets, beginning of year, as restated	<u>79,508,249</u>	<u>65,251,844</u>
Net assets, end of year	<u>\$82,581,293</u>	<u>\$79,508,249</u>

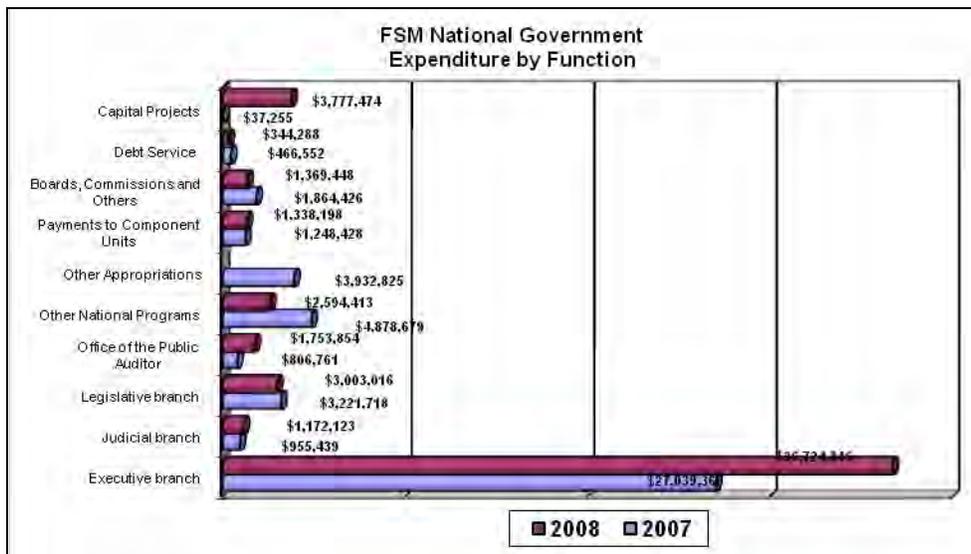
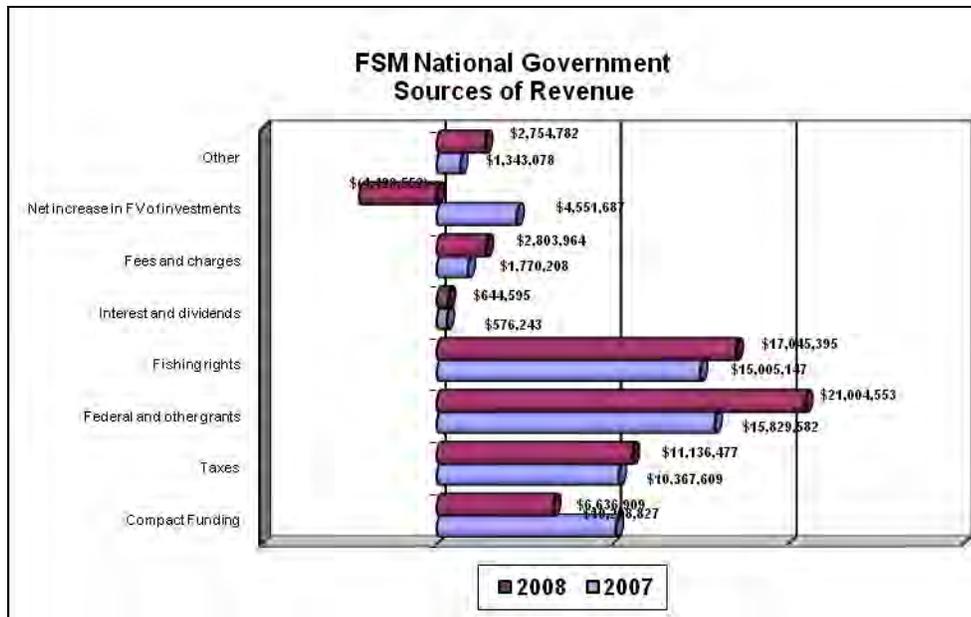
FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT

Management's Discussion and Analysis
September 30, 2008

FUND ANALYSIS OF NATIONAL GOVERNMENT FUNDS

The above analysis incorporates a restatement, which is more fully discussed in Note 11 to the accompanying financial statements.

National Government revenues from governmental activities, including local revenues, loss on investments, compact and other grants funding totaled \$57,606,123 (FY07 \$59,652,381). In FY08, the cost of governmental activities totaled \$52,077,160 (FY07 as restated \$44,451,443). In FY08, the special items amounted to \$2,455,919 (FY07 \$944,533). The difference between the two including special items representing increased in net assets of \$3,073,044 (increased in FY07 as restated \$14,256,405). To assist in appreciating the details of governmental activities, the above governmental activities information is shown in pictorial form in the following graph.



FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT

Management's Discussion and Analysis
September 30, 2008

Table 3 shows The National Governmental Fund changes in fund balances for the year ended September 30, 2008.

Table 3
Changes in Fund Balances

	<u>General Fund</u>		<u>Other Funds</u>		<u>Total</u>	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
Revenues:						
Compact funding	\$ -	\$ -	\$ 6,636,909	\$10,208,827	\$ 6,636,909	\$10,208,827
Federal and other grants	1,066,088		19,938,465	15,829,582	21,004,553	15,829,582
Taxes	11,136,477	10,367,609	-	-	11,136,477	10,367,609
Fishing rights fees	17,045,395	15,005,147	-	-	17,045,395	15,005,147
Net increase in fair value of investments	(2,219,360)	2,921,999	(2,201,192)	2,205,931	(4,420,552)	5,127,930
Other	<u>4,511,229</u>	<u>1,706,323</u>	<u>1,479,206</u>	<u>1,406,963</u>	<u>5,990,435</u>	<u>3,113,286</u>
Total revenues	<u>31,539,829</u>	<u>30,001,078</u>	<u>25,853,388</u>	<u>29,651,303</u>	<u>57,393,217</u>	<u>59,652,381</u>
Expenditures	<u>28,083,091</u>	<u>26,623,817</u>	<u>32,867,122</u>	<u>30,505,515</u>	<u>60,950,213</u>	<u>57,129,332</u>
Excess of revenue over expense	<u>3,546,738</u>	<u>3,377,261</u>	<u>(7,013,734)</u>	<u>(854,212)</u>	<u>(3,556,996)</u>	<u>2,523,049</u>
Net transfers	156,887	(1,410,057)	3,475,562	4,926,033	3,632,449	3,515,976
Special items	<u>(2,455,919)</u>	<u>(944,533)</u>	-	-	<u>(2,455,919)</u>	<u>(944,533)</u>
Net change in F/B	<u>\$ 1,157,706</u>	<u>\$ 1,022,671</u>	<u>\$ (3,538,172)</u>	<u>\$ 4,071,821</u>	<u>\$(2,380,466)</u>	<u>\$5,094,492</u>

Analysis of Budgetary Variations- General Fund:

During the year, the FSM National Government revised its budget several times to accommodate supplemental funding for departments and offices requiring increases in appropriations. As can be seen in the following table, actual revenues exceeded budgets by \$1,096,344 or 4% while expenditures were less than budgets by \$5,660,605 or 15.45%. There were no material budget overruns at any level.

	Budget <u>Original</u>	Budget <u>Final</u>	Actual <u>Amounts</u>	Variance <u>Positive(Negative)</u>
Revenues	\$27,550,000	\$30,443,485	\$31,539,829	\$1,096,344
Expenditures	<u>35,453,141</u>	<u>36,591,280</u>	<u>30,930,675</u>	<u>5,660,605</u>
Excess of revenues	(7,903,141)	(6,147,795)	609,154	6,756,949
Other financing sources (uses) and special items	<u>(1,584,084)</u>	<u>(2,584,084)</u>	<u>(2,299,032)</u>	<u>285,052</u>
Net changed unreserved	(9,487,225)	(8,731,879)	(1,689,878)	7,042,001
Other changes in unreserved			(3,168,101)	(3,168,101)
Unreserved-beginning	<u>6,124,246</u>	<u>6,124,246</u>	<u>6,124,246</u>	-
Unreserved-ending	<u>\$(3,362,979)</u>	<u>\$(2,607,633)</u>	<u>\$1,266,267</u>	<u>\$3,873,900</u>

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

At the end of the September 30, 2008, FSM National Government had invested \$81,215,448 (FY07 \$67,716,094) in capital assets. These assets consist basically of infrastructure, office equipment and machinery, buildings and improvements, ship/boats, motor vehicles, aircraft, and construction in progress. The summary of capital assets of the year is shown below:

FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT

Management's Discussion and Analysis
September 30, 2008

Primary Government
Governmental Activities

	<u>2008</u>	(As Restated) <u>2007</u>
Buildings and improvement	\$16,761,302	\$16,661,608
Infrastructure	6,587,872	1,661,100
Ships and boats	23,332,744	23,322,100
Computer equipment	4,005,571	3,653,760
Aircraft	709,207	709,207
Furniture, equipment and machinery	3,890,808	3,393,116
Construction in progress	17,976,981	-
Motor vehicles	<u>7,960,963</u>	<u>7,631,163</u>
	81,215,448	67,716,094
Less: accumulated depreciation	<u>(27,772,795)</u>	<u>(24,846,297)</u>
Total	<u>\$53,442,653</u>	<u>\$42,869,797</u>

Further information on the FSM National Government's long term obligations can be obtained from note 5 to the accompanying financial statements on page 46.

Long Term Debt

At the end of fiscal year 2008, National Government had long term debt of \$51,775,981 (FY07 \$42,448,974) relating to Governmental Activities as shown below:

	<u>2008</u>	<u>2007</u>
ADB Loan - Early retirement	\$19,935,753	\$17,682,020
-Fisheries and water project	15,761,325	13,658,034
-Private sector development	10,252,016	8,460,857
-Basic social services	4,090,242	1,829,927
-Omnibus infrastructure dev.	715,241	-
Compensated Absences (Annual Leave)	<u>1,021,404</u>	<u>818,136</u>
Total	<u>\$51,775,981</u>	<u>\$42,448,974</u>

Further information on the FSM National Government's long-term obligations can be obtained from note 6 to the accompanying financial statements on page 49.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

Fiscal year 2008 represents the fifth full year the FSM is implementing the economic assistance provisions available under the Amended compact. During the year, the total funds appropriated for the National Government operations and programs during the fiscal year amounted to \$47,788,603. Funding under the amended Compact represents 27% of the National Government FY08 annual budget. The remaining 73% came from locally generated tax revenues, fishing access fees and related government services fees. The FSM National Government ended fiscal year 2008 with a positive unreserved general fund surplus.

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Management's Discussion and Analysis
September 30, 2008

The FSM economy has performed modestly in recent years. The economy will continue to depend largely on external assistance, suggesting limited potential for development objectives of budgetary self-reliance and long-term economic advancement. The public sector expenditures continue to account for almost two-thirds of the FSM GDP and are funded largely by external assistance rather than domestic production. In the long term, real potential for economic growth will likely have to originate from the private sector.

In 2009, locally generated revenues provided an estimated \$ 29,268,691 or 87.84% of the FSM National Government first annual appropriation of \$33,321,789. It is anticipated that FY09 budget will reflect slightly decreased from FY08 budgetary level due to decreased in the carry over in FY08 and possible loss in the investment , unless other revenues sources are identified.

In addition to receiving compact grant assistance, the FSM receives substantial programs assistance from agencies of the United States Federal Government, Peoples Republic of China, Japan and other foreign governments. Grants and other technical assistance programs are also made available to the FSM from the international and regional organizations. During FY08, assistance received from these sources was estimated at approximately \$26 million.

FINANCIAL MANAGEMENT CONTACT –NATIONAL GOVERNMENT

This financial report is designed to provide all interested users with a general overview of the National Government's finances. Inquiries concerning this report, if any, may be directed to the Secretary of the Department of Finance and Administration, P.O. Box PS 158, Palikir, Pohnpei, FM 96941.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Statement of Net Assets
September 30, 2008

	Primary Government	Component Units
<u>ASSETS</u>		
Current assets:		
Cash and cash equivalents	\$ 1,735,841	\$ 10,689,028
Restricted assets - cash and cash equivalents	3,516,201	505,042
Time certificates of deposit	541,482	1,003,892
Investments	21,185,108	8,085,902
Receivables, net of allowance for uncollectibles	21,660,560	9,785,654
Due from primary government	-	579,608
Due from component units	500,777	-
Advances	1,791,515	2,730,930
Prepayments	-	4,374,398
Other current assets	-	770,393
Total current assets	50,931,484	38,524,847
Noncurrent assets:		
Investments	14,371,936	13,809,234
Loans receivable, net of current portion	34,470,002	17,642,961
Capital assets, net of accumulated depreciation	53,442,653	61,702,176
Deposits and other assets	1,149,850	-
Total noncurrent assets	103,434,441	93,154,371
Total assets	\$ 154,365,925	\$ 131,679,218
<u>LIABILITIES</u>		
Current liabilities:		
Current portion of long-term obligations	\$ 743,012	\$ 5,235,230
Short-term notes	-	3,930,617
Accounts payable	6,216,823	2,873,769
Due to component units	579,608	-
Compensated absences payable	88,764	-
Other liabilities and accruals	277,601	2,793,609
Tax refunds payable	466,320	-
Retention payable	402,569	-
Due to federal agencies	1,542,116	-
Due to FSM State Governments	8,798,341	-
Due to primary government	-	500,577
Deferred revenue	1,725,272	2,508,456
Total current liabilities	20,840,426	17,842,259
Noncurrent liabilities:		
Noncurrent portion of long-term obligations	50,011,565	28,474,652
Compensated absences payable, net of current portion	932,641	-
Total noncurrent liabilities	50,944,206	28,474,652
Total liabilities	71,784,632	46,316,910
<u>NET ASSETS</u>		
Invested in capital assets, net of related debt	53,442,653	33,830,762
Restricted for:		
Nonexpendable:		
Future operations	9,114,902	3,277,845
Expendable:		
Compact related	184,971	-
Other purposes	5,677,561	-
Unrestricted	14,161,206	48,253,700
Total net assets	82,581,293	85,362,307
Total liabilities and net assets	\$ 154,365,925	\$ 131,679,218

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Statement of Activities
Year Ended September 30, 2008

Functions/Programs	Program Revenues				Net (Expenses) Revenues and Changes in Net Assets	
	Expenses	Charges for Services	Grants and Contributions	Capital Grants and Contributions	Primary Government	Component Units
Primary government:						
Governmental activities:						
Current:						
Office of the President	\$ 664,184	\$ -	\$ -	\$ -	\$ (664,184)	\$ -
Foreign affairs	3,376,686	-	-	-	(3,376,686)	-
Finance and administration	7,086,133	81,573	1,249,709	-	(5,754,851)	-
Resources and development	3,048,085	48,133	918,241	-	(2,081,711)	-
Transportation, communication and infrastructure	7,354,931	99,661	2,394,396	-	(4,860,874)	-
Health and social affairs	4,642,088	20,701	4,333,460	-	(287,927)	-
Education	3,871,556	-	2,620,662	-	(1,250,894)	-
Justice	4,059,495	145	16,386	-	(4,042,964)	-
Office of the Public Defender	663,790	-	-	-	(663,790)	-
SBOC Office	974,846	-	65,790	-	(909,056)	-
Environment and emergency management	669,546	-	359,221	-	(310,325)	-
National archives, cultural and historic preservation	313,006	-	190,309	-	(122,697)	-
Legislature	3,003,016	80,671	-	-	(2,922,345)	-
Judiciary	1,172,123	-	-	-	(1,172,123)	-
Office of the National Public Auditor	1,753,854	-	580,845	-	(1,173,009)	-
National government programs	2,594,413	-	-	-	(2,594,413)	-
Agencies, boards and commissions	1,166,179	1,686,521	1,216,277	-	1,736,619	-
Payments to component units	1,338,198	-	118,319	-	(1,219,879)	-
Future operations	203,269	625,926	(2,450,980)	-	(2,028,323)	-
Capital projects	3,777,474	-	-	12,856,571	9,079,097	-
Debt Service	344,288	341,625	-	-	(2,663)	-
Total primary government	\$ 52,077,160	\$ 2,984,956	\$ 11,612,635	\$ 12,856,571	(24,622,998)	-
Component units:						
FSM Telecommunications Corporation	\$ 14,271,434	\$ 12,464,669	\$ -	\$ -	-	(1,806,765)
FSM Development Bank	1,677,657	(326,908)	-	-	-	(2,004,565)
National Fisheries Corporation	525,492	142,937	135,000	-	-	(247,555)
College of Micronesia - FSM	20,634,314	19,481,494	-	-	-	(1,152,820)
FSM Coconut Development Authority	256,605	91,281	143,558	-	-	(21,766)
FSM Petroleum Corporation	19,953,377	23,649,429	-	-	-	3,696,052
MiCare Plan, Inc.	5,163,378	5,489,620	-	-	-	326,242
Total component units	\$ 62,482,257	\$ 60,992,522	\$ 278,558	\$ -	-	(1,211,177)
General revenues:						
Taxes:						
Income					3,621,662	-
Import					4,136,704	-
Gross receipts					3,385,961	-
Corporate tax					34,318	-
Fuel					118,465	-
Fishing rights					17,045,395	-
Unrestricted investment losses					(2,011,414)	(1,594,662)
Grants					1,066,088	-
Other					2,754,782	814,352
Special item:						
Write-off of receivable balances					(2,455,919)	-
Total general revenues and special items					27,696,042	(780,310)
Change in net assets					3,073,044	(1,991,487)
Net assets at the beginning of the year, as restated					79,508,249	87,353,794
Net assets at the end of the year					\$ 82,581,293	\$ 85,362,307

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

**Balance Sheet
Governmental Funds
September 30, 2008**

	Special Revenue					Permanent		Total
	General	Grants Assistance	Section 111 Investment Development	Early Retirement Program	Asian Development Bank Loan	Compact Trust	Other Governmental Funds	
ASSETS								
Cash and cash equivalents	\$ 632,345	\$ -	\$ -	\$ -	\$ 1,103,496	\$ -	\$ -	\$ 1,735,841
Time certificates of deposit	-	-	541,482	-	-	-	-	541,482
Equity in internal investment pool	11,715,940	-	2,471,854	-	-	-	3,676,839	17,864,633
Investments	5,257,034	-	-	3,320,475	-	-	-	8,577,509
Receivables, net:								
General	140,290	-	-	-	85,381	-	-	225,671
Taxes	3,634,689	-	-	-	-	-	-	3,634,689
Federal agencies	-	8,238,238	-	-	-	-	-	8,238,238
Loans	1,500,000	-	7,735,675	-	30,512,729	-	-	39,748,404
Other governments and agencies	-	40,516	15,838	-	-	-	-	56,354
Accrued interest	-	-	19,544	-	-	-	-	19,544
Due from component units	500,777	-	-	-	-	-	-	500,777
Due from other funds	4,407,925	2,845,010	-	-	769,579	-	2,046,524	10,069,038
Advances, net	196,637	1,594,878	-	-	-	-	-	1,791,515
Deposits and other assets	1,149,850	-	-	-	-	-	-	1,149,850
Restricted assets:								
Cash and cash equivalents	3,038,685	-	-	-	477,516	-	-	3,516,201
Investments	-	-	-	-	-	9,114,902	-	9,114,902
Total assets	\$ 32,174,172	\$ 12,718,642	\$ 10,784,393	\$ 3,320,475	\$ 32,948,701	\$ 9,114,902	\$ 5,723,363	\$ 106,784,648
LIABILITIES AND FUND BALANCES								
Liabilities:								
Accounts payable	\$ 2,556,579	\$ 3,578,778	\$ -	\$ -	\$ 54,158	\$ -	\$ 27,308	\$ 6,216,823
Retention payable	-	402,569	-	-	-	-	-	402,569
Other liabilities and accruals	277,601	-	-	-	-	-	-	277,601
Tax refunds payable	466,320	-	-	-	-	-	-	466,320
Due to component units	527,692	51,916	-	-	-	-	-	579,608
Due to federal agencies	-	1,542,116	-	-	-	-	-	1,542,116
Due to FSM State Governments	4,102,500	4,631,070	-	-	64,771	-	-	8,798,341
Due to other funds	5,661,113	947,905	-	3,460,020	-	-	-	10,069,038
Deferred revenue	36,750	1,688,522	-	-	-	-	-	1,725,272
Total liabilities	13,628,555	12,842,876	-	3,460,020	118,929	-	27,308	30,077,688
Fund balances (deficits):								
Reserved for:								
Related assets	9,315,555	-	7,735,675	3,320,475	32,179,122	9,114,902	-	61,665,729
Encumbrances	2,847,584	54,240,182	-	-	23,236	-	97,607	57,208,609
Continuing appropriations	5,116,211	36,098,750	-	-	-	-	-	41,214,961
Compact programs	-	-	3,048,718	-	-	-	-	3,048,718
Unreserved:								
General fund	1,266,267	-	-	-	-	-	-	1,266,267
Special revenue funds	-	(90,463,166)	-	(3,460,020)	627,414	-	1,921,609	(91,374,163)
Permanent funds	-	-	-	-	-	-	3,676,839	3,676,839
Total fund balances (deficit)	18,545,617	(124,234)	10,784,393	(139,545)	32,829,772	9,114,902	5,696,055	76,706,960
Total liabilities and fund balances	\$ 32,174,172	\$ 12,718,642	\$ 10,784,393	\$ 3,320,475	\$ 32,948,701	\$ 9,114,902	\$ 5,723,363	
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							53,442,653	
Long-term liabilities, including loans payable, are not due and payable in the current period and, therefore, are not reported in the funds. These liabilities include:								
Loans payable							(50,754,577)	
Additional loans receivable from the states							4,207,662	
Compensated absences payable							(1,021,405)	
								5,874,333
Net assets of governmental activities								<u>\$ 82,581,293</u>

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

	Special Revenue					Permanent	Other Governmental Funds	Total
	General	Grants Assistance	Section 111 Investment Development	Early Retirement Program	Asian Development Bank Loan	Compact Trust		
Revenues:								
Compact funding	\$ -	\$ 6,636,909	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 6,636,909
Taxes	11,136,477	-	-	-	-	-	-	11,136,477
Federal and other grants	1,066,088	19,938,465	-	-	-	-	-	21,004,553
Fishing rights	17,045,395	-	-	-	-	-	-	17,045,395
Interest and dividends	207,946	-	94,264	-	341,625	-	760	644,595
Fees and charges	1,766,848	-	-	-	-	-	1,037,116	2,803,964
Net change in the fair value of investments	(2,219,360)	-	250,548	-	-	(1,925,294)	(526,446)	(4,420,552)
Other	2,536,435	-	5,441	-	-	-	-	2,541,876
Total revenues	31,539,829	26,575,374	350,253	-	341,625	(1,925,294)	511,430	57,393,217
Expenditures:								
Current:								
General government:								
Office of the President	609,498	-	-	-	-	-	-	609,498
Foreign affairs	3,322,354	-	-	-	-	-	-	3,322,354
Finance and administration	2,640,905	1,332,176	-	-	1,304,158	-	-	5,277,239
Resources and development	833,711	574,211	1,635,000	-	501	-	-	3,043,423
Transportation, communication and infrastructure	2,510,795	2,924,886	-	-	-	-	1,090,546	6,526,227
Health and social affairs	199,653	4,489,878	-	-	-	-	3,407	4,692,938
Education	706,746	2,918,673	-	-	-	-	219,434	3,844,853
Justice	3,572,879	16,386	-	-	-	-	80,671	3,669,936
Office of the Public Defender	658,005	-	-	-	-	-	-	658,005
SBOC Office	877,056	65,790	-	-	18,674	-	-	961,520
Environment and emergency management	268,708	400,838	-	-	-	-	-	669,546
National archives, cultural and historic preservation	141,428	173,463	-	-	-	-	-	314,891
Legislature	2,986,312	15,000	-	-	-	-	-	3,001,312
Judiciary	1,152,247	-	-	-	-	-	-	1,152,247
Office of the National Public Auditor	1,171,481	580,845	-	-	-	-	-	1,752,326
National government programs	1,302,303	1,268,111	-	-	-	-	-	2,570,414
Agencies, boards and commissions	1,121,226	875	-	-	-	-	68,854	1,190,955
Payments to component units	971,456	118,319	250,000	-	-	-	-	1,339,775
Capital projects	3,036,328	12,333,581	-	-	-	-	-	15,369,909
Debt service:								
Principal and interest payments	-	-	-	-	982,845	-	-	982,845
Total expenditures	28,083,091	27,213,032	1,885,000	-	2,306,178	-	1,462,912	60,950,213
Excess (deficiency) of revenues over (under) expenditures	3,456,738	(637,658)	(1,534,747)	-	(1,964,553)	(1,925,294)	(951,482)	(3,556,996)
Other financing sources (uses):								
Loan proceeds	-	-	-	-	3,632,449	-	-	3,632,449
Operating transfers in	3,749,806	-	-	-	-	-	3,592,919	7,342,725
Operating transfers out	(3,592,919)	(3,337,255)	-	-	-	-	(412,551)	(7,342,725)
Total other financing sources (uses), net	156,887	(3,337,255)	-	-	3,632,449	-	3,180,368	3,632,449
Special item:								
Write-off of receivable balances	2,455,919	-	-	-	-	-	-	2,455,919
Net change in fund balances (deficits)	1,157,706	(3,974,913)	(1,534,747)	-	1,667,896	(1,925,294)	2,228,886	(2,380,466)
Fund balances (deficit) at the beginning of the year	17,387,911	3,850,679	12,319,140	(139,545)	31,161,876	11,040,196	3,467,169	79,087,426
Fund balances (deficit) at the end of the year	\$ 18,545,617	\$ (124,234)	\$ 10,784,393	\$ (139,545)	\$ 32,829,772	\$ 9,114,902	\$ 5,696,055	\$ 76,706,960

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Combining Statement of Fiduciary Net Assets
Fiduciary Funds - Private Purpose Trusts
September 30, 2008

	<u>FSM Social Security Administration</u>	<u>Pohnpei State Development Loan Fund</u>	<u>Yap State Development Loan Fund</u>	<u>Total</u>
<u>ASSETS</u>				
Cash and cash equivalents	\$ 3,353,578	\$ 262,139	\$ 94,683	\$ 3,710,400
Time certificates of deposit	-	557,995	140,282	698,277
Receivables, net:	-			
Contributions	1,797,223	-	-	1,797,223
Accrued interest	139,652	4,500	139	144,291
Loans	-	55,239	71,816	127,055
Other	60,865	-	-	60,865
Investments	31,637,481	-	-	31,637,481
Capital assets, net of accumulated depreciation	87,352	-	-	87,352
Total assets	<u>37,076,151</u>	<u>879,873</u>	<u>306,920</u>	<u>38,262,944</u>
<u>LIABILITIES</u>				
Accounts payable	173,503	-	-	173,503
Other liabilities and accruals	21,286	-	1,975	23,261
Due to component units	44,967	159,958	65,059	269,984
Total liabilities	<u>239,756</u>	<u>159,958</u>	<u>67,034</u>	<u>466,748</u>
<u>NET ASSETS</u>				
Held in trust for:				
Social security benefits	36,836,395	-	-	36,836,395
Restricted	-	55,239	71,816	127,055
Other purposes	-	664,676	168,070	832,746
Total net assets	<u>\$ 36,836,395</u>	<u>\$ 719,915</u>	<u>\$ 239,886</u>	<u>\$ 37,796,196</u>

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Combining Statement of Changes in Fiduciary Net Assets
Fiduciary Funds - Private Purpose Trusts
Year Ended September 30, 2008

	<u>FSM Social Security Administration</u>	<u>Pohnpei State Development Loan Fund</u>	<u>Yap State Development Loan Fund</u>	<u>Total</u>
Additions:				
Contributions	\$ 12,488,497	\$ -	\$ -	\$ 12,488,497
	<u>12,488,497</u>	<u>-</u>	<u>-</u>	<u>12,488,497</u>
Investment earnings (loss):				
Net change in the fair value of investments	(8,037,625)	14,496	5,152	(8,017,977)
Interest and dividends	<u>1,209</u>	<u>4,417</u>	<u>7,268</u>	<u>12,894</u>
Total investment earnings (loss)	(8,036,416)	18,913	12,420	(8,005,083)
Less investment expense	<u>236,805</u>	<u>-</u>	<u>-</u>	<u>236,805</u>
Net investment earnings (loss)	<u>(8,273,221)</u>	<u>18,913</u>	<u>12,420</u>	<u>(8,241,888)</u>
Other	<u>931,973</u>	<u>443</u>	<u>32</u>	<u>932,448</u>
Total additions	<u>5,147,249</u>	<u>19,356</u>	<u>12,452</u>	<u>5,179,057</u>
Deductions:				
Benefits	14,515,752	-	-	14,515,752
Refunds	18,586	-	-	18,586
Administrative expenses	<u>1,093,732</u>	<u>19,356</u>	<u>6,226</u>	<u>1,119,314</u>
Total deductions	<u>15,628,070</u>	<u>19,356</u>	<u>6,226</u>	<u>15,653,652</u>
Change in net assets	(10,480,821)	-	6,226	(10,474,595)
Net assets at the beginning of the year	<u>47,317,216</u>	<u>719,915</u>	<u>233,660</u>	<u>48,270,791</u>
Net assets at the end of the year	<u>\$ 36,836,395</u>	<u>\$ 719,915</u>	<u>\$ 239,886</u>	<u>\$ 37,796,196</u>

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Combining Statement of Net Assets
Component Units
September 30, 2008

	FSM Tele- Communications Corporation	FSM Development Bank	National Fisheries Corporation	College of Micronesia- FSM	FSM Coconut Development Authority	FSM Petroleum Corporation	MiCare Plan, Inc.	Total
ASSETS								
Current assets:								
Cash and cash equivalents	\$ 774,009	\$ 3,425,012	\$ 44,293	\$ 4,574,692	\$ 91,048	\$ 1,626,747	\$ 153,227	\$ 10,689,028
Restricted cash and cash equivalents	-	-	-	-	-	505,042	-	505,042
Time certificates of deposit	112,617	891,275	-	-	-	-	-	1,003,892
Investments	7,580,162	-	-	-	-	-	505,740	8,085,902
Receivables, net:								
General	1,376,609	6,593	7,826	2,580,833	4,433	956,396	260,993	5,193,683
Loans	-	2,542,990	-	-	-	-	-	2,542,990
Interest	317,232	244,252	-	-	-	-	-	561,484
Other	20,227	225,017	-	1,211,573	-	2,305	28,375	1,487,497
Due from primary government	-	-	-	579,608	-	-	-	579,608
Advances	-	-	-	-	-	2,730,930	-	2,730,930
Inventories	657,118	-	83,460	675,313	11,844	2,946,663	-	4,374,398
Prepaid expenses	407,981	2,700	-	135,944	1,300	-	222,468	770,393
Total current assets	<u>11,245,955</u>	<u>7,337,839</u>	<u>135,579</u>	<u>9,757,963</u>	<u>108,625</u>	<u>8,768,083</u>	<u>1,170,803</u>	<u>38,524,847</u>
Noncurrent assets:								
Capital assets, net of accumulated depreciation	44,435,621	226,565	120,759	11,674,584	229,142	4,981,934	33,571	61,702,176
Investments	-	11,031,389	-	2,777,845	-	-	-	13,809,234
Loans receivable	-	17,642,961	-	-	-	-	-	17,642,961
Total noncurrent assets	<u>44,435,621</u>	<u>28,900,915</u>	<u>120,759</u>	<u>14,452,429</u>	<u>229,142</u>	<u>4,981,934</u>	<u>33,571</u>	<u>93,154,371</u>
Total assets	<u>\$ 55,681,576</u>	<u>\$ 36,238,754</u>	<u>\$ 256,338</u>	<u>\$ 24,210,392</u>	<u>\$ 337,767</u>	<u>\$ 13,750,017</u>	<u>\$ 1,204,374</u>	<u>\$ 131,679,218</u>
LIABILITIES								
Current liabilities:								
Current portion of long-term debt	\$ 887,269	\$ 400,000	\$ 3,600,000	\$ -	\$ -	\$ 347,961	\$ -	\$ 5,235,230
Short term notes	-	-	-	-	-	3,930,617	-	3,930,617
Accounts payable	512,294	111,049	212,565	518,092	1,043	620	1,518,106	2,873,769
Other liabilities and accruals	1,029,270	96,165	6,451	1,097,759	1,006	562,958	-	2,793,609
Due to primary government	-	-	-	-	-	500,577	-	500,577
Deferred revenue	179,788	-	-	2,328,668	-	-	-	2,508,456
Total current liabilities	<u>2,608,621</u>	<u>607,214</u>	<u>3,819,016</u>	<u>3,944,519</u>	<u>2,049</u>	<u>5,342,734</u>	<u>1,518,106</u>	<u>17,842,259</u>
Noncurrent liabilities:								
Noncurrent portion of long-term debt	21,937,145	1,600,000	-	238,468	-	4,699,039	-	28,474,652
Total noncurrent liabilities	<u>21,937,145</u>	<u>1,600,000</u>	<u>-</u>	<u>238,468</u>	<u>-</u>	<u>4,699,039</u>	<u>-</u>	<u>28,474,652</u>
Total liabilities	<u>24,545,766</u>	<u>2,207,214</u>	<u>3,819,016</u>	<u>4,182,987</u>	<u>2,049</u>	<u>10,041,772</u>	<u>1,518,106</u>	<u>46,316,910</u>
NET ASSETS								
Invested in capital assets, net of related debt	21,611,207	226,565	120,759	11,674,584	229,142	(65,066)	33,571	33,830,762
Restricted for:								
Nonexpendable	-	500,000	-	2,777,845	-	-	-	3,277,845
Unrestricted	9,524,603	33,304,975	(3,683,437)	5,574,976	106,576	3,773,310	(347,303)	48,253,700
Total net assets	<u>31,135,810</u>	<u>34,031,540</u>	<u>(3,562,678)</u>	<u>20,027,405</u>	<u>335,718</u>	<u>3,708,244</u>	<u>(313,732)</u>	<u>85,362,307</u>
Total liabilities and net assets	<u>\$ 55,681,576</u>	<u>\$ 36,238,754</u>	<u>\$ 256,338</u>	<u>\$ 24,210,392</u>	<u>\$ 337,767</u>	<u>\$ 13,750,017</u>	<u>\$ 1,204,374</u>	<u>\$ 131,679,218</u>

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

	FSM Tele- Communications Corporation	FSM Development Bank	National Fisheries Corporation	College of Micronesia- FSM	FSM Coconut Development Authority	FSM Petroleum Corporation	MiCare Plan, Inc.	Total
Operating revenues:								
Charges for services	\$ 12,344,662	\$ (408,540)	\$ 142,937	\$ 17,882,280	\$ 91,281	\$ -	\$ 5,481,462	\$ 35,534,082
Other	120,007	81,632	-	1,599,214	-	23,649,429	8,158	25,458,440
Total operating revenues	12,464,669	(326,908)	142,937	19,481,494	91,281	23,649,429	5,489,620	60,992,522
Operating expenses:								
Cost of services	10,125,159	892,372	296,617	17,319,179	57,596	17,612,203	5,022,314	51,325,440
Depreciation and amortization	3,375,204	80,564	1,945	1,149,782	38,793	163,053	10,067	4,819,408
Administrative costs	-	601,372	226,930	2,165,353	160,216	2,178,121	130,997	5,462,989
Total operating expenses	13,500,363	1,574,308	525,492	20,634,314	256,605	19,953,377	5,163,378	61,607,837
Operating income (loss)	(1,035,694)	(1,901,216)	(382,555)	(1,152,820)	(165,324)	3,696,052	326,242	(615,315)
Nonoperating revenues (expenses):								
Net decrease in the fair value of investments	(1,217,353)	-	-	(420,892)	-	-	27,290	(1,610,955)
Interest income	10,120	-	-	-	-	6,173	-	16,293
Interest expense	(771,071)	(103,349)	-	-	-	-	-	(874,420)
Contributions from primary government	-	-	135,000	-	143,558	-	-	278,558
Other income	-	346,772	305,707	40,607	-	6,019	115,247	814,352
Total nonoperating revenues (expenses), net	(1,978,304)	243,423	440,707	(380,285)	143,558	12,192	142,537	(1,376,172)
Net income (loss)	(3,013,998)	(1,657,793)	58,152	(1,533,105)	(21,766)	3,708,244	468,779	(1,991,487)
Net assets at the beginning of the year	34,149,808	35,689,333	(3,620,830)	21,560,510	357,484	-	(782,511)	87,353,794
Net assets at the end of the year	\$ 31,135,810	\$ 34,031,540	\$ (3,562,678)	\$ 20,027,405	\$ 335,718	\$ 3,708,244	\$ (313,732)	\$ 85,362,307

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2008

(1) Summary of Significant Accounting Policies

The accompanying financial statements of the Federated States of Micronesia (FSM) National Government 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 FSM National Government's accounting policies are described below.

A. Reporting Entity

The FSM is an independent sovereign nation made up of the four states of Chuuk, Kosrae, Pohnpei, and Yap (the States). The FSM National Government is a constitutional government comprised of three branches: the Legislative Branch (the Congress), consisting of 14 members (one from each State who are elected for a term of four years, and ten who are elected for a term of two years, whose seats are apportioned by population); the Executive Branch, headed by the President and Vice President who are primarily responsible for executing the laws and administering national government services; and the Judiciary Branch made up of the FSM Supreme Court, which consists of a Chief Justice and up to five Associate Justices. The Congress elects two of its four-year members at its first session following an election to serve as President and Vice President.

For financial reporting purposes, the FSM National Government has included all funds, organizations, agencies, boards, commissions and institutions. The FSM National Government 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 FSM National Government are such that exclusion would cause the FSM National Government's financial statements to be misleading or incomplete. The criteria to be considered in determining financial accountability include whether the FSM National Government, 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 FSM National Government. 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 FSM National Government has a September 30 year-end except for the FSM Development Bank, FSM Petroleum Corporation and the FSM Social Security Administration, which each have a December 31 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 FSM National Government, are deemed to be related organizations. The nature and relationship of the FSM National Government's component units and related organizations are disclosed in the following section.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

Blended component units are entities that are legally separate from the FSM National Government, but are so related to the FSM National Government that they are, in substance, the same as the FSM National Government or entities providing services entirely or almost entirely to the FSM National Government. The net assets and results of operations of the following legally separate entities are presented as part of the FSM National Government's operations:

Blended Component Units

The following component units are blended within the primary government:

FSM Social Security Administration (FSMSSA), a Fiduciary Fund Type - Private Purpose Trust Fund. FSMSSA was established under FSM Public Law No. 2-74 to provide retirement, disability and survivor benefits for the citizens of the FSM. FSMSSA is governed by a five-member Board of Directors nominated by the President and confirmed by the Congress.

Discretely Presented Component Units

Discretely presented component units are entities which are legally separate from the FSM National Government, but are financially accountable to the FSM National Government, or whose relationships with the FSM National Government are such that exclusion would cause the FSM National Government'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:

FSM Telecommunications Corporation (FSMTC): FSMTC was incorporated under FSM Public Law No. 2-10 to engage in the business of providing telecommunications services, except radio and television broadcasting, throughout the FSM and to points outside the FSM. FSMTC is governed by a five-member Board of Directors, which includes one appointee by the President (with the advice and consent of the Congress) and four appointees by the Governors of each State (with the advice and consent of the respective State legislatures).

FSM Development Bank (FSMDB): FSMDB was established under FSM Public Law No. 8-47 to advance the economic development of the FSM through the provision of economic development loans. FSMDB is governed by a seven-member Board of Directors appointed by election at the annual shareholders meeting by the plurality of votes thereof. As of December 31, 2008, FSMDB has issued 2,997,883 shares to the FSM National Government (98.7%), the State of Chuuk (1%), and the State of Kosrae (0.3%).

National Fisheries Corporation (NFC): NFC was established under FSM Public Law No. 3-14 to promote the development of pelagic fisheries and related industries within the extended fishery zone for the benefit of the people of the FSM. NFC is governed by a seven-member Board of Directors, which includes one appointee by the President (with the advice and consent of the Congress), four appointees by the Governors of each State (with the advice and consent of the respective State legislatures), the Executive Director of the Micronesian Maritime Authority, and the Secretary of the Department of Economic Affairs.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

Discretely Presented Component Units, Continued

College of Micronesia-FSM (COM-FSM): COM-FSM was established under FSM Public Law No. 7-79 to serve the varied post-secondary and adult educational needs of the FSM. COM-FSM is governed by a five-member Board of Regents appointed by the President with the advice and consent of the Congress.

FSM Coconut Development Authority (CDA): CDA was established under FSM Public Law No. 1-156 to engage in the manufacture and processing of all products derived from the coconut tree; to buy, collect, market, sell, export, inspect, improve the quality, and deal with, in general, all products derived from the coconut tree; to establish prices to producers or sellers of coconut products in the FSM; to collect and receive all monies derived from the sales of coconut products; and to stabilize the price of these products. CDA is governed by a five-member Board of Directors, which includes one appointee by the President (with the advice and consent of the Congress) and four appointees by the Governors of each State (with the advice and consent of the respective State legislatures).

FSM Petroleum Corporation (FSMPC): FSMPC was established under Public Law 15-08, which was signed into law on September 11, 2007, for the purpose of providing the oil and gas distribution for the entire FSM. FSMPC is governed by a seven-member Board of Directors, which includes one appointee by the President (with the advice and consent of the Congress) and four appointees by the Governors of each State (with the advice and consent of the respective State legislatures), and two appointees from the private sector by the President (with the advice and consent of the Congress).

MiCare Plan, Inc. (the Plan): The Plan was established under FSM Public Law No. 12-77 to provide, arrange, pay, or reimburse the costs of medical, dental and vision treatment and care, hospitalization, surgery, prescription drugs, medicine, prosthetic appliances, out-patient care, and other medical care benefits. The Plan is governed by a seven-member Board of Directors appointed by the President with the advice and consent of the Congress. The Plan superseded the Employees' Health Insurance Fund, effective October 1, 2004. The Employees' Health Insurance Fund was previously accounted for as a governmental fund type - special revenue fund of the FSM National Government.

The FSM National Government'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 PS05
Palikir, Pohnpei State, FM, 96941

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

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.

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 FSM National Government 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 \$14,977,434 of restricted net assets, of which \$5,677,561 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.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

C. Fund Financial Statements

Separate financial statements are provided for governmental funds and fiduciary funds even though the latter are excluded from the government-wide financial statements. 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 FSM National Government reports its financial position and results of operations in funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues and expenditures/expenses. Transactions between funds within a fund type, if any, have not been eliminated.

D. Measurement Focus and Basis of Accounting

The government-wide financial statements are reported using the economic resources management focus and the accrual basis of accounting, as are the fiduciary fund financial statements. 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 FSM National Government 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 FSM National Government 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.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

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

The FSM National Government reports the following fund types:

1. Governmental Fund Types

i. General Fund

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

ii. Special Revenue Funds

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

iii. Permanent Funds

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

2. Fiduciary Fund Types

i. Private Purpose Trust Funds

These funds are used to account for resources held in trust under which principal and income benefit certain individuals.

These include funds held in trust by the FSM Social Security Administration (FSMSSA) for the beneficiaries of the FSMSSA Retirement Fund, and funds held in trust by the FSM Development Bank for the State of Pohnpei and the State of Yap.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

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 FSM National Government reports the following major funds:

Grants Assistance Fund, a Governmental Fund Type - Special Revenue Fund, which was established to account for all financial transactions that are subgranted to the FSM National Government, including federal assistance funds received from the United States government by the FSM National Government.

Section 111 Investment Development Fund, a Governmental Fund Type - Special Revenue Fund, which was established to account for United States Congress appropriations under United States Public Law 99-239, Compact of Free Association, Section 111, and approved by the FSM Congress. These funds are administered by the FSM Development Bank.

Early Retirement Program Fund, a Governmental Fund Type - Special Revenue Fund, which was established to account for the Early Retirement Program activities.

Asian Development Bank Loan Fund, a Governmental Fund Type - Special Revenue Fund, which was established by FSM Public Law No. 7-101 mainly to carry out the purpose of the Fisheries Development Project Loan Agreement of 1992 between the Government of the Federated States of Micronesia and the Asian Development Bank (ADB), and the Technical Assistance Agreement of 1992 for Institutional Strengthening for Marine Resource Management and Conservation between the FSM and ADB.

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

E. Reporting Standards

As allowed by GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, the FSM National Government'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.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

F. Cash and Cash Equivalents and Time Certificates of Deposit

Cash and cash equivalents include cash held in demand accounts as well as short-term investments with a maturity date within three months of the date acquired by the FSM National Government. 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 carried at fair value, which is the amount at which an investment could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

An investment of 20% or more of the voting stock of an investee is presumed to give the investor significant influence. Under the equity method, the investor records, as earnings or loss, its proportionate share of the investee's earnings or loss.

H. Receivables

In general, tax revenue is recognized on the government-wide financial statements, when assessed or levied and on the governmental fund financial statements to the extent that it is both measurable and available. Receivables are stated net of estimated allowances for uncollectible accounts. Reimbursements due to the FSM National Government for expenditures on federally funded reimbursement and grant programs are reported as "receivables from federal agencies".

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 FSM National Government records transactions between individual funds for goods provided or services rendered. Receivables and payables resulting from transactions between funds are classified as "due from other funds" or "due to other funds" on the governmental fund balance sheet.

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

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

K. Restricted Assets

Certain assets of the primary government are classified as restricted assets because their use is completely restricted through loan agreements or enabling legislation. Specifically, the FSM National Government has cash and cash equivalents and deposits recorded in the General Fund of \$4,188,535 and investments recorded in the Compact Trust Fund of \$9,114,902, which are restricted in that they are not available to be used in current operations. The Asian Development Bank has \$477,516 of loan proceeds maintained in an imprest revolving fund that are not available to be used in current operations.

L. Capital Assets

Capital assets, which include property, plant, equipment and infrastructure (e.g. roads, bridges, ramps and other similar items), are reported in the applicable governmental or business-type activities columns of the government-wide financial statements. Singular pieces of equipment, vehicles, computer equipment and software that equal or exceed \$1,000 are capitalized. Buildings and infrastructure projects with a cost that equals or exceeds \$50,000 are capitalized. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at fair market value at the date of donation.

Property, plant and equipment 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	50 years
Improvements	20 years
Infrastructure	20 years
Facilities	3 - 40 years
Machinery and equipment	3 - 20 years
Furniture and fixtures	3 - 10 years
Ships	25 years
Aircraft	20 years
Motor vehicles	3 - 10 years
Over-the-road vehicles	3 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.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

N. Deferred Revenue

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 from federal funds received in advance of eligible expenditures.

O. Compensated Absences

It is the government’s policy to permit employees to accumulate earned but unused vacation and sick pay benefits. There is no liability for unpaid accumulated sick leave since the government does not have a policy to pay any amounts when employees separate from service with the government. All vacation pay is accrued when incurred in the government-wide 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 bi-weekly, if less than 3 years of service, 6 hours bi-weekly, if between 3 and 10 years of service, and 8 hours bi-weekly if over 10 years of service, limited to 45 working days.

P. Fund Equity

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

	General	Grants Assistance	Section 111 Investment Development	Early Retirement Program	Asian Development Bank Loan	Compact Trust	Other Governmental Funds	Total
Cash and cash equivalents	\$ 884,321	\$ -	\$ -	\$ -	\$ 1,103,496	\$ -	\$ -	\$ 1,987,817
Investments	5,257,034	-	-	3,320,475	-	-	-	8,577,509
Receivables:								
General	23,573	-	-	-	85,381	-	-	108,954
Loans	1,500,000	-	7,735,675	-	31,821,492	-	-	39,748,484
Due from component units	500,777	-	-	-	-	-	-	500,777
Deposits and others	1,149,850	-	-	-	-	-	-	1,149,850
Restricted cash	-	-	-	-	477,516	-	-	477,516
Investments	-	-	-	-	-	9,114,902	-	9,114,902
	<u>\$ 9,315,555</u>	<u>\$ -</u>	<u>\$ 7,735,675</u>	<u>\$ 3,320,475</u>	<u>\$ 32,179,122</u>	<u>\$ 9,114,902</u>	<u>\$ -</u>	<u>\$61,665,729</u>

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

Q. New Accounting Standards

During fiscal year 2008, the FSM National Government 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 Postemployment Benefits Other Than Pensions*. GASB Statement No. 45 establishes standards for the measurement, recognition, and display of other post employment benefits expense/expenditures and related liabilities, note disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employers. The provisions of this statement are effective for periods beginning after December 15, 2007. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the FSM National Government.

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

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

In November 2007, GASB issued Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*. GASB Statement No. 52 improves the quality of financial reporting by requiring endowments to report their land and other real estate investments at fair value, creating consistency in reporting among similar entities that exist to invest resources for the purpose of generating income. The provisions of this statement are effective for periods beginning after June 15, 2008. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the FSM National Government.

**FEDERATED STATES OF MICRONESIA
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Notes to Financial Statements
September 30, 2008

(1) Summary of Significant Accounting Policies, Continued

Q. New Accounting Standards, Continued

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

R. Risk Financing

The FSM National Government is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. It is the policy of the primary government not to purchase commercial insurance for the risks of loss to which it is exposed. Instead, the FSM National Government management believes it is more economical to manage its risks internally. In the event of claim settlements and judgments, the FSM National Government reports all of its risk management activities in its General Fund. Claims expenditures and liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. These losses include an estimate of claims that have been incurred but not reported. No losses have occurred as a result of these risks in any of the past three fiscal years.

S. Estimates

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

T. 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 FSM National Government's financial statements for the year ended September 30, 2007 from which summarized information was derived.

(2) Deposits and Investments

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

**FEDERATED STATES OF MICRONESIA
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Notes to Financial Statements
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(2) Deposits and Investments, Continued

The FSM National Government 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 FSM National Government has invested the majority of its excess funds in a pooled investment fund which is managed under the control of the Federated Development Authority (FDA), 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 FSM National Government are governed by legislation enacted by the Congress. The Secretary of Finance 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. Furthermore, the Secretary of Finance is responsible for the investment of any monies of the FSM National Government that are deemed not necessary for immediate use.

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

- i. Cash equivalents - the investment manager may engage in all normally accepted short-term investment practices including, but not limited to U.S. Treasury and government agency securities, bankers acceptances, certificates of deposit, commercial paper and repurchase agreements using any of the foregoing as collateral. The following restrictions apply: (1) Commercial paper must be rated A-1/P-1 or higher by Standard & Poor 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 Poor 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.

**FEDERATED STATES OF MICRONESIA
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Notes to Financial Statements
September 30, 2008

(2) Deposits and Investments, Continued

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 FSM National Government or its agent in the FSM National Government'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 FSM National Government'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 FSM National Government'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 FSM National Government'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 FSM National Government does not have a deposit policy for custodial credit risk.

As of September 30, 2008, the carrying amount of the primary government's total cash and cash equivalents and time certificates of deposit was \$5,793,524 and the corresponding bank balances were \$4,892,456. Of the bank balances, \$4,571,693 is maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance while \$2,631,661 represents short-term investments held and administered by FSM National Government's trustees in accordance with various trust agreements and bond indentures. Based on negotiated trust and custody contracts, all of these investments were held in FSM National Government's name by FSM National Government's custodial financial institutions at September 30, 2008 while the remaining amount of \$325,732 is maintained in financial institution not subject to FDIC insurance. As of September 30, 2008, bank deposits in the amount of \$1,001,025 were FDIC insured. The FSM National Government 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.

As of September 30, 2008, the carrying amount of the fiduciary funds' total cash and cash equivalents and time certificates of deposit was \$4,408,677 and the corresponding bank balances were \$4,653,575. All is maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2008, bank deposits in the amount of \$1,000,000 were FDIC insured. The fiduciary funds do not require collateralization of their cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized. Accordingly, these deposits are exposed to custodial credit risk.

**FEDERATED STATES OF MICRONESIA
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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 discretely presented component units' total cash and cash equivalents and time certificates of deposit was \$12,197,962 and the corresponding bank balances were \$13,704,425, which are maintained in financial institutions subject to FDIC insurance. As of September 30, 2008, bank deposits in the amount of \$1,446,330 were FDIC insured and \$500,000 is subject to coverage by Securities Investor Protection Corporation. The component units do not require collateralization of their 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 FSM National Government or its agent in the FSM National Government'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 FSM National Government'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 FSM National Government'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.

Primary Government

As of September 30, 2008, investments at fair value are as follows:

Fixed income securities:	
Domestic fixed income	\$ <u>5,510,896</u>
Other investments:	
Domestic equities	8,941,211
Money market funds	37,839
Cash management accounts	<u>6,695,162</u>
	<u>15,674,212</u>
	\$ <u>21,185,108</u>

**FEDERATED STATES OF MICRONESIA
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Notes to Financial Statements
September 30, 2008

(2) Deposits and Investments, Continued

B. Investments, Continued

Primary Government, Continued

Additionally, the primary government owns 50,000 shares of the common stock of a commercial enterprise located in the Commonwealth of the Northern Marianas. The investment of \$1,500,000 is accounted for at cost since the investment constitutes less than a 20% ownership share. Furthermore, the primary government owns 290,921 shares of the common stock of the Bank of the Federated States of Micronesia, which engages in commercial banking services in the FSM. The investment of \$3,757,034 is accounted for on the equity method since the investment constitutes a 31% ownership share.

A summary of audited financial information as of and for the twelve months ended December 31, 2008, for investees accounted for using the equity method of accounting for investments, is as follows:

Assets	\$ <u>85,973,236</u>
Liabilities	\$ <u>69,475,088</u>
Net earnings	\$ <u>1,126,172</u>

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

<u>Investment Type</u>	<u>Rating Type</u>	<u>Maturity (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	\$ 131,053	691,713	292,814	147,201	1,262,781
U.S. government agency obligations:						
California Water Sewer	AAA	-	-	-	125,362	125,362
Federal Farm Credit Bank	AAA	511,096	98,156	-	-	609,252
Federal Home Loan Mortgage Corporation	AAA	449,595	63,209	19,639	475,952	1,008,395
Federal National Mortgage Association	AAA	-	25,213	11,012	164,170	200,395
FFCB	AAA	-	25,047	-	-	25,047
FHLB	AAA	25,164	128,063	-	-	153,227
FNMA	AAA	30,047	75,675	-	-	105,722
Government National Mtg Association	AAA	-	-	-	744,858	744,858
Government National Mtg Corporation	AAA	-	-	-	6,427	6,427
Housing Urban Development	AAA	-	11,046	-	-	11,046
Sonoma County Pension	AAA	-	-	-	47,530	47,530
Tennessee Valley Authority	AAA	31,114	-	-	8,593	39,707
Corporate notes and bonds	A1	-	160,573	63,589	-	224,162
Corporate notes and bonds	A2	22,976	113,676	126,513	20,893	284,058
Corporate notes and bonds	A3	-	14,738	-	8,929	23,667
Corporate notes and bonds	AA1	-	63,418	-	-	63,418
Corporate notes and bonds	AA2	-	28,428	-	26,806	55,234
Corporate notes and bonds	AA3	3,200	82,132	57,055	16,972	159,359
Corporate notes and bonds	AAA	4,044	-	-	-	4,044
Corporate notes and bonds	B2	-	3,350	-	-	3,350
Corporate notes and bonds	BA1	-	35,330	-	-	35,330
Corporate notes and bonds	BAA1	-	21,705	107,488	6,904	136,097
Corporate notes and bonds	BAA2	-	44,704	50,884	5,131	100,719
Corporate notes and bonds	BAA3	7,674	-	11,676	-	19,350
Corporate notes and bonds	N/A	20,001	-	-	42,358	62,359
Grand Total		<u>\$1,235,964</u>	<u>\$1,686,176</u>	<u>\$740,670</u>	<u>\$1,848,086</u>	<u>\$5,510,896</u>

**FEDERATED STATES OF MICRONESIA
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Notes to Financial Statements
September 30, 2008

(2) Deposits and Investments, Continued

B. Investments, Continued

Primary Government, Continued

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 FSM National Government'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 FSM National Government will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. The FSM National Government's investments are held and administered by trustees. Based on negotiated trust and custody contracts, all of these investments were held in the FSM National Government's name by the FSM National Government's custodial financial institutions at September 30, 2008.

Concentration of credit risk for investments is the risk of loss attributed to the magnitude of an entity's investment in a single issuer. GASB Statement No. 40 requires disclosure by issuer and amount of investments in any one issuer that represents five percent (5%) or more of total investments for the State. As of September 30, 2008, the FSM National Government did not hold an investment in any one issuer that represented more than 5% of the FSM National Government's total investments.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of debt instruments. The FSM National Government 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.

Fiduciary Funds

The deposit and investment policies of the FSM Social Security Administration (FSMSSA) are governed by FSMSSA enabling legislation. The FSMSSA Board is required to engage one or more fund custodians to assume responsibility for the physical possession of their investments. Legally authorized investments are as follows:

- i. Government obligations - Obligations issued or guaranteed as to principal and interest by the FSM National Government and/or State governments of the Federated States of Micronesia or by the Government of the United States, provided that the principal and interest on each obligation are payable in the currency of the United States.
- ii. Corporate obligations and mortgage-backed securities - Obligations of any public or private entity or corporation created or existing under the laws of the Federated States of Micronesia or of the United States or any state, territory or commonwealth thereof, or obligations of any other government or economic community which are payable in United States dollars, or pass through and other mortgage-backed securities provided that the obligation is issued by an agency of the United States Government, the FSM National Government, or is rated in one of the three highest categories by two nationally recognized rating agencies. No investment under this heading shall exceed ten percent of the market value of the Fund or ten percent of the outstanding value of the issue at the time of purchase.

**FEDERATED STATES OF MICRONESIA
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Notes to Financial Statements
September 30, 2008

(2) Deposits and Investments, Continued

B. Investments, Continued

Fiduciary Funds, Continued

- iii. Preferred and common stocks - Shares of preferred or common stocks of any corporation created or existing under the laws of the Federated States of Micronesia or under the laws of the United States or any state, territory or commonwealth thereof provided that the purchase of such shares shall be considered reasonable and prudent by the respective investment advisors at the time of purchase, that not more than five percent of the market value of the Fund shall be invested in the stock of any one corporation, and that not more than ten percent of the market value of the Fund shall be invested in any one industry group.
- iv. Insurance company obligations - Contracts and agreements supplemental thereto providing for participation in one or more accounts of a life insurance company authorized to do business in the Federated States of Micronesia or in any state, territory or commonwealth of the United States provided that the total market value of these investments at no time shall exceed ten percent of all investments of the Fund.

As of December 31, 2008, investments at fair value are as follows:

Fixed income securities:		
Domestic fixed income		\$ 16,054,705
International fixed income		<u>470,178</u>
		16,524,883
Other investments:		
Domestic equities		<u>15,112,598</u>
		\$ <u>31,637,481</u>

As of December 31, 2008, FSMSSA's fixed income securities, including their Moody's Investors Service credit ratings, had the following maturities:

	<u>Investment Maturities (In Years)</u>				
	Less <u>Than 1</u>	<u>1 to 5</u>	<u>6 to 10</u>	Greater <u>Than 10</u>	Fair <u>Value</u>
U.S. Treasury obligations	\$ 144,727	\$ 2,967,155	\$ 413,396	\$ 899,120	\$ 4,424,398
Mortgage and asset-backed securities	250,000	415,771	328,468	87,380	1,081,619
U.S. Government agencies	-	-	-	6,461,162	6,461,162
Corporate notes	-	1,879,158	1,941,420	558,924	4,379,502
Municipal bonds	-	-	-	<u>178,202</u>	<u>178,202</u>
	<u>\$ 394,727</u>	<u>\$ 5,262,084</u>	<u>\$ 2,683,284</u>	<u>\$ 8,184,788</u>	<u>\$ 16,524,883</u>

FSMSSA's investments are held and administered by trustees. Based on negotiated trust and custody contracts, all of these investments were held in FSMSSA's name by FSMSSA's custodial financial institutions at December 31, 2008.

As of December 31, 2008, FSMSSA did not hold an investment in any one issuer that represented more than 5% of FSMSSA's total investments.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2008

(2) Deposits and Investments, Continued

B. Investments, Continued

FSMSSA 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.

Discretely Presented Component Units

The deposit and investment policies of the discretely presented component units' generally follow those of the primary government.

As of September 30, 2008, investments at fair value are as follows:

FSM Telecommunications Corporation (FSMTC):

Fixed income securities:	
U.S. Treasury obligations	\$ 585,549
U.S. Government agencies	664,229
Corporate notes	<u>1,537,450</u>
	<u>2,787,198</u>
Other investments:	
Domestic and international equities	4,302,600
Money market funds	<u>490,364</u>
	<u>4,792,964</u>
	<u>\$ 7,580,162</u>

College of Micronesia - FSM (COM-FSM):

Fixed income securities:	
Domestic fixed income	\$ 745,809
International fixed income	<u>51,701</u>
	<u>797,510</u>
Other investments:	
Common equities	1,725,346
Money market funds	<u>254,989</u>
	<u>1,980,335</u>
	<u>\$ 2,777,845</u>

The National Fisheries Corporation (NFC) owns 50,493 shares of the common stock of the Micronesia Longline Fishing Company, Inc., an unconsolidated entity, representing a 97% ownership share. Additionally, NFC owns 50% of the shares of the common stock of the following unconsolidated entities: Yap Fishing Corporation, Yap Fresh Tuna, Inc., Chuuk Fresh Tuna, Inc., and Kosrae Sea Venture, Inc. These investments have been written down to a nil value.

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Notes to Financial Statements
September 30, 2008

(2) Deposits and Investments, Continued

B. Investments, Continued

Discretely Presented Component Units, Continued

As of December 31, 2008, investments at fair value are as follows:

FSM Development Bank (FSMDB):

Fixed income securities:

Domestic fixed income \$ 3,032,615

Other investments:

Domestic equities 3,199,435

Money market funds 4,137,151

\$ 10,369,201

FSMDB owns 100,000 shares of the common stock of the Bank of the Federated States of Micronesia. The investment of \$662,188 is accounted for at cost since the investment constitutes an 11% ownership share.

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

	Moody's Credit Rating	Investment Maturities (In Years)				Fair Value
		Less Than 1	1 to 5	6 to 10	Greater Than 10	
U.S. Treasury obligations	Aaa/P-1	\$ -	\$ 513,889	\$ 71,660	\$ -	\$ 585,549
U.S. Government agencies	Aaa/P-1	-	501,629	162,600	-	664,229
Corporate notes and bonds	A1/P-1	-	238,486	122,977	-	361,463
Corporate notes and bonds	A2/P-1	-	355,188	-	-	355,188
Corporate notes and bonds	A3/P-2	-	100,047	-	-	100,047
Corporate notes and bonds	Aaa/P-1	-	92,867	-	-	92,867
Corporate notes and bonds	Aa1/P-1	-	98,627	-	-	98,627
Corporate notes and bonds	Aa2/P-1	-	272,327	-	-	272,327
Corporate notes and bonds	Aa3/P-1	-	142,102	114,797	-	256,899
		\$ -	\$ <u>2,315,164</u>	\$ <u>472,034</u>	\$ -	\$ <u>2,787,198</u>

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

Investment Type	Fair Value	Investment Maturities (in years)			
		Less than 1	1-5	5-10	more than 10
International bond	\$ 51,701	\$ -	\$ 19,219	\$ 9,796	\$ 22,686
Corporate bond	430,617	-	136,815	94,082	199,720
Government bond	<u>315,192</u>	-	<u>164,718</u>	<u>104,650</u>	<u>45,824</u>
	\$ <u>797,510</u>	\$ -	\$ <u>320,752</u>	\$ <u>208,528</u>	\$ <u>268,230</u>

**FEDERATED STATES OF MICRONESIA
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Notes to Financial Statements
September 30, 2008

(2) Deposits and Investments, Continued

B. Investments, Continued

Discretely Presented Component Units, Continued

<u>Moody's Rating</u>	<u>Total</u>	<u>Domestic</u>	<u>International</u>
AAA/AAA	\$ 361,962	\$ 361,962	\$ -
AAA/AA	11,145	11,145	-
AA1/AA+	9,266	9,266	-
AA1/AA-	10,071	10,071	-
AA2/AA	19,177	19,177	-
AA2/AA-	8,633	8,633	-
AA3/AA	10,104	10,104	-
AA3/A+	5,971	5,971	-
A1/AA-	8,631	-	8,631
A1/A+	10,250	10,250	-
A2/A	34,873	34,873	-
A3/A	9,383	9,383	-
A3/A-	26,393	16,235	10,158
A3/BBB+	28,670	18,874	9,796
BAAA1/A-	31,385	8,269	23,116
BAA1/BBB+	8,424	8,424	-
BAA2/BBB+	43,640	43,640	-
BAA2/BBB	5,347	5,347	-
BAA3/BBB+	8,274	8,274	-
BAA3/BBB	8,527	8,527	-
BAA3/BBB-	17,519	17,519	-
BA1/BBB-	8,054	8,054	-
No Rating	<u>111,811</u>	<u>111,811</u>	<u>-</u>
Total credit risk debt securities	\$ <u>797,510</u>	\$ <u>745,809</u>	\$ <u>51,701</u>

As of December 31, 2008, FSMDB's fixed income securities, including their Moody's Investors Service credit ratings, had the following maturities:

	<u>Less Than 1 Year</u>	<u>1 to 5 Years</u>	<u>6 to 10 Years</u>	<u>Greater Than 10 Years</u>	<u>Fair Value</u>
U.S. Treasury obligations	\$ -	\$ 1,058,189	\$ 659,806	\$ -	\$ 1,717,995
U.S. Government agency obligations	<u>945,651</u>	<u>216,962</u>	<u>152,007</u>	<u>-</u>	<u>1,314,620</u>
	<u>\$ 945,651</u>	<u>\$ 1,275,151</u>	<u>\$ 811,813</u>	<u>\$ -</u>	<u>\$ 3,032,615</u>

	<u>Total</u>	<u>Domestic</u>	<u>International</u>
Moody's Rating – AAA	\$ <u>3,032,615</u>	\$ <u>3,032,615</u>	\$ <u>-</u>
Total credit risk debt securities	\$ <u>3,032,615</u>	\$ <u>3,032,615</u>	\$ <u>-</u>

**FEDERATED STATES OF MICRONESIA
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Notes to Financial Statements
September 30, 2008

(3) Receivables

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

	General	Grants Assistance	Section 111 Investment Development	Early Retirement Program	Asian Development Bank Loan	Compact Trust	Nonmajor and Fiduciary Funds	Totals
Receivables:								
General	\$ 1,394,729	\$ -	\$ -	\$ -	\$ 85,381	\$ -	\$ -	\$ 1,480,110
Taxes	3,634,689	-	-	-	-	-	-	3,634,689
Federal agencies	-	8,238,754	-	-	-	-	-	8,238,754
Contributions	-	-	-	-	-	-	1,797,223	1,797,223
Loans	5,661,987	-	7,749,175	-	34,182,875	-	1,734,008	49,328,045
Due from component units	500,777	-	-	-	-	-	-	500,777
Other governments and agencies	-	40,516	15,838	-	-	-	-	56,354
Accrued interest	-	-	19,544	-	-	-	144,291	163,835
Other	-	-	-	-	-	-	60,865	60,865
	<u>11,192,182</u>	<u>8,278,754</u>	<u>7,784,557</u>	<u>-</u>	<u>34,268,256</u>	<u>-</u>	<u>3,736,387</u>	<u>65,260,136</u>
Less: allowance for uncollectable accounts	<u>(5,416,426)</u>	<u>-</u>	<u>(13,500)</u>	<u>-</u>	<u>(3,670,146)</u>	<u>-</u>	<u>(1,606,953)</u>	<u>(10,707,025)</u>
Net receivables	<u>\$ 5,775,756</u>	<u>\$ 8,278,754</u>	<u>\$ 7,771,057</u>	<u>\$ -</u>	<u>\$ 30,598,110</u>	<u>\$ -</u>	<u>\$ 2,129,434</u>	<u>\$ 54,553,111</u>

Loans receivable of the primary government are as follows:

General Fund:

Notes receivable from the National Fisheries Corporation (NFC), payable in various annual installments of \$1,962 to \$86,639, non-interest bearing, and due on various dates ranging from July 2007 through April 2014. These notes have been fully provided for by an allowance for uncollectable accounts. \$ 3,600,000

Loan receivable from the State of Chuuk, payable in quarterly installments of \$416,667, non-interest bearing with a service charge of 1% per annum, due on September 30, 2001. This loan has been fully provided for by an allowance for uncollectable accounts. 561,987

Loan receivable from the State of Kosrae, payable in equal quarterly installments of \$37,500, non-interest bearing, on each of the first day of the month of October, January, April and July starting on October 1, 2009 and ending on July 1, 2019. This loan has been fully provided for by an allowance for uncollectable accounts. 1,500,000

\$ 5,661,987

Section 111 Investment Development Fund:

Loans receivable from businesses and individuals at varying terms and conditions administered by the FSM Development Bank. \$ 7,749,175

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2008

(3) Receivables, Continued

Asian Development Bank Loan Fund:

Loan receivable from Micronesia Longline Fishing Company, a majority-owned subsidiary of NFC, in the amount of SDR 3,514,000, interest at 6.64% per annum, repayments commencing January 15, 1998, with a maturity date of July 15, 2007. The loan is a subsidiary loan of a loan agreement (Loan Number 1257 FSM (SF)) between the FSM National Government and the Asian Development Bank (ADB).

\$ 4,893,528

Loans receivable from the Chuuk Public Utility Corporation (CPUC), the Pohnpei Utilities Corporation (PUC), and the Yap State Public Service Corporation (YSPSC). These loans are subsidiary loans of a loan agreement (Loan Number 1459 FSM (SF)) between the FSM National Government and the ADB. The FSM National Government entered into Financing Agreements with the States of Chuuk, Pohnpei and Yap whereby a portion of the loan proceeds under this ADB loan were relent under the same terms and conditions imposed by the ADB. The States in turn on lent the loan proceeds to CPUC, PUC, and YSPSC, respectively, as follows:

Chuuk Public Utility Corporation	\$	3,293,540
Pohnpei Utilities Corporation		2,023,369
Yap State Public Service Corporation		<u>2,163,473</u>

7,480,382

Loans receivable from the States to assist in the implementation of an Early Retirement Scheme (ERS) in which employees holding certain nonessential positions as identified by the States were retired early with a payout of the equivalent of two-years wages. These loans are subsidiary loans of a loan agreement (Loan Number 1520 FSM (SF)) between the FSM National Government and the ADB. The FSM National Government entered into Financing Agreements with the States whereby a portion of the loan proceeds under this ADB loan were relent under the same terms and conditions imposed by the ADB. The amounts outstanding from the States are as follows:

State of Chuuk	\$	5,181,633
State of Kosrae		1,955,102
State of Pohnpei		4,106,123
State of Yap		<u>3,422,449</u>

14,665,307

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Notes to Financial Statements
September 30, 2008

(3) Receivables, Continued

Asian Development Bank Loan Fund, Continued:

Loans receivable from the States to assist in the implementation of the Basic Social Services Program. These loans are subsidiary loans of a loan agreement (Loan Number 1816 FSM (SF)) between the FSM National Government and the ADB. The FSM National Government entered into Financing Agreements with the States whereby a portion of the loan proceeds under this ADB loan was relent under the same terms and conditions imposed by the ADB. The amounts outstanding from the States are as follows:

State of Kosrae	\$ 314,736	
State of Yap	439,579	
State of Chuuk	<u>1,309,989</u>	
		2,064,304

Loans receivable from the States to assist in the implementation of the Private Sector Development Program. These loans are subsidiary loans of loan agreements (Loan Number 1873 FSM (SF) and Loan Number 1874 FSM (SF)) between the FSM National Government and the ADB. The FSM National Government entered into Financing Agreements with the States whereby a portion of the loan proceeds under these ADB loans was relent under the same terms and conditions imposed by the ADB. The amounts outstanding from the States are as follows:

State of Chuuk	\$ 1,427,705	
State of Kosrae	1,583,247	
State of Pohnpei	845,615	
State of Yap	<u>1,222,778</u>	
		<u>5,079,345</u>
		\$ <u>34,182,875</u>

Nonmajor Governmental and Fiduciary Funds

Student Loan Fund:

Loans receivable from students under a student financial assistance loan program, interest at 4% per annum, with repayment commencing ten years and nine months after completion of study. \$ 1,606,953

Pohnpei Development Loan Fund:

Loans receivable from businesses and individuals at varying terms and conditions administered by the FSM Development Bank. 55,239

**FEDERATED STATES OF MICRONESIA
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Notes to Financial Statements
September 30, 2008

(3) Receivables, Continued

Yap Development Loan Fund:

Loans receivable from businesses and individuals at varying terms and conditions administered by the FSM Development Bank. 71,816

\$ 1,734,008

Due from component units in the general fund consists of \$500,777 of advances from FSMPC.

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

	FSM Tele- Communications Corporation	FSM Development Bank	National Fisheries Corporation	College of Micronesia- FSM	FSM Coconut Development Authority	MiCare Plan, Inc.	FSM Petroleum Corporation	Total
Receivables:								
General	\$1,924,221	\$ 6,593	\$1,014,507	\$6,556,416	\$14,944	\$260,993	\$956,396	\$10,734,070
Loans	-	25,481,600	-	-	-	-	-	25,481,600
Interest	317,232	244,252	-	-	-	-	-	561,484
Other	<u>20,227</u>	<u>225,017</u>	<u>-</u>	<u>1,434,584</u>	<u>-</u>	<u>102,821</u>	<u>2,305</u>	<u>1,784,954</u>
	2,261,680	25,957,462	1,014,507	7,991,000	14,944	363,814	-	38,562,108
Less: allowance for uncollectible accounts	<u>(547,612)</u>	<u>(5,295,649)</u>	<u>(1,006,681)</u>	<u>(4,198,594)</u>	<u>(10,511)</u>	<u>(74,446)</u>	<u>-</u>	<u>(11,133,493)</u>
	<u>\$1,714,068</u>	<u>\$20,661,813</u>	<u>\$ 7,826</u>	<u>\$3,792,406</u>	<u>\$ 4,433</u>	<u>\$289,368</u>	<u>\$ 958,701</u>	<u>\$27,428,615</u>

The due from primary government of the College of Micronesia-FSM amounts to \$579,608.

(4) Interfund Receivables and Payables

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

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General	Grants Assistance	\$ 947,905
General	Early Retirement Program	3,460,020
Asian Development Bank Loan	General	769,579
Grants Assistance	General	2,845,010
Nonmajor governmental funds	General	<u>2,046,524</u>
		\$ <u>10,069,038</u>

Due to component units as of September 30, 2008 in the general and grants fund consist of payable to College of Micronesia-FSM amounting to \$579,608.

Due to primary government from FSMPC amounts to \$500,777.

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Notes to Financial Statements
September 30, 2008

(5) Capital Assets

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

	Balance October 1, 2007 <u>As Restated</u>	<u>Additions</u>	<u>Retirements</u>	Balance September 30, 2008
Governmental Activities:				
Buildings and improvements	\$ 16,661,608	\$ 99,695	\$ -	\$ 16,761,302
Boats	23,322,100	10,644	-	23,332,744
Infrastructures	1,661,100	4,926,772	-	6,587,872
Motor vehicles	7,631,163	361,360	(41,560)	7,960,963
Computer equipment	3,653,760	389,887	(38,076)	4,005,571
Aircraft	709,207	-	-	709,207
Furniture, equipment and machinery	<u>3,393,116</u>	<u>620,907</u>	<u>(123,215)</u>	<u>3,890,808</u>
	<u>57,032,053</u>	<u>6,409,265</u>	<u>(202,851)</u>	<u>63,238,467</u>
Less accumulated depreciation:				
Buildings and improvements	(3,796,731)	(345,461)	-	(4,142,192)
Boats	(11,084,608)	(927,888)	-	(12,012,496)
Infrastructure	-	(503,811)	-	(503,811)
Motor vehicles	(3,859,778)	(729,646)	41,560	(4,547,864)
Computer equipment	(2,774,915)	(321,850)	34,604	(3,062,161)
Aircraft	(300,348)	(35,460)	-	(335,808)
Furniture, equipment and machinery	<u>(3,029,917)</u>	<u>(261,761)</u>	<u>123,215</u>	<u>(3,168,463)</u>
	<u>(24,846,297)</u>	<u>(3,125,877)</u>	<u>199,379</u>	<u>(27,772,795)</u>
Construction in progress	<u>10,684,040</u>	<u>7,292,941</u>	<u>-</u>	<u>17,976,981</u>
	<u>\$ 42,869,796</u>	<u>\$ 10,576,329</u>	<u>\$ (3,472)</u>	<u>\$ 53,442,653</u>

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

President's office	\$ 56,842
External affairs and LNOs	54,332
Health and social affairs	247,775
Education	67,671
Resources and development	22,836
Transportation, communication and infrastructure	858,724
Finance and administration	41,944
Justice	413,459
Office of the Public Defender	9,550
Office of Statistics, Budget and Compact Management	22,625
Judiciary	21,451
Legislature	90,127
Office of the Public Auditor	20,222
National government programs	61,823
Boards, commissions and other	26,437
Capital projects	<u>1,110,059</u>
	<u>\$ 3,125,877</u>

**FEDERATED STATES OF MICRONESIA
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Notes to Financial Statements
September 30, 2008

(5) Capital Assets, Continued

The primary government has assumed a construction management role for various infrastructure grant related expenditures. These expenditures are accounted for at the government-wide level as construction in progress until completion of the project and resulting turnover to the applicable beneficiary. Until formal turnover occurs, the assets are capitalized and are depreciated by the primary government.

(6) Long-Term Obligations

Primary Government

Asian Development Bank (ADB) Loan Number 1257 FSM (SF) - Fisheries Development Project Loan (SDR 3,792,000), non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The loan is payable semiannually commencing January 15, 2004 in an amount of SDR 46,100 increasing to SDR 92,400 on January 15, 2014, with a maturity date of July 15, 2033. \$ 5,724,773

ADB Loan Number 1459 FSM (SF) - Water Supply and Sanitation Project Loan (SDR 7,233,000), non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The loan is payable semiannually commencing February 1, 2007 in an amount of SDR 69,200, increasing to SDR 138,500 on February 1, 2017, with a maturity date of August 1, 2036. 10,036,552

ADB Loan Number 1520 FSM (SF) - Public Sector Reform Program Loan (SDR 12,979,000), non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The loan is payable semiannually commencing February 1, 2008 in an amount of SDR 129,800, increasing to SDR 259,600 on February 1, 2018, with a maturity date of August 1, 2037. 19,935,753

ADB Loan Number 1816 FSM (SF) - Basic Social Services Project Loan (SDR 6,199,000), non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The loan is payable semiannually commencing February 1, 2009 in an amount of SDR 129,145, at which time the service charge increases to 1.5% per annum, with a maturity date of August 1, 2032. 4,090,242

ADB Loan Number 1873 FSM (SF) - Private Sector Development Program Loan (SDR 3,912,000), non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The loan is payable semiannually commencing May 15, 2010 in an amount of SDR 122,250, at which time the service charge increases to 1.5% per annum, with a maturity date of November 15, 2025. 3,892,241

**FEDERATED STATES OF MICRONESIA
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Notes to Financial Statements
September 30, 2008

(6) Long-Term Obligations, Continued

Primary Government, Continued

ADB Loan Number 1874 FSM (SF) - Private Sector Development Project Loan (SDR 6,273,000), non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The loan is payable semiannually commencing May 15, 2010 in an amount of SDR 130,687, at which time the service charge increases to 1.5% per annum, with a maturity date of November 15, 2033. 6,359,775

ADB Loan Number 2100 FSM (SF) - Omnibus Infrastructure Development Project (SDR 9,686,000), interest bearing equivalent to the sum of LIBOR and .60% per annum on the amount of the loan withdrawn from the Loan account with a loan term of 25 years including a grace period of 5 years. The loan is payable semiannually commencing January 15, 2010, at which time the grace period ends, in an amount of .83% of the outstanding loan balance and incrementing at certain years between .04% - .16% up to the maturity date of July 15, 2009. 100,697

ADB Loan Number 2099 FSM (SF) - Omnibus Infrastructure Development Project (SDR 9,686,000), interest bearing at the rate of 1% per annum on the amount of the loan withdrawn from the Loan Account during the grace period. The loan is payable semiannually commencing January 15, 2013 in an amount of SDR 201,791, at which time the interest rate increases to 1.5% per annum, with a maturity date of July 15, 2036. 614,544

\$ 50,754,577

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

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest and Service Charge</u>	<u>Total</u>
2009	\$ 743,012	\$ 503,477	\$ 1,246,489
2010	1,386,278	570,831	1,957,109
2011	1,387,323	553,752	1,941,075
2012	1,388,552	536,657	1,925,209
2013	1,393,976	519,544	1,913,520
2014 – 2018	8,918,398	2,312,568	11,230,966
2019 – 2023	11,348,751	1,688,752	13,037,503
2024 – 2028	10,959,134	1,024,411	11,983,545
2029 – 2033	8,708,453	454,040	9,162,493
2034 – 2037	<u>4,520,700</u>	<u>72,158</u>	<u>4,592,858</u>
	\$ <u>50,754,577</u>	\$ <u>8,236,190</u>	\$ <u>58,990,767</u>

**FEDERATED STATES OF MICRONESIA
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Notes to Financial Statements
September 30, 2008

(6) 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 Loan 1257 FSM (SF)	\$ 4,731,606	\$ 1,095,967	\$ (102,800)	\$ 5,724,773	\$ 127,166
ADB Loan 1459 FSM (SF)	8,926,428	1,292,213	(182,089)	10,036,552	208,971
ADB Loan 1520 FSM (SF)	17,682,020	2,607,401	(353,668)	19,935,753	406,875
ADB Loan 1816 FSM (SF)	1,829,927	2,260,315	-	4,090,242	-
ADB Loan 1873 FSM (SF)	3,553,325	338,916	-	3,892,241	-
ADB Loan 1874 FSM (SF)	4,907,532	1,452,243	-	6,359,775	-
ADB Loan 2100 FSM (SF)	-	100,697	-	100,697	-
ADB Loan 2099 FSM (SF)	-	614,544	-	614,544	-
	<u>41,630,838</u>	<u>9,762,296</u>	<u>(638,557)</u>	<u>50,754,577</u>	<u>743,012</u>
Other:					
Compensated absences	818,136	638,195	(434,927)	1,021,404	88,764
	<u>\$ 42,448,974</u>	<u>\$ 10,400,491</u>	<u>\$ (1,073,484)</u>	<u>\$ 51,775,981</u>	<u>\$ 831,776</u>

Included in the additions is a foreign exchange adjustment due to a change in the SDR calculation of \$6,129,847. Of this amount, \$4,207,662 was allocated to the States, which also resulted in an increase in loans receivable from the States of the same amount.

Discretely Presented Component Units

As of September 30, 2008, the discretely presented component units had the following long-term debt outstanding:

FSM Telecommunications Corporation (FSMTC)

Loan with the Rural Utilities Service (RUS) (formerly the Rural Electrification Administration) from the Rural Electrification and Telephone Revolving Fund, dated August 1, 1990 of \$39.6 million, with interest at 5% per annum, unconditionally guaranteed by the FSM National Government, under which the FSM National Government will make debt service payments to RUS in the event of default by FSMTC. Mortgages over specific FSMTC ground leases and essentially all assets of FSMTC collateralize the loan.

\$ 22,824,414

National Fisheries Corporation (NFC)

Notes payable to the FSM National Government, due in various annual installments of \$1,962 to \$86,639, non-interest bearing, with final maturities due on various dates ranging from July 2007 through April 2014. These notes are all delinquent as payments should have commenced in 1994 and 1995. However, no repayments have been made. Therefore, these notes are classified as current.

3,600,000

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Notes to Financial Statements
September 30, 2008

(6) Long-Term Obligations, Continued

Discretely Presented Component Units, Continued

FSM Development Bank (FSMDB)

On September 29, 2007, the Bank entered into a line of credit agreement with Export and Import Bank of China in the amount of \$2,000,000, due July 21, 2013, for the purpose of funding its loan programs. The loan is uncollateralized, bears interest at 7.38% per annum. Repayment of principal and interest commenced January 21, 2009 in semi-annual installment of \$200,000.

2,000,000

FSM Petroleum Corporation (FSMPC)

Notes payable to Bank of Guam, due in monthly installments of \$57,949, with interest at 7% per annum with final payment due on March 2019, unconditionally guaranteed by the FSM National Government. The loan is essentially collateralized by all assets of FSMPC.

5,047,000

\$ 33,471,414

Annual the 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	\$ 5,235,230	\$ 1,474,664	\$ 6,709,894
2010	1,706,581	1,507,821	3,214,402
2011	1,781,717	1,403,166	3,184,882
2012	1,860,513	1,294,849	3,155,362
2013	1,945,556	1,180,286	3,125,842
2014 - 2018	7,947,878	3,723,640	11,671,517
2019 - 2023	7,699,666	2,341,934	10,041,600
2024 - 2025	<u>5,294,274</u>	<u>394,039</u>	<u>5,688,313</u>
	\$ <u>33,471,414</u>	\$ <u>13,320,399</u>	\$ <u>46,791,813</u>

Changes in long-term liabilities of the discretely presented component units for the year ended September 30, 2008, are as follows:

	Balance October 1, 2007	Additions	Reductions	Balance September 30, 2008	Due Within One Year
Loans payable:					
FSMTC	\$ 23,668,097	-	\$ (843,683)	\$ 22,824,414	\$ 887,269
NFC	3,600,000	-	-	3,600,000	3,600,000
FSMDB	-	2,000,000	-	2,000,000	400,000
FSMPC	-	5,047,000	-	5,047,000	347,961
	<u>\$ 27,268,097</u>	<u>\$ 7,047,000</u>	<u>\$ (843,683)</u>	<u>\$ 33,471,414</u>	<u>\$ 5,235,230</u>

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Notes to Financial Statements
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(7) Short-Term Obligations

Discretely Presented Component Units

FSMPC have two line of credit facilities (LOC) with a bank of \$4,300,000 and \$240,000. The LOC is evidenced by promissory notes drawn on various dates for various amounts. This line of credit is utilized by FSMPC to fund fuel inventory purchases. The LOC and the related long-term obligation are secured and collateralized by an executed Pledge and Security Agreement for the assignment of the Reserve Bank Account and Revenue, an executed Notice of Security Interest and Chattel Mortgage and are for the guaranteed by the FSM National Government.

Changes in short-term borrowings during the year were as follows:

	<u>Beginning Balance</u>	<u>Increases</u>	<u>Reductions</u>	<u>Ending Balance</u>
Line of credit	\$ -	\$16,226,054	\$12,295,437	\$3,930,617

(8) Operating Transfers In/Out

Operating transfers in/out for each major governmental fund and nonmajor governmental funds in the aggregate, for the year ended September 30, 2007, are as follows:

<u>Source</u>	<u>Recipient</u>	<u>Transfers Out</u>	<u>Transfers In</u>
<u>Major Governmental Funds</u>			
General	Nonmajor governmental funds	\$ 3,592,919	\$ -
Grants Assistance	General	3,337,255	3,337,255
Nonmajor governmental funds	General	<u>-</u>	<u>412,551</u>
		<u>6,930,174</u>	<u>3,749,806</u>
<u>Nonmajor Governmental Funds</u>			
General	Nonmajor governmental funds	-	3,592,919
Nonmajor governmental funds	General	<u>412,551</u>	<u>-</u>
		<u>412,551</u>	<u>3,592,919</u>
		\$ <u>7,342,725</u>	\$ <u>7,342,725</u>

Transfers are used to 1) move revenues from the fund that enabling legislation or budget requires to collect them to the fund that enabling legislation or budget requires to expend them, 2) use unrestricted revenues collected in the General Fund to finance various programs accounted for in other funds in accordance with budgetary authorizations, and 3) record reductions in interfund loans for amounts that are not expected to be repaid.

(9) Contingencies and Commitments

Sick Leave

It is the policy of the FSM National Government 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.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2008

(9) Contingencies and Commitments, Continued

FSMPC Loan Guaranty

The FSM National Government is a full faith and credit guarantor of FSMPC's loan to the Bank of Guam. The National Government is jointly and severally liable for FSMPC's obligations under the loan and waives the sovereign immunity of the National Government with regard to any legal action arising from the guaranty.

Insurance Coverage

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

Federal Grants

The FSM National Government participates in a number of federally assisted grant programs. These programs are subject to financial and compliance audits to ascertain if Federal laws and guidelines have been followed. Cumulative questioned costs of \$7,115,095 have been set forth in the FSM National Government's Single Audit Report as of September 30, 2008. The ultimate disposition of these questioned costs can be determined only by final action of the respective grantor agencies. Therefore, no provision for any liability that may result upon resolution of this matter has been made in the accompanying financial statements. In addition, a material amount of questioned costs exists from the four States, which receive federal funds in a subrecipient capacity. If these questioned costs are sustained, such will be funded by State resources.

Pursuant to Title I, Section 105 of United States Public Law 99-290, the FSM National Government 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. Accordingly, the States have made no adjustment to the above questioned costs for amounts which were incurred prior to the implementation of the Compact of Free Association.

Leases

The FSM National Government has entered into house lease agreements varying from one to five years. The aggregate amount of future lease payments has not been accumulated as renewal is subject to annual appropriation.

Litigation

The FSM National Government is party to various legal proceedings, many of which are normal recurrences in governmental operations. The Attorney General of the FSM National Government is of the opinion that the probable outcome of suits existing at September 30, 2008, is not predictable. No provision for any liability has been made in the accompanying financial statements because management believes that no unfavorable outcome is likely to occur.

Asian Development Bank (ADB) Loans

On December 20, 2000, the FSM National Government entered into a loan agreement (Loan Number 1816 FSM (SF)) with the ADB for the Basic Social Services Project in the amount of \$8,019,000. The purpose of the loan is to design and introduce reform in the health and education sectors in the FSM, which will include on lending a portion of the loan proceeds to the States under separate Financing Agreements. As of September 30, 2008, the FSM National Government had drawn down \$4,090,242 against this loan.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Notes to Financial Statements
September 30, 2008

(9) Contingencies and Commitments, Continued

Asian Development Bank (ADB) Loans, Continued

On December 12, 2001, the FSM National Government entered into a loan agreement (Loan Number 1874 FSM (SF)) with the ADB for the Private Sector Development Project in the amount of \$8,017,000. The purpose of this loan is to promote economic growth by expanding the private sector in the FSM, thereby raising domestic employment and incomes and reducing dependence on external assistance, which will include on lending a portion of the loan proceeds to the States under separate Financing Agreements. As of September 30, 2007, the FSM National Government had drawn down \$6,359,775 against this loan.

On November 5, 2004, the FSM National Government entered into two loan agreements (Loan Number 2099 FSM (SF) and Loan Number 2100 FSM (SF)) with the Asian Development Bank in the combined amount of \$19,000,000 for the Omnibus Infrastructure Development Project. The proceeds are to be used to enhance public health and the environment through assistance to improve water supply infrastructure in Kosrae and Yap, and wastewater infrastructure in Pohnpei; and to support economic growth and poverty reduction in Chuuk through improvements to the electrical power sector, which will include on lending a portion of the loan proceeds to the States under separate Financing Agreements. As of September 30, 2008, the FSM National Government had drawn down \$715,241 against these loans.

(10) Continuing Appropriations

As of September 30, 2008, the general fund has a continuing appropriation representing amounts legally segregated for a specific future use from the general fund of \$5,116,211. In prior years, the National Government appropriated approximately \$59 million for various infrastructure projects based on Compact infrastructure grants to be received from the U.S. Department of the Interior. As of September 30, 2008, the remaining balance of these appropriations approximates \$36.1 million, as reflected in the Grants Assistance fund.

(11) Restatement

During the year ended September 30, 2008, the FSM National Government reconciled amounts previously expended in the prior year for Compact Infrastructure and other related funds and added such to capital assets. As a result of this determination, the following account balances have been restated from amounts previously reported:

At September 30:	<u>As Previously Reported</u>	<u>As Restated</u>
Noncurrent assets:		
Capital assets, net of accumulated depreciation	\$ <u>24,761,802</u>	\$ <u>42,869,797</u>
Net assets as of September 30, 2006	\$ <u>61,113,385</u>	\$ <u>65,251,844</u>
Executive Branch expenditures	\$ <u>41,008,896</u>	\$ <u>27,039,360</u>

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

YEAR ENDED SEPTEMBER 30, 2008

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

	<u>Budgeted Amounts</u>		Actual Amounts	Variance with Final Budget - Positive (Negative)
	<u>Original</u>	<u>Final</u>		
Revenues:				
Taxes	\$ 10,800,000	\$ 10,800,000	\$ 11,136,477	\$ 336,477
Fishing rights	13,900,000	15,471,232	17,045,395	1,574,163
Postal revenues	350,000	365,303	431,518	66,215
Investment earnings	1,500,000	497,540	(2,011,414)	(2,508,954)
Fees and charges	-	168,063	1,335,330	1,167,267
Grants	-	-	1,066,088	1,066,088
Other	<u>1,000,000</u>	<u>3,141,347</u>	<u>2,536,435</u>	<u>(604,912)</u>
Total revenues	<u>27,550,000</u>	<u>30,443,485</u>	<u>31,539,829</u>	<u>1,096,344</u>
Expenditures:				
General government:				
Executive Branch	17,351,564	18,263,703	17,652,899	610,804
Judicial Branch	1,341,194	1,364,194	1,225,917	138,277
Legislative Branch	3,585,166	3,745,166	3,522,267	222,899
Office of the Public Auditor	1,252,812	1,252,812	1,288,000	(35,188)
Other National Programs	1,629,072	1,654,072	1,393,231	260,841
Boards and Commissions	1,441,144	1,459,144	1,234,631	224,513
Payments to Component Units	644,079	644,079	1,006,976	(362,897)
Legislative Appropriations	<u>8,208,110</u>	<u>8,208,110</u>	<u>3,606,754</u>	<u>4,601,356</u>
Total general government	<u>35,453,141</u>	<u>36,591,280</u>	<u>30,930,675</u>	<u>5,660,605</u>
Total expenditures	<u>35,453,141</u>	<u>36,591,280</u>	<u>30,930,675</u>	<u>5,660,605</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(7,903,141)</u>	<u>(6,147,795)</u>	<u>609,154</u>	<u>6,756,949</u>
Other financing sources (uses):				
Operating transfers in	-	-	3,749,806	3,749,806
Operating transfers out	<u>(2,584,084)</u>	<u>(3,584,084)</u>	<u>(3,592,919)</u>	<u>(8,835)</u>
Total other financing sources (uses), net	<u>(2,584,084)</u>	<u>(3,584,084)</u>	<u>156,887</u>	<u>3,740,971</u>
Special items:				
Write-off of receivable balances	<u>(1,000,000)</u>	<u>(1,000,000)</u>	<u>2,455,919</u>	<u>3,455,919</u>
Net change in unreserved fund balance	<u>(9,487,225)</u>	<u>(8,731,879)</u>	<u>(1,689,878)</u>	<u>7,042,001</u>
Unreserved fund balance at the beginning of the year	6,124,246	6,124,246	6,124,246	-
Other changes in unreserved fund balance:				
Decrease in reserve for related assets, net of others	-	-	(1,168,727)	(1,168,727)
Decrease in reserve for continuing appropriations	<u>-</u>	<u>-</u>	<u>(1,999,374)</u>	<u>(1,999,374)</u>
Unreserved fund balance at the end of the year	<u>\$ (3,362,979)</u>	<u>\$ (2,607,633)</u>	<u>\$ 1,266,267</u>	<u>\$ 3,873,900</u>

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

(1) Budgetary Information

The Congress of the Federated States of Micronesia (CFSM) enacts the budget through passage of specific departmental appropriations. Before signing the Appropriations Act, the President may veto or reduce any specific appropriation, subject to Congressional override. Under the Compact of Free Association, which went into effect November 3, 1986, approval of all CFSM Laws is vested with the President of the Federated States of Micronesia.

During fiscal year 2008, supplemental appropriations were also made for both operating and capital purposes, to reflect the evolving priorities of the FSM National Government.

Budgetary control is maintained at the departmental level. Budget revisions during the year, reflecting program changes, may be effected by CFSM approval.

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

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 Deficit - Budget and Actual - General Fund (which are presented on a non-GAAP budgetary basis) are reconciled to unreserved deficit of the Governmental Fund Balance Sheet within the other changes in unreserved deficit section of that statement.

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

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

<u>Program Area</u>	<u>Excess</u>
Payment to Component Units	\$ 362,897

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

(2) Reconciliation - GAAP and Budgetary Bases of Accounting

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

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

Net change in fund balance (deficit)	\$ 1,157,706
Encumbrances	<u>(2,847,584)</u>
Net change in unreserved fund deficit	\$ <u>(1,689,878)</u>

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

OTHER SUPPLEMENTARY INFORMATION

YEAR ENDED SEPTEMBER 30, 2008

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

GENERAL FUND

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

	2008	2007
Revenue:		
Taxes:		
Import	\$ 3,976,071	\$ 3,989,403
Fuel	118,465	137,348
Coporate tax	34,318	-
Income tax, individuals, net of tax refunds	3,621,662	2,398,611
Gross receipts tax, businesses	3,385,961	3,842,247
	11,136,477	10,367,609
Federal and other grants:		
Other	1,066,088	-
	1,066,088	-
Fishing rights	17,045,395	15,005,147
Fees and charges:		
Postal collections	431,518	377,566
Business license and various fees	147,228	218,316
Other	1,188,102	230,533
	1,766,848	826,415
Investment earnings (loss):		
Net change in the fair value of investments	(2,219,360)	2,459,304
Dividend and interest income	207,946	462,695
	(2,011,414)	2,921,999
Other	2,536,435	879,908
Total revenues	31,539,829	30,001,078
Expenditures:		
Executive Branch:		
President's Office	609,498	721,443
Department of External Affairs and LNO's	3,322,354	2,958,372
Department of Health and Social Affairs	199,653	247,949
Department of Education	706,746	-
Resources and development	833,711	-
National archives, cultural and historic prevention	141,428	-
SBOC Office	877,056	-
Environment and emergency management	268,708	-
Department of Economic Affairs	-	1,038,358
Department of Transportation, Communication and Infrastructure	2,510,795	670,924
Department of Finance and Administration	2,640,905	2,575,878
Department of Justice	3,572,879	3,165,860
Office of the Public Defender	658,005	554,836
Total Executive Branch	16,341,738	11,933,620
Judicial Branch	1,152,247	978,198
Legislative Branch:		
Office of the Speaker and members	1,300,115	1,510,255
Congress staff	1,076,632	1,062,770
Delegation offices	575,023	549,990
Legislative committees	34,542	31,453
Total Legislative Branch	2,986,312	3,154,468

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

GENERAL FUND

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

	2008	2007
Expenditures, continued:		
Office of the Public Auditor	1,171,481	669,013
Other National Government Programs	1,302,303	3,828,528
Agencies, Boards and Commissions	1,121,226	1,120,491
Payments to Component Units:		
Micare Plan, Inc.	-	300,000
FSM Petroleum Corporation	32,228	-
College of Micronesia-FSM	620,000	294,174
FSM Coconut Development Authority	184,228	139,474
National Fisheries Corporation	135,000	100,000
	971,456	833,648
Other Legislative appropriations	-	3,871,555
Capital Projects	3,036,328	234,296
Total expenditures	28,083,091	26,623,817
Excess of revenues over expenditures	3,456,738	3,377,261
Other financing sources (uses):		
Operating transfers in:		
Section 215(a)(2) Communications	-	233,875
Section 216(a)(1) Marine Surveillance	-	266,616
Section 216(a)(1) Health and Medical	-	210,660
Section 216(a)(3) Post Secondary	-	175,486
Section 221(b) Special Block Grant	-	35,487
OIA Capital Projects	78,822	-
Compact Capital Projects	3,258,433	-
Fisheries Observer Revolving Fund	78,247	-
Passport Revolving Fund	334,304	282,548
	3,749,806	1,204,672
Operating transfers out:		
FSM Trust Fund	(2,508,835)	(1,500,000)
Section 215(b)(2) Communications	-	(14,564)
Section 216(b)(1) Marine Surveillance	-	(993)
Section 214 Energy	-	(105,246)
Disaster assistance Fund	(200,000)	-
Maritime Operations Revolving Fund	(884,084)	(827,180)
Scholarship fund	-	(166,746)
	(3,592,919)	(2,614,729)
Total other financing uses, net	156,887	(1,410,057)
Special items:		
Write-off of receivable balances	2,455,919	944,533
Net change in fund balance	1,157,706	1,022,671
Fund balance at the beginning of the year	17,387,911	16,365,240
Fund balance at the end of the year	\$ 18,545,617	\$ 17,387,911

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

GENERAL FUND

**Statement of Revenues, Expenditures and Changes in Fund Balance -
Budget and Actual, Budgetary Basis
Year Ended September 30, 2008**

	Budgeted Amounts		Actual Amounts	Variance with Final Budget - Positive (Negative)
	Original	Final		
Revenues:				
Local taxes	\$ 10,800,000	\$ 10,800,000	\$ 11,136,477	\$ 336,477
Fishing right fees	13,900,000	15,471,232	17,045,395	1,574,163
Postal revenues	350,000	365,303	431,518	66,215
Investment earnings	1,500,000	497,540	(2,011,414)	(2,508,954)
Fees and charges	-	168,063	1,335,330	1,167,267
Grants	-	-	1,066,088	1,066,088
Other	1,000,000	3,141,347	2,536,435	(604,912)
Total revenues	<u>27,550,000</u>	<u>30,443,485</u>	<u>31,539,829</u>	<u>1,096,344</u>
Expenditures-budgetary basis by department:				
Executive Branch:				
Office of the President	486,610	565,513	560,737	4,776
President's Office Non-operational Projects	50,750	50,750	99,422	(48,672)
Public Information	125,364	110,564	85,632	24,932
Total	<u>662,724</u>	<u>726,827</u>	<u>745,791</u>	<u>(18,964)</u>
Department of External Affairs:				
Administration	257,599	244,699	315,120	(70,421)
Division of APA & Multilateral Affairs	97,658	97,658	89,663	7,995
Division of American and European Affairs	76,141	76,141	63,330	12,811
Preparation for China Embassy	439,454	439,454	361,282	78,172
FSM Consulate - Guam	192,117	195,617	193,909	1,708
FSM Consulate - Honolulu	272,016	277,016	273,787	3,229
FSM Embassy - Tokyo	875,402	875,402	877,755	(2,353)
FSM Embassy - Washington D.C.	401,294	483,304	409,981	73,323
FSM Embassy - Fiji	190,145	233,645	230,184	3,461
FSM Permanent Mission - New York	580,588	557,778	557,565	213
Total	<u>3,382,414</u>	<u>3,480,714</u>	<u>3,372,576</u>	<u>108,138</u>
Department of Health and Social Affairs:				
Personnel	57,384	57,384	47,604	9,780
Women's Interests Unit	44,833	36,751	33,456	3,295
Sports & Youth Unit	93,104	93,104	99,051	(5,947)
Non Operational Programs	74,873	74,873	45,688	29,185
Total	<u>270,194</u>	<u>262,112</u>	<u>225,799</u>	<u>36,313</u>
Department of Education:				
Administration	32,072	32,072	22,377	9,695
Basic Education Support - Aid to Non-public schools	450,000	450,000	450,000	-
Basic Education Support - Others	153,400	153,400	120,157	33,243
Division of Career and Technical Education	171,236	171,236	120,410	50,826
Total	<u>806,708</u>	<u>806,708</u>	<u>712,944</u>	<u>93,764</u>
Department of Resources and Development:				
Administration	163,461	173,461	161,287	12,174
Division of Sectoral Development	418,616	394,616	371,047	23,569
Division of Trade and Investment	128,256	128,256	130,790	(2,534)
Division of Energy	124,503	124,503	73,654	50,849
Resource and Development Non Operational Projects	297,270	297,270	254,076	43,194
Total	<u>1,132,106</u>	<u>1,118,106</u>	<u>990,854</u>	<u>127,252</u>
Office of National archives, cultural and historic prevention:				
Office of the Director	115,378	115,378	118,409	(3,031)
Non operational projects	2,760	52,760	43,106	9,654
Total	<u>118,138</u>	<u>168,138</u>	<u>161,515</u>	<u>6,623</u>
SBOC Office:				
Office of the Director	26,353	26,353	10,511	15,842
Division of Statistics	336,094	325,694	350,685	(24,991)
Division of Overseas Development	34,989	34,989	28,548	6,441
Division of Budget and Economic Management	238,254	238,254	198,200	40,054
Division of Compact Management	478,448	485,248	503,116	(17,868)
Total	<u>1,114,138</u>	<u>1,110,538</u>	<u>1,091,060</u>	<u>19,478</u>
Office of Environment and Emergency Management:				
Office of the Director	-	-	6,438	(6,438)
Division of Sustainable Development	55,771	55,771	46,716	9,055
Division of Emergency Management	34,915	45,915	49,867	(3,952)
Non operational projects	106,783	190,783	186,475	4,308
Total	<u>197,469</u>	<u>292,469</u>	<u>289,496</u>	<u>2,973</u>

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

GENERAL FUND

**Statement of Revenues, Expenditures and Changes in Fund Balance -
Budget and Actual, Budgetary Basis, Continued
Year Ended September 30, 2006**

	Budgeted Amounts		Actual Amounts	Variance with Final Budget - Positive (Negative)
	Original	Final		
Expenditures-budgetary basis by department, continued:				
Department of Transportation, Communication & Infrastructure:				
Administration	173,481	328,660	330,212	(1,552)
Division of Marine Transportation	119,937	116,937	98,490	18,447
Division of Infrastructure	393,295	483,704	457,238	26,466
Civil Aviation	81,335	86,445	51,857	34,588
Communication	116,893	168,544	184,304	(15,760)
Drydocking of Caroline Voyager	750,000	750,000	865,381	(115,381)
Other National Programs	600,690	600,690	601,484	(794)
Total	2,235,631	2,534,980	2,588,966	(53,986)
Department of Finance and Administration:				
Administration	200,326	198,649	145,520	53,129
Division of National Treasury & Investment	529,066	526,862	525,751	1,111
Division of Customs and Tax Administration	766,167	757,490	750,115	7,375
Division of Personnel	955,409	1,006,463	876,920	129,543
Investment & International Finance	137,272	137,272	132,030	5,242
Maintenance fee for FMIS	120,000	120,000	95,148	24,852
Reimbursible	206,216	206,216	206,216	-
Finance Non operational Projects and Adjustments	200,000	200,000	227,169	(27,169)
Total	3,114,456	3,152,952	2,958,869	194,083
Department of Justice:				
Administration	236,943	260,943	260,660	283
Registry of Corporation	33,763	36,763	29,652	7,111
Division of Law	187,916	195,917	195,806	111
Division of Litigation	173,336	185,836	188,127	(2,291)
Division of Immigration & Labor	742,414	814,886	863,872	(48,986)
FSM National Police	1,904,552	2,077,152	2,074,025	3,127
Other Programs	27,657	27,657	15,682	11,975
Joint Law	177,173	177,173	144,513	32,660
Total	3,483,754	3,776,327	3,772,337	3,990
Office of the Public Defender				
Total Executive Branch	833,832	833,832	742,693	91,139
Judicial Branch	1,341,194	1,364,194	1,225,917	138,277
Legislative Branch:				
Office of the Speaker	1,738,229	1,844,729	1,613,699	231,030
Congress staff	1,277,450	1,318,950	1,279,282	39,668
Delegation offices	532,487	544,487	594,744	(50,257)
Legislative committees	37,000	37,000	34,542	2,458
Total Legislative Branch	3,585,166	3,745,166	3,522,267	222,899
Office of the Public Auditor				
Public Auditor	916,182	916,182	783,899	132,283
Single Audit	336,630	336,630	504,101	(167,471)
Total Office of the Public Auditor	1,252,812	1,252,812	1,288,000	(35,188)
Other National Government Programs:				
FEMA Matching	39,524	39,524	37,891	1,633
National Election Director	383,960	383,960	378,134	5,826
Micronesia Legal Services Corporation	150,000	150,000	150,000	-
FSM Red Cross	70,000	95,000	70,000	25,000
Fisheries Marine Institute	650,000	650,000	650,000	-
2009 National Election	245,000	245,000	38,737	206,263
Other	90,588	90,588	68,469	22,119
Total Other National Government Programs	1,629,072	1,654,072	1,393,231	260,841

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

GENERAL FUND

**Statement of Revenues, Expenditures and Changes in Fund Balance -
Budget and Actual, Budgetary Basis, Continued
Year Ended September 30, 2007**

	Budgeted Amounts		Actual Amounts	Variance with Final Budget - Positive (Negative)
	Original	Final		
Expenditures-budgetary basis by department, continued:				
Board and Commissions:				
Micronesia Maritime Authority	432,081	432,081	287,433	144,648
FSM Banking Board	247,256	247,256	174,910	72,346
Board of Regents-COM	58,000	58,000	58,000	-
Postal Services	688,073	706,073	706,277	(204)
National Board of Nursing	15,734	15,734	8,011	7,723
Total Boards and Commissions	<u>1,441,144</u>	<u>1,459,144</u>	<u>1,234,631</u>	<u>224,513</u>
Payments to component units:				
FSM Petroleum Corporation	50,000	50,000	32,228	17,772
Copra Subsidy	50,000	50,000	50,000	-
Coconut Development Authority	139,079	139,079	169,748	(30,669)
National Fisheries Corporation	135,000	135,000	135,000	-
COM-FSM	270,000	270,000	620,000	(350,000)
Total payments to component units	<u>644,079</u>	<u>644,079</u>	<u>1,006,976</u>	<u>(362,897)</u>
Public Projects	<u>8,208,110</u>	<u>8,208,110</u>	<u>3,606,754</u>	<u>4,601,356</u>
Total expenditures	<u>35,453,141</u>	<u>36,591,280</u>	<u>30,930,675</u>	<u>5,660,605</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(7,903,141)</u>	<u>(6,147,795)</u>	<u>609,154</u>	<u>6,756,949</u>
Other financing sources (uses):				
Operating Transfer in:				
OIA Capital Projects	-	-	78,822	78,822
Compact Capital Projects	-	-	3,258,433	3,258,433
Fisheries Observer Revolving Fund	-	-	78,247	78,247
Passport Revolving Fund	-	-	334,304	334,304
Total Operating Transfer in	<u>-</u>	<u>-</u>	<u>3,749,806</u>	<u>3,749,806</u>
Operating Transfer out:				
Disaster Assistance Fund	200,000	200,000	200,000	-
FSM Trust Fund	1,500,000	2,500,000	2,508,835	(8,835)
Maritime Revolving Fund	884,084	884,084	884,084	-
Total Operating Transfer out	<u>2,584,084</u>	<u>3,584,084</u>	<u>3,592,919</u>	<u>(8,835)</u>
Total other financing sources (uses), net	<u>(2,584,084)</u>	<u>(3,584,084)</u>	<u>156,887</u>	<u>3,740,971</u>
Special items:				
Write-off of receivable balances	<u>(1,000,000)</u>	<u>(1,000,000)</u>	<u>2,455,919</u>	<u>3,455,919</u>
Net change in unreserved fund balance	<u>(9,487,225)</u>	<u>(8,731,879)</u>	<u>(1,689,878)</u>	<u>7,042,001</u>
Unreserved fund balance at beginning of year	6,124,246	6,124,246	6,124,246	
Other changes in unreserved fund balance:				
Increase in reserve for related assets, net of others	-	-	(1,168,727)	(1,168,727)
Increase in reserve for continuing appropriations	-	-	(1,999,374)	(1,999,374)
Unreserved fund balance at end of year	<u>\$ (3,362,979)</u>	<u>\$ (2,607,633)</u>	<u>\$ 1,266,267</u>	<u>\$ 3,873,900</u>

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

NONMAJOR GOVERNMENTAL FUNDS

Combining Balance Sheet
September 30, 2008

	26	27	28	29	31	32	33	34	35	38	39	89	Total
	Disaster Relief	Permit Revolving Fund	Filling Office Revolving	Maritime Operations Revolving	Passport Revolving	Aquaculture Revolving	Fisheries Observer Revolving	Medical Revolving	Nurse Board Revolving	Student Loans	Scholarship Fund	FSM Trust	
ASSETS													
Equity in internal investment pool	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 3,676,839	\$ 3,676,839
Due from other funds	<u>534,304</u>	<u>350,272</u>	<u>13,315</u>	<u>110,923</u>	<u>103,649</u>	<u>40,731</u>	<u>116,442</u>	<u>5,516</u>	<u>11,121</u>	<u>609,012</u>	<u>151,239</u>	<u>-</u>	<u>2,046,524</u>
Total assets	<u>\$ 534,304</u>	<u>\$ 350,272</u>	<u>\$ 13,315</u>	<u>\$ 110,923</u>	<u>\$ 103,649</u>	<u>\$ 40,731</u>	<u>\$ 116,442</u>	<u>\$ 5,516</u>	<u>\$ 11,121</u>	<u>\$ 609,012</u>	<u>\$ 151,239</u>	<u>\$ 3,676,839</u>	<u>\$ 5,723,363</u>
LIABILITIES AND FUND BALANCES													
Liabilities:													
Accounts payable	\$ -	\$ -	\$ -	\$ 19,187	\$ 3,649	\$ -	\$ 3,472	\$ -	\$ -	\$ -	\$ 1,000	\$ -	\$ 27,308
Total liabilities	<u>-</u>	<u>-</u>	<u>-</u>	<u>19,187</u>	<u>3,649</u>	<u>-</u>	<u>3,472</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,000</u>	<u>-</u>	<u>27,308</u>
Fund balances:													
Reserved for:													
Encumbrances	-	-	-	14,678	34,850	8,362	39,570	-	147	-	-	-	97,607
Unreserved:													
Special revenue funds	534,304	350,272	13,315	77,058	65,150	32,369	73,400	5,516	10,974	609,012	150,239	-	1,921,609
Permanent funds	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>3,676,839</u>	<u>3,676,839</u>
Total fund balances	<u>534,304</u>	<u>350,272</u>	<u>13,315</u>	<u>91,736</u>	<u>100,000</u>	<u>40,731</u>	<u>112,970</u>	<u>5,516</u>	<u>11,121</u>	<u>609,012</u>	<u>150,239</u>	<u>3,676,839</u>	<u>5,696,055</u>
Total liabilities and fund balances	<u>\$ 534,304</u>	<u>\$ 350,272</u>	<u>\$ 13,315</u>	<u>\$ 110,923</u>	<u>\$ 103,649</u>	<u>\$ 40,731</u>	<u>\$ 116,442</u>	<u>\$ 5,516</u>	<u>\$ 11,121</u>	<u>\$ 609,012</u>	<u>\$ 151,239</u>	<u>\$ 3,676,839</u>	<u>\$ 5,723,363</u>

See Accompanying Independent Auditors' Report

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

NONMAJOR GOVERNMENTAL FUNDS

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

	26	27	28	29	31	32	33	34	35	38	39	89	Total
	Disaster Relief	Permit Revolving Fund	Filling Office Revolving	Maritime Operations Revolving	Passport Revolving	Aquaculture Revolving	Fisheries Observer Revolving	Medical Revolving	Nurse Board Revolving	Student Loans	Scholarship Fund	FSM Trust	
Revenues:													
Fees and charges	\$ -	\$ 190,635	\$ 1,735	\$ 99,661	\$ 414,975	\$ 17,040	\$ 148,863	\$ 410	\$ 961	\$ 2,203	\$ 160,633	\$ -	\$ 1,037,116
Net decrease in the fair value of investments	-	-	-	-	-	-	-	-	-	-	-	(526,446)	(526,446)
Interest and dividends	-	-	-	-	-	-	-	-	-	-	-	760	760
Other	-	-	-	-	-	-	-	-	-	-	-	-	-
Total revenues	<u>-</u>	<u>190,635</u>	<u>1,735</u>	<u>99,661</u>	<u>414,975</u>	<u>17,040</u>	<u>148,863</u>	<u>410</u>	<u>961</u>	<u>2,203</u>	<u>160,633</u>	<u>(525,686)</u>	<u>511,430</u>
Expenditures by function:													
Current:													
General government:													
Justice	-	-	-	-	80,671	-	-	-	-	-	-	-	80,671
Education	-	-	-	-	-	-	-	-	-	-	219,434	-	219,434
Health and social affairs	-	-	-	-	-	-	-	-	3,407	-	-	-	3,407
Transportation, communication and infrastructure	-	-	-	1,090,546	-	-	-	-	-	-	-	-	1,090,546
Agencies, boards and commissions	-	-	-	-	-	-	68,854	-	-	-	-	-	68,854
Total expenditures	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,090,546</u>	<u>80,671</u>	<u>-</u>	<u>68,854</u>	<u>-</u>	<u>3,407</u>	<u>-</u>	<u>219,434</u>	<u>-</u>	<u>1,462,912</u>
Excess (deficiency) of revenues over (under) expenditures	<u>-</u>	<u>190,635</u>	<u>1,735</u>	<u>(990,885)</u>	<u>334,304</u>	<u>17,040</u>	<u>80,009</u>	<u>410</u>	<u>(2,446)</u>	<u>2,203</u>	<u>(58,801)</u>	<u>(525,686)</u>	<u>(951,482)</u>
Other financing sources (uses):													
Operating transfers in	200,000	-	-	884,084	-	-	-	-	-	-	-	2,508,835	3,592,919
Operating transfers out	-	-	-	-	(334,304)	-	(78,247)	-	-	-	-	-	(412,551)
Total other financing sources (uses), net	<u>200,000</u>	<u>-</u>	<u>-</u>	<u>884,084</u>	<u>(334,304)</u>	<u>-</u>	<u>(78,247)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>2,508,835</u>	<u>3,180,368</u>
Net change in fund balances	200,000	190,635	1,735	(106,801)	-	17,040	1,762	410	(2,446)	2,203	(58,801)	1,983,149	2,228,886
Fund balances at the beginning of the year	334,304	159,637	11,580	198,537	100,000	23,691	111,208	5,106	13,567	606,809	209,040	1,693,690	3,467,169
Fund balances at the end of the year	<u>\$ 534,304</u>	<u>\$ 350,272</u>	<u>\$ 13,315</u>	<u>\$ 91,736</u>	<u>\$ 100,000</u>	<u>\$ 40,731</u>	<u>\$ 112,970</u>	<u>\$ 5,516</u>	<u>\$ 11,121</u>	<u>\$ 609,012</u>	<u>\$ 150,239</u>	<u>\$ 3,676,839</u>	<u>\$ 5,696,055</u>

See Accompanying Independent Auditors' Report

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

GRANTS ASSISTANCE FUND

Combining Balance Sheet
September 30, 2008

	10	11	12	13	14	15	19	20	23	49	51	97	Total
	Section 211(a)(1) Education Sector	Section 211(a)(2) Health Sector	Section 211(a)(5) Environment	Section 211(a)(3) Private Sector Development	Section 211(a)(4) Capacity Building	Supplemental Education	Section 211(a)(6) Infrastructure	U.S. Federal Grants	Non-U.S. Grants	OIA Capital Projects	Compact Capital Projects	NOAA Reimbursable	Total
ASSETS													
Receivables:													
Federal agencies	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 1,172,756	\$ 7,065,482	\$ -	\$ -	\$ -	\$ -	\$ 8,238,238
Other governments and agencies	-	-	-	-	-	-	-	40,516	-	-	-	-	40,516
Due from other funds	-	9,763	-	19,069	179,447	-	-	870,762	1,735,891	-	-	30,078	2,845,010
Advances	3,049	15,107	9,853	3,217	7,362	5,060	9,114	1,542,116	-	-	-	-	1,594,878
	<u>\$ 3,049</u>	<u>\$ 24,870</u>	<u>\$ 9,853</u>	<u>\$ 22,286</u>	<u>\$ 186,809</u>	<u>\$ 5,060</u>	<u>\$ 1,181,870</u>	<u>\$ 9,518,876</u>	<u>\$ 1,735,891</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 30,078</u>	<u>\$ 12,718,642</u>
LIABILITIES AND FUND BALANCES													
Liabilities:													
Accounts payable	\$ 12,700	\$ 27,191	\$ 14,406	\$ 5,438	\$ 18,686	\$ 16,652	\$ 373,557	\$ 3,014,207	\$ 65,863	\$ -	\$ -	\$ 30,078	\$ 3,578,778
Retention payable	-	-	-	-	-	-	97,237	305,332	-	-	-	-	402,569
Due to component units	-	-	-	-	-	-	-	51,916	-	-	-	-	51,916
Due to federal agencies	-	-	-	-	-	-	-	1,542,116	-	-	-	-	1,542,116
Due to FSM State Governments	-	-	-	-	-	-	-	4,631,070	-	-	-	-	4,631,070
Due to other funds	72,360	-	3,488	-	-	48,800	823,257	-	-	-	-	-	947,905
Deferred revenues	-	-	-	-	-	-	-	-	1,688,522	-	-	-	1,688,522
Total liabilities	<u>85,060</u>	<u>27,191</u>	<u>17,894</u>	<u>5,438</u>	<u>18,686</u>	<u>65,452</u>	<u>1,294,051</u>	<u>9,544,641</u>	<u>1,754,385</u>	<u>-</u>	<u>-</u>	<u>30,078</u>	<u>12,842,876</u>
Fund balances (deficits):													
Reserved for:													
Encumbrances	30,356	184,480	16,949	21,018	1,129,027	74,943	7,962,977	44,525,003	263,453	-	-	31,976	54,240,182
Continuing appropriations	-	-	-	-	-	-	36,098,750	-	-	-	-	-	36,098,750
Unreserved (deficits)	(112,367)	(186,801)	(24,990)	(4,170)	(960,904)	(135,335)	(44,173,908)	(44,550,768)	(281,947)	-	-	(31,976)	(90,463,166)
Total fund balances (deficits)	<u>(82,011)</u>	<u>(2,321)</u>	<u>(8,041)</u>	<u>16,848</u>	<u>168,123</u>	<u>(60,392)</u>	<u>(112,181)</u>	<u>(25,765)</u>	<u>(18,494)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(124,234)</u>
Total liabilities and fund balances	<u>\$ 3,049</u>	<u>\$ 24,870</u>	<u>\$ 9,853</u>	<u>\$ 22,286</u>	<u>\$ 186,809</u>	<u>\$ 5,060</u>	<u>\$ 1,181,870</u>	<u>\$ 9,518,876</u>	<u>\$ 1,735,891</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 30,078</u>	<u>\$ 12,718,642</u>

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

GRANTS ASSISTANCE FUND

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

	10	11	12	13	14	15	19	20	23	49	51	97	(120,410)
	Section 211(a)(1) Education Sector	Section 211(a)(2) Health Sector	Section 211(a)(5) Environment	Section 211(a)(3) Private Sector Development	Section 211(a)(4) Capacity Building	Supplemental Education	Section 211(a)(6) Infrastructure	U.S. Federal Grants	Non-U.S. Grants	OIA Capital Projects	Compact Capital Projects	NOAA Reimbursable	Total
Revenues:													
Compact funding	\$ 445,234	\$ 429,129	\$ (8,243)	\$ 41,330	\$ 852,003	\$ 128,892	\$ 4,748,564	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 6,636,909
Federal and other grants	-	-	-	-	-	-	-	17,703,766	1,018,422	-	-	1,216,277	19,938,465
	<u>445,234</u>	<u>429,129</u>	<u>(8,243)</u>	<u>41,330</u>	<u>852,003</u>	<u>128,892</u>	<u>4,748,564</u>	<u>17,703,766</u>	<u>1,018,422</u>	<u>-</u>	<u>-</u>	<u>1,216,277</u>	<u>26,575,374</u>
Expenditures by function:													
Current:													
General government:													
Legislature	-	-	-	-	-	-	-	-	-	-	15,000	-	15,000
Office of the National Public Auditor	-	-	-	-	106,777	-	-	473,057	1,011	-	-	-	580,845
Finance and administration	-	-	-	-	763,118	-	-	569,058	-	-	-	-	1,332,176
SBOC Office	-	-	-	-	64,575	-	-	1,215	-	-	-	-	65,790
Justice	-	-	-	-	-	-	-	-	16,386	-	-	-	16,386
Resources and development	-	-	-	-	-	-	-	78,322	495,889	-	-	-	574,211
Environment and emergency management	-	-	33,374	-	-	-	-	337,431	30,033	-	-	-	400,838
National archives, cultural and historic preservation	-	-	-	24,484	-	-	-	148,979	-	-	-	-	173,463
Education	490,225	-	-	-	-	381,912	-	2,046,536	-	-	-	-	2,918,673
Health and social affairs	-	585,547	-	-	-	-	-	3,428,446	475,885	-	-	-	4,489,878
Transportation, communication and infrastructure	-	-	-	-	-	-	522,990	2,394,396	-	-	7,500	-	2,924,886
National government programs	-	-	-	-	-	-	-	-	-	-	51,834	1,216,277	1,268,111
Agencies, boards and commissions	-	-	-	-	-	-	-	-	-	-	875	-	875
Payments to component units	-	-	-	-	-	-	-	118,319	-	-	-	-	118,319
Capital Projects	-	-	-	-	-	-	4,225,574	8,108,007	-	-	-	-	12,333,581
Total expenditures	<u>490,225</u>	<u>585,547</u>	<u>33,374</u>	<u>24,484</u>	<u>934,470</u>	<u>381,912</u>	<u>4,748,564</u>	<u>17,703,766</u>	<u>1,019,204</u>	<u>-</u>	<u>75,209</u>	<u>1,216,277</u>	<u>27,213,032</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(44,991)</u>	<u>(156,418)</u>	<u>(41,617)</u>	<u>16,846</u>	<u>(82,467)</u>	<u>(253,020)</u>	<u>-</u>	<u>-</u>	<u>(782)</u>	<u>-</u>	<u>(75,209)</u>	<u>-</u>	<u>(637,658)</u>
Other financing sources (uses):													
Operating transfers out	-	-	-	-	-	-	-	-	-	(78,822)	(3,258,433)	-	(3,337,255)
Total other financing sources (uses), net	-	-	-	-	-	-	-	-	-	(78,822)	(3,258,433)	-	(3,337,255)
Net change in fund balances (deficit)	(44,991)	(156,418)	(41,617)	16,846	(82,467)	(253,020)	-	-	(782)	(78,822)	(3,333,642)	-	(3,974,913)
Fund balances (deficit) at the beginning of the year	(37,020)	154,097	33,576	2	250,590	192,628	(112,181)	(25,765)	(17,712)	78,822	3,333,642	-	3,850,679
Fund balances (deficit) at the end of the year	<u>\$ (82,011)</u>	<u>\$ (2,321)</u>	<u>\$ (8,041)</u>	<u>\$ 16,848</u>	<u>\$ 168,123</u>	<u>\$ (60,392)</u>	<u>\$ (112,181)</u>	<u>\$ (25,765)</u>	<u>\$ (18,494)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (124,234)</u>

See Accompanying Independent Auditors' Report.

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

Honorable Emmanuel Mori
President
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 Federated States of Micronesia (FSM) National Government as of and for the year ended September 30, 2008, which collectively comprise the FSM National Government's basic financial statements, and have issued our report thereon dated June 30, 2009, which was qualified with respect to: 1) the effect on the determination of revenues and expenditures/expenses for governmental activities, the General Fund, the Grants Assistance Fund, and the aggregate remaining fund information for the year ended September 30, 2008, due to the inadequacy of accounting records concerning receivables, advances, amounts due to the FSM State Governments and deferred revenues for the governmental activities; receivables, advances and amounts due to the FSM State Governments for the General Fund; receivables and amounts due to the FSM State Governments for the Grants Assistance Fund; and deferred revenues for the aggregate remaining fund information at September 30, 2007; 2) the lack of audited financial statements of Micronesia Longline Fishing Company, Yap Fishing Corporation, Yap Fresh Tuna, Inc., Chuuk Fresh Tuna, Inc., and Kosrae Sea Venture, Inc.; and 3) the lack of audited financial statements of the National Fisheries Corporation and the FSM Petroleum Corporation. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

For purposes of this report, our consideration of internal control over financial reporting and our tests of compliance with certain provisions of laws, regulations, contracts and grants, and other matters did not include the FSM Social Security Administration, the FSM Telecommunications Corporation, the FSM Development Bank, the FSM National Fisheries Corporation, the College of Micronesia-FSM, the FSM Coconut Development Authority, and the MiCare Plan, Inc., 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 FSM National Government's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the FSM National Government's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the FSM National Government's internal control over financial reporting.

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

A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies described in the accompanying Schedule of Findings and Questioned Costs (pages 85 through 117) as items 2008-11 through 2008-16 to be significant deficiencies in internal control over financial reporting.

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

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that the significant deficiencies described above are material weaknesses.

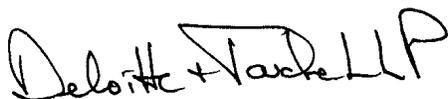
Compliance and Other Matters

As part of obtaining reasonable assurance about whether the FSM National Government's basic 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 one instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards* and which is described in the accompanying Schedule of Findings and Questioned Costs as item 2007-15.

We noted certain matters that we reported to management of the FSM National Government in a separate letter dated June 30, 2009.

The FSM National Government'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 FSM National Government's responses and, accordingly, we express no opinion on them.

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



June 30, 2009

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

Honorable Emmanuel Mori
President
Federated States of Micronesia:

Compliance

We have audited the compliance of the Federated States of Micronesia (FSM) National Government 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 FSM National Government's major federal programs are identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs (pages 85 through 117). Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the FSM National Government's management. Our responsibility is to express an opinion on the FSM National Government's compliance based on our audit.

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

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the FSM National Government'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 of the FSM National Government's compliance with those requirements.

As described in items 2008-01, 2008-02, 2008-04, 2008-05, 2008-06, 2008-10, and 2008-13 in the accompanying Schedule of Findings and Questioned Costs, the FSM National Government did not comply with requirements regarding allowable costs/cost principles, cash management, equipment and real property management, procurement and suspension and debarment, and reporting that are applicable to its major programs, respectively, as described in the Federal Award Findings and Questioned Cost Section of the accompanying Schedule of Findings and Questioned Costs (page 85). Compliance with such requirements is necessary, in our opinion, for the FSM National Government to comply with the requirements applicable to those programs.

In our opinion, except for the noncompliance described in the preceding paragraph, the FSM National Government complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended September 30, 2008. The results of our auditing procedures also disclosed other instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying Schedule of Findings and Questioned Costs as items 2008-01, 2008-03, 2008-07, 2008-08, 2008-09, 2008-12, and 2008-15.

Internal Control Over Compliance

The management of the FSM National Government 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 FSM National Government'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 FSM National Government's internal control over compliance.

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

A *control deficiency* in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs as items 2008-01 through 2008-12, 2008-13 and 2008-15 to be significant deficiencies.

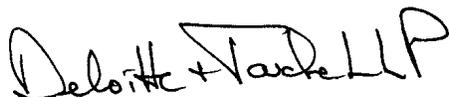
A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. Of the significant deficiencies in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs, we consider items 2008-01, 2008-02, 2008-04, 2008-05, 2008-06, 2008-10, and 2008-13 to be material weaknesses.

The FSM National Government'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 FSM National Government'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 Federated States of Micronesia (FSM) National Government as of and for the year ended September 30, 2008, which collectively comprise the FSM National Government's basic financial statements, and have issued our report thereon dated June 30, 2009, which was qualified with respect to: 1) the effect on the determination of revenues and expenditures/expenses for governmental activities, the General Fund, the Grants Assistance Fund, and the aggregate remaining fund information for the year ended September 30, 2008, due to the inadequacy of accounting records concerning receivables, advances, amounts due to the FSM State Governments and deferred revenues for the governmental activities; receivables, advances and amounts due to the FSM State Governments for the General Fund; receivables and amounts due to the FSM State Governments for the Grants Assistance Fund; and deferred revenues for the aggregate remaining fund information at September 30, 2007; 2) the lack of audited financial statements of Micronesia Longline Fishing Company, Yap Fishing Corporation, Yap Fresh Tuna, Inc., Chuuk Fresh Tuna, Inc., and Kosrae Sea Venture, Inc.; and 3) the lack of audited financial statements of the National Fisheries Corporation and the FSM Petroleum Corporation. Our audit was performed for the purpose of forming our opinion on the financial statements that collectively comprise the FSM National Government's basic financial statements. The accompanying Schedule of Expenditures of Federal Awards (pages 73 through 83) 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 FSM National Government. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had accounting records regarding amounts due to the FSM State Governments for the U.S. Federal Grants Fund been reconciled for prior periods, 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 FSM National Government, federal awarding agencies, pass-through entities and the cognizant audit and other federal agencies, and is not intended to be and should not be used by anyone other than these specified parties.



June 30, 2009

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

<u>Agency/Program</u>	<u>Expenditures</u>	<u>Amounts Passed-Through to Subrecipients</u>
U.S. Department of Agriculture	\$ 76,125	\$ 165,415
U.S. Department of Commerce	1,218,474	-
U.S. Department of the Interior	8,378,088	55,603,463
U.S. Department of Labor	-	418,013
U.S. Department of Transportation	10,508,579	-
U.S. Department of Homeland Security	335,161	4,085,027
U.S. Department of Education	2,006,034	2,566,847
U.S. Department of Health and Human Services	3,588,264	1,461,868
Institute of Museum and Library Services	<u>6,621</u>	<u>-</u>
 GRAND TOTAL	 <u>\$ 26,117,346</u>	 <u>\$ 64,300,633</u>
 Note: All grant awards are received from the respective grantor agencies in a direct capacity.		
Reconciliation to the financial statements:		
Expenditures for U.S. Federal Grants (page 67)	\$ 17,703,766	
Expenditures for NOAA (page 67)	1,216,277	
Expenditures for Compact Sector (page 67)	7,198,576	
Others	<u>1,273</u>	
 Total expenditures per financial statements	 <u>\$ 26,119,892</u>	

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

<u>Agency/Program</u>	<u>Federal CFDA Number</u>	<u>Expenditures</u>	<u>Amounts Passed-Through to Subrecipients</u>
U.S. DEPARTMENT OF AGRICULTURE			
Rural Self-Help Housing Technical Assistance	10.420	\$ -	\$ -
Forestry Research	10.652	-	33,316
Cooperative Forestry Assistance	10.664	-	16,800
Urban and Community Forestry Program	10.675	76,125	60,586
Forest Stewardship Program	10.678	-	13,389
Community Facility Loans and Grants	10.766	-	-
Rural Sanitation Project	10.999	-	41,324
		<u>-</u>	<u>41,324</u>
U.S. DEPARTMENT OF AGRICULTURE TOTAL		<u>\$ 76,125</u>	<u>\$ 165,415</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

<u>Agency/Program</u>	<u>Federal CFDA Number</u>	<u>Expenditures</u>	<u>Amounts Passed-Through to Subrecipients</u>
U.S. DEPARTMENT OF COMMERCE			
Anadromous Fish Conservation Act Program	11.405	\$ -	\$ -
Financial Assistance for National Centers for Coastal Ocean Science	11.426	2,197	-
Special Oceanic and Atmospheric Projects -NOAA	11.460	<u>1,216,277</u>	<u>-</u>
U.S. DEPARTMENT OF COMMERCE		<u>\$ 1,218,474</u>	<u>\$ -</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

<u>Agency/Program</u>	<u>Federal CFDA Number</u>	<u>Expenditures</u>	<u>Amounts Passed-Through to Subrecipients</u>
U.S. DEPARTMENT OF THE INTERIOR			
Economic, Social and Political Development of the Territories	15.875		
Compact Capital Account		\$ -	\$ 302,840
Compact Energy Grant		-	52,930
Compact Communications-One Time		-	-
Compact Marine Surveillance-Annual		-	-
Compact Health and Medical 216(a)		-	225,479
Compact Post Secondary Education		-	-
Compact Marine Surveillance-One Time		-	-
Compact Scholarship Grant		-	-
Compact Special Block Grant 221(b)		-	287,508
Compact Sector Funds:			
Infrastructure		4,748,564	865,326
Education		490,225	21,751,549
Health		585,547	15,319,825
Capacity		934,470	3,143,648
Environment		33,374	1,550,328
Private		24,484	1,827,904
Compact Supplemental Ed		381,912	9,311,429
Subtotal Compact Sector Funds		<u>7,198,576</u>	<u>53,770,009</u>
Technical Assistance:			
Single Audit		409,562	-
Other Technical Assistance:		628,169	
Technical Assistance OIA/DOI Other		-	792,860
		<u>1,037,731</u>	<u>792,860</u>
Total CFDA #15.875		8,236,307	55,431,626
Historic Preservation Fund Grants-In-Aid	15.904	141,781	171,837
U.S. DEPARTMENT OF THE INTERIOR TOTAL		<u>\$ 8,378,088</u>	<u>\$ 55,603,463</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

<u>Agency/Program</u>	<u>Federal CFDA Number</u>	<u>Expenditures</u>	<u>Amounts Passed-Through to Subrecipients</u>
U.S. DEPARTMENT OF LABOR			
Employment Services and Job Training Pilots-Demonstrations and Research	17.249	\$ -	\$ -
Workforce Investment Act	17.255	-	9,220
WIA Adult Program	17.258	-	30,755
WIA Youth Activities	17.259	-	16,518
WIA Dislocated Workers - WIA National Emergency/TS Chat	17.260	-	329,552
WIA Dislocated Workers	17.260	-	31,968
U.S. DEPARTMENT OF LABOR TOTAL		\$ -	\$ 418,013

See accompanying notes to Schedule of Expenditures of Federal Awards.

**NATIONAL GOVERNMENT
FEDERATED STATES OF MICRONESIA**

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

<u>Agency/Program</u>	<u>Federal CFDA Number</u>	<u>Expenditures</u>	<u>Amounts Passed-Through to Subrecipients</u>
U.S. DEPARTMENT OF TRANSPORTATION			
Airport Improvement Program	20.106	\$ <u>10,508,579</u>	\$ <u> -</u>
U.S. DEPARTMENT OF TRANSPORTATION TOTAL		\$ <u><u>10,508,579</u></u>	\$ <u><u> -</u></u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

<u>Agency/Program</u>	<u>Federal CFDA Number</u>	<u>Expenditures</u>	<u>Amounts Passed-Through to Subrecipients</u>
U.S. DEPARTMENT OF HOMELAND SECURITY			
Public Assistance Grants - Typhoon Fern HMGP/Subgrantee	83.544	\$ -	\$ 4,170
Public Assistance Grants - Public Assistance (Presidentially Declared Disasters) (B)	97.036	233,606	3,420,097
Individual and Family Grants - FEMA 1427/IFG Admin. Cost	83.543	-	-
Hazard Mitigation Grant	83.548	73,250	494,134
Hazard Mitigation Grant	97.039	-	166,626
Crisis Counseling	97.032	-	-
Emergency Management Performance Grants	97.042	<u>28,305</u>	<u>-</u>
U.S. DEPARTMENT OF HOMELAND SECURITY TOTAL		<u>\$ 335,161</u>	<u>\$ 4,085,027</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

<u>Agency/Program</u>	<u>Federal CFDA Number</u>	<u>Expenditures</u>	<u>Amounts Passed-Through to Subrecipients</u>
U.S. DEPARTMENT OF EDUCATION			
Adult Education-State Grant Program	84.002A	\$ -	\$ -
Special Education - Grants to States	84.027	2,006,034	2,550,481
Public Library Services (LSCA - Title I)	84.034	-	-
Career and Technical Education -- Basic Grants to States	84.048B	-	13,568
Byrd Honors Scholarship	84.185A	-	-
Bilingual Education-Professional Development	84.195	-	-
Freely Associated States - Educational Grant Program	84.256A	-	-
Goals 2000-State and Local Education Systemic Improvement Grants	84.276A	-	-
School To Work Opportunities	84.278	-	-
Bilingual Education-Comprehensive School Grants	84.290	-	-
Teacher Quality Enhancement Grants	84.336A	-	2,798
Vocational Education-Occupational and Employment Information State Grants	84.346A	-	-
Pacific Vocational Education Improvement Program	84.994	-	-
		<u> </u>	<u> </u>
U.S. DEPARTMENT OF EDUCATION TOTAL		<u>\$ 2,006,034</u>	<u>\$ 2,566,847</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

<u>Agency/Program</u>	<u>Federal CFDA Number</u>	<u>Expenditures</u>	<u>Amounts Passed-Through to Subrecipients</u>
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES			
Public Health and Social Services Emergency Fund	93.003	\$ 114,830	\$ -
Maternal and Child Health Federal Consolidated Programs	93.110	65,781	19,381
Project Grants and Cooperative Agreements for Tuberculosis Control Programs	93.116	132,425	66,418
<u>Health Activities Recommendation Panel Health Activities - Tobacco Use Prevention Progr</u>	93.203	135,205	
Family Planning-Services	93.217	256,487	174,032
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	-	236,074
Immunization Grants	93.268	655,028	199,696
Abstinence Education Program	93.235	7,898	-
Substance Abuse and Mental Health Services - Projects of Regional and National Significance	93.243	-	-
Centers for Disease Control and Prevention-Investigations and Technical Assistance	93.283	-	50,783
National Bioterrorism Hospital Preparedness Program	93.889	753,971	57,756
HIV Care Formula Grants	93.917	38,636	9,231
Cooperative Agreements to Support Comprehensive School Health Programs to Prevent the Spread of HIV and Other Important Health Problems	93.938	47,875	-
HIV Prevention Activities-Health Department Based Epidemiologic Research Studies of AIDS and HIV Infection in Selected Population Groups	93.940	-	76,539
HIV/AIDS Surveillance	93.943	128,188	-
HIV/AIDS Surveillance	93.944	7,022	9,173
Block Grants for Community Mental Health Services	93.958	118,306	-
Block Grants for Prevention and Treatment of Substance Abuse	93.959	389,034	282,473
Preventive Health Services - Sexually Transmitted Diseases Control Grants	93.977	47,028	6,800
Cooperative Agreements for State-Based Diabetes Control Programs and Evaluation of Surveillance Systems	93.988	79,998	38,575
Preventive Health and Health Services Block Grant	93.991	72,675	14,952
Maternal and Child Health Services Block Grant to the States	93.994	251,189	193,510
Unknown	93.18C	-	-
Small Business Innovation Research (NIAAA, NIDA, NIMH)	93.126	49,074	-
Centers for Disease Control and Prevention-Investigations and Technical Assistance - Comp	93.283	236,947	-
Occupational Health and Safety Surveillance	93.957	667	
Pacific Cancer Initiative	93.Unknown	-	26,475
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES TOTAL		<u>\$ 3,588,264</u>	<u>\$ 1,461,868</u>
INSTITUTE OF MUSEUM AND LIBRARY SERVICES			
Museums for America	45.301	<u>\$ 6,621</u>	<u>\$ -</u>
INSTITUTE OF MUSEUM AND LIBRARY SERVICES		<u>\$ 6,621</u>	<u>\$ -</u>
GRAND TOTAL		<u>\$ 26,117,346</u>	<u>\$ 64,300,633</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

1. Scope of Audit

The Federated States of Micronesia (FSM) is a governmental entity governed by its own Constitution. All significant operations of the FSM 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 FSM's cognizant agency for Single Audit. All programs are received in a direct capacity from the specified grantor agency.

a. Programs Subject to Single Audit

- U.S. Department of Agriculture
- U.S. Department of Education
- U.S. Department of Health and Human Services
- U.S. Department of the Interior
- U.S. Department of Labor
- U.S. Department of Homeland Security
- U.S. Department of Commerce
- U.S. Department of Transportation
- Institute of Museum and Library Services

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. The Schedule of Expenditures of Federal Awards is prepared 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 FSM National Government'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 FSM National Government, as defined above, for the year ended September 30, 2008.

C. Indirect Cost Allocation

The FSM National Government did not receive an indirect cost allocation and did not charge indirect costs against federal programs in fiscal year 2008.

D. 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.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

2. Summary of Significant Accounting Policies, Continued

E. Subgrantees

Certain program funds are passed through the FSM National Government to subrecipients. The Schedule of Expenditures of Federal Awards does not contain separate schedules disclosing how all subgrantees outside of the FSM National Government's control utilize these funds. However, the FSM National Government's primary subrecipients are its four component states and the College of Micronesia – FSM for the Compact Sector grants. Per the recommendation of the U.S. Department of the Interior, Office of Inspector General (OIG), the federal expenditures of these entities that were passed through from the FSM National Government are incorporated in the accompanying Schedule of Expenditures of Federal Awards. Direct U.S. federal awards received by the four States are not included in the accompanying Schedule.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

Schedule of Programs
Selected for audit in accordance with
OMB Circular A-133
Year Ended September 30, 2008

<u>Grantor</u>	<u>Description</u>	<u>CFDA No.</u>	<u>Amount of 2007 Expenditures</u>
<u>U.S. Department of the Interior</u>			
	Economic, Social and Political Development of the Territories:		
	Compact of Free Association:		
	Compact Sector Grants	15.875	\$ 7,198,576
	DOI Other Technical Assistance	15.875	628,169
<u>U.S. Department of Transportation</u>			
	Airport Improvement Program	20.106	10,508,579
<u>U.S. Department of Education</u>			
	Special Education – Grants to States	84.027	<u>2,006,034</u>
	Total program expenditures selected		\$ <u>20,341,358</u>
	Total U.S. Federal Program expenditures		\$ <u>26,117,346</u>
	% of Total U.S. Federal expenditures covered by major programs		<u>78%</u>

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Part I - Summary of Auditors' Results

Financial Statements

- | | | |
|----|--|---------------|
| 1. | Type of auditors' report issued: | Qualified |
| | Internal control over financial reporting: | |
| 2. | Material weakness(es) identified? | Yes |
| 3. | Significant deficiency(ies) identified that is not considered to be a material weakness? | None reported |
| 4. | Noncompliance material to the financial statements noted? | Yes |

Federal Awards

Internal control over major programs:

- | | | |
|----|--|-----------|
| 5. | Material weakness(es) identified? | Yes |
| 6. | Significant deficiency(ies) identified that is not considered to be a material weakness? | Yes |
| 7. | Type of auditors' report issued on compliance for major programs: | Qualified |
| 8. | Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB Circular A-133? | Yes |
| 9. | The FSM National Government's major programs were as follows: | |

<u>CFDA Number</u>	<u>Federal Program</u>
	Economic, Social and Political Development of the Territories
15.875	Compact Sector Grants
15.875	DOI Other Technical Assistance
20.106	Airport Improvement Program
84.027	Special Education – Grants to States

- | | | |
|-----|--|-----------|
| 10. | Dollar threshold used to distinguish between Type A and Type B Programs, as those terms are defined in OMB Circular A-133: | \$783,559 |
| 11. | The State qualified as a low-risk auditee, as that term is defined in OMB Circular A-133? | No |

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Part II - Financial Statement Findings Section

<u>Finding #</u>	<u>Findings</u>
2008-13	Accounts Payable
2008-14	Timely Reconciliation of Accounts
2008-15	Fixed Asset Reconciliation
2008-16	ADB Loans
2008-17	Federal Holding Bank Account Reconciliation
2008-18	Encumbrances

Part III - Federal Award Findings and Questioned Cost Section

<u>Finding #</u>	<u>CFDA #</u>	<u>Findings</u>	<u>Questioned Costs</u>
2008-01	20.106	Cash Management	\$ 0
2008-01	84.027	Cash Management	\$ 0
2008-01	93.283	Cash Management	\$ 0
2008-01	15.875-OTA	Cash Management	\$ 0
2008-02	15.875-OTA	Allowable Costs/Cost Principles	\$ 0
		Procurement and Suspension and Debarment	\$ 4,775
2008-03	93.268	Allowable Costs/Cost Principles	\$ 90,762
2008-04	84.027	Allowable Costs/Cost Principles	\$ 261,275
		Procurement and Suspension and Debarment	\$ 118,555
2008-05	15.875-CSG	Reporting	\$ 0
	15.875-OTA	Reporting	\$ 0
	84.027	Reporting	\$ 0
2008-06	15.875-CSG	Reporting	\$ 113,489
2008-07	93.268	Allowable Costs/Cost Principles	\$ 25,913
		Procurement and Suspension and Debarment	\$ 0
2008-08	15.875-CSG	Procurement – Contracts Provisions	\$ 0
	84.027	Procurement – Contracts Provisions	\$ 0
	20.106	Procurement – Contracts Provisions	\$ 0
2008-09	15.904	Procurement and Suspension and Debarment	\$ 18,200
2008-10	20.106	Equipment and Real Property Management	\$ 0
2008-11	15.875-CSG	Allowable Costs/Cost Principles	\$ 125,961
		Procurement and Suspension and Debarment	\$ 437,130
2008-12	20.106	Allowable Costs/Cost Principles	\$ 1,130,708
		Procurement and Suspension and Debarment	\$ 45,273
2008-15	All Major	Equipment and Real Property Management	\$ 0
2008-17	All Major	Cash Management	\$ 0
Total Questioned Costs			\$2,372,041

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No.: 2008-01
Federal Agency: U.S. Department of the Interior
U.S. Department of Transportation Federal Aviation Administration
U.S. Department of Education
U.S. Department of Health and Human Services
CFDA Program: 15.875 - Various
20.106 - AIP
84.027 - Special Education – Grants to the States
93.283 CDC and Prevention – Investigations and Technical Assistance
Grant Number: Various Other Technical Assistance Grants
Airport Improvement Projects (AIP)
H027A070005, H027B030002-04
Requirement: Cash Management
Questioned Costs: \$0

Criteria: In accordance with applicable cash management requirements, the time elapsed between the receipt of Federal funds and the clearing of the applicable check should be minimized, and any amounts for interest from advances in excess of the minimum allowable for retention should be returned to the federal government.

Condition: For CFDA# 20.106, 84.027 and 93.283, the FSM National Government could not provide documented details of certain drawdowns for the program. Therefore, it is not possible to ensure compliance with cash management requirements.

For CFDA#20.106 the FSM National Government advanced a reimbursable portion of contract CD179 for travel and living allowances of approximately \$140,000 in July 2008. The advance was subsequently applied against contractor billings.

Cause: The Government did not monitor drawdowns for compliance with applicable cash management requirements. Furthermore, the FSM does not have readily available ACH capacity, which exacerbates the cash management function.

For condition 2, no questioned cost will not be raised as the estimated amount of interest related to this matter is below the threshold.

Effect: It is not possible to determine the amount of questioned costs, if any, due to the lack of available information.

For condition 2, no questioned cost will be raised as approximate amount of interest is below the threshold.

Recommendation: The Government should follow applicable federal cash management policies. We are aware that the Government does not have the ability to utilize ACH as banks in the FSM do not readily provide that service. Therefore, we recommend that this matter be referred to the Joint Economic Management Committee (JEMCO) and an alternative to the three-day rule as per EDGAR be proposed. We will be happy to provide additional information for an alternative if such will be of assistance. For condition 2, approval from the Grantor should be obtained and be documented in writing.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No.: 2008-01, Continued

Auditee Response and Corrective Action: We agree with this and recommendation. Cash management has been an issue for the FSM National Government. The Federated States of Micronesia operates in an isolated environment. Local banks do not provide ACH services and many payments are made to those who do not have bank accounts. Therefore, cash management compliance can become quite difficult.

Successive discussions have been made on this issue and FSM has decided to engage in an extensive study of its cash management clearance pattern or will have to obtain federal approval for an alternative clearance pattern. We will also bring this matter to the attention of JEMCO for approval and to the other federal agencies.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No: 2008-02
 Federal Agency: U.S. Department of the Interior
 CFDA Program: 15.875 Economic, Social and Political Development of the Territories
 Grant Award: Technical Assistance Grants: Public Auditor's Training, FSM Financial Management Improvement
 Requirement: Allowable Costs/Cost Principles
 Requirement: Procurement and Suspension and Debarment
 Questioned Costs: \$4,775

Criteria: In accordance with applicable allowable costs/cost principles requirements, expenditures should be necessary and reasonable for program needs and should be in accordance with program requirements. In accordance with applicable procurement requirements, procurements shall provide full and open competition among vendors, and any allowable exceptions should be approved and documented in the procurement file.

Condition:

1. For two (or 4%) of 54 expenditures tested for the Technical Assistance Grants, procurement documents were not provided that demonstrate open competition in the selection of the vendors.
2. For 1 (or 2%) of 54 expenditures tested, there was either only partial or no financial and/or programmatic records (i.e., contracts, receiving reports, invoices, boarding passes, etc.) on file to substantiate the transactions.
3. For contract CB0423, retainer payments of \$300,000 were made, but the contract did not support this practice. As we can confirm that services were rendered, no questioned cost results. However, the contract should support the payment methodology followed.
4. For travel beyond Hawaii or Guam, there is no documentation to demonstrate the Government's cost consideration of alternative airlines or itineraries. No questioned cost will be raised for related travel as the National Government is still in the process of determining its related processes.

<u>Item</u>	<u>S Eqv</u>	<u>CC/ Prog</u>	<u>YR</u>	<u>Desc</u>	<u>Ref</u>	<u>Oblig No</u>	<u>Proc</u>	<u>Allowable</u>
1	11	NH5002		FSM FMIP SYS. Upgrd Phase II		CB0423	\$	\$ 424,811
2	1	24015	07	FSM FMIP Sys Upgrd Phase II	JVE0350	N70281	2,775	2,775
3	2	24015	07	FSM FMIP Sys Upgrd Phase II	35101	CB0423	-	48,025
4	1	NH5002		FSM FMIP Sys Upgrd Phase II	800588801	N70281	<u>2,000</u>	<u>-</u>
							4,775	<u>475,611</u>
				Less items already questioned for procurement and CB0423 (items 1, 2 and 3)			<u>-</u>	<u>(475,611)</u>
				Net questioned costs			<u>\$ 4,775</u>	\$ <u>-</u>

Cause: The Government did not implement controls to ensure compliance with applicable allowable costs/cost principles requirements or procurement requirements.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No: 2008-02, Continued
Federal Agency: U.S. Department of the Interior
CFDA Program: 15.875 Economic, Social and Political Development of the Territories
Grant Award: Technical Assistance Grants: Public Auditor's Training, FSM Financial Management Improvement
Requirement: Allowable Costs/Cost Principles
Requirement: Procurement and Suspension and Debarment
Questioned Costs: \$4,775

Effect: The Government appears to be in noncompliance with applicable allowable costs/cost principles requirements and procurement requirements; questioned costs result.

Recommendation: We recommend that FSM National Government should comply with the grant requirements. In addition basis of payments made on contracts be determinable from the contract terms.

Auditee Response and Corrective Action Plan: We disagree with the condition 1 for items 3 and 5 (Total \$4,775) for lack of competitive procurements available. Treasury records show that FMIS project manager documented the procurement process. It shows that he used applicable web-sites to request quotations to four vendors in February 2007. However, quotations were only received from Progressive Service Inc. Based on the reasonableness of their quote as well as the fact that both Yap and Pohnpei States were using the same vendor, a purchase order was prepared. Following website was considered during the process:

1. ganson-store.com
2. checkdepot.net
3. formsandchecks.com
4. printwithpsi.com

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No.: 2008-03
Federal Agency: U.S. Department of Health and Human Services
CFDA Program: 93.268 Immunization Grants
Grant Number: CH23/CCH922505-05
Requirement: Allowable Costs/Cost Principles
Questioned Costs: \$90,762

Criteria: Financial and programmatic records should be maintained on file for at least three years and readily available for verification.

Condition: The Immunization Grants program incurred charges from the Department of Justice for the use of the FSM Patrol boat for purposes of conducting immunization programs in the outer islands of Chuuk. Program costs totaled \$90,762 (i.e., JVE0334, consisting of \$84,002 for diesel fuel and \$6,760 for victuals and supplies). However, documentation was insufficient to substantiate the appropriateness of such costs, including the lack of the boat's activity log and passenger manifest. Furthermore, we noted inconsistencies in dates between the trip reports and corresponding vaccination logs.

Cause: The Government did not maintain sufficient documents to substantiate program costs.

Effect: The Government may be in noncompliance with applicable allowable costs/cost principles requirements. A questioned cost of \$90,762 exists.

Recommendation: The Government should comply with grant requirements and should maintain sufficient documentation on file to substantiate program costs.

Auditee Response and Corrective Action Plan: We agree with this finding and recommendation. We have requested the Department of Health to provide additional documentation to support the expenditures and to explain the inconsistencies on trip report when compared against logs relative to the dates of the trip. We will provide the response from Department of Health no later than September 30, 2009.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No.: 2008-04
 Federal Agency: U.S. Department of Education
 CFDA Program: 84.027 Special Education – Grants to States
 Grant Number: H027A070005, H027B030002-04
 Requirement: Allowable Costs/Cost Principles
 Questioned Costs: \$261,275
 Requirement: Procurement and Suspension and Debarment
 Questioned Costs: \$118,555

Criteria: Expenditures should be supported by purchase requisitions, purchase orders, vendor invoices, receiving reports, contracts, journal vouchers, personnel action forms (PAFs), timesheets, procurement documents and other underlying supporting documentation to substantiate compliance with applicable allowable costs/cost principles requirements and procurement requirements. Furthermore, such records should be kept on file and made available for review.

Conditions:

1. For 22 (or 26%) of 85 transactions tested, there was insufficient documentation to evidence the Program's procurement of services in the transactions listed below. For items 3, 4 and 5, the underlying contracts were initially executed in prior years. Management provided email copies of quotation solicitations that were represented as being sent to potential providers. However, there was no follow up or documentation evidencing that the emails had actually been received by the solicited parties or that alternative sources, such as web postings, had been explored. While we understand management's execution of the related procurements, we believe that methods used could be enhanced to foster better technical conduct of the procurement process.
2. For 32 (or 38%) of 85 transactions tested, there was either only partial or no financial and/or programmatic records (i.e., contracts, receiving reports, invoices, boarding passes, etc.) on file to substantiate the following transactions.

<u>Item</u>	<u>S Eqv</u>	<u>CC/Prg</u>	<u>YR</u>	<u>Ref</u>	<u>REF 2</u>	<u>CK No</u>	<u>Procurement</u>	<u>Allowable Cost</u>
1	1	NT7091		820186701		5012071	\$ 17,160	\$ -
2	1	NT7091		820504401	C8C01101	5014369	1,760	-
3	1	NA6092		800494101	CC009901	78182	30,928	-
4	8	NA6092		800643401	CC010301	79342	192,000	10,560
5	1	NA6092		800588301	CD012301	78875	17,183	-
6	1	NA6092		800165901	CD0075	75630	20,000	-
7	1	NA6092		800698401	CD007601		-	18,940
8	2	NA7091		860267201	CD0126	3020807	58,436	58,436
9	3	NA7091		800698301	CD017701		-	71,876
10	1	NA6092		800819001	CE006301	80802	20,125	-
11	1	NA7091		800209302	CE006302	76372	25,434	-
12	2	NA8091		800921901	CE023401	81451	44,636	-
13	1	NT6091		820287102	LC711402		449	449
14	1	NT8091		820224301	LC801701		9,000	9,000
15	1	NT7091		820956001	LC808701		2,261	2,261

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No.: 2008-04, Continued
 Federal Agency: U.S. Department of Education
 CFDA Program: 84.027 Special Education – Grants to States
 Grant Number: H027A070005, H027B030002-04
 Requirement: Allowable Costs/Cost Principles
 Questioned Costs: \$261,275
 Requirement: Procurement and Suspension and Debarment
 Questioned Costs: \$118,555

Conditions, Continued:

<u>Item</u>	<u>S Eqv</u>	<u>CC/Prg</u>	<u>YR</u>	<u>Ref</u>	<u>REF 2</u>	<u>CK No</u>	<u>Procurement</u>	<u>Allowable Cost</u>
16	1	NK7091		860267301	N70228	3020806	-	1,500
17	1	NT7091		820252101	T7C14602		-	1,055
18	1	NA8091		800950801	TE0046		-	2,550
19	1	NA6092		800648601	TE0913	79309	-	2,406
20	1	NA7091		801012901	TE1516		-	600
21	1	NK8091		860244101	TKE03101	3020585	-	2,279
22	1	NT7091		0			-	15,341
23	1	NT8091		0			-	16,452
24	1	NT8091		0			-	14,610
25	1	20010	06	JVE0535			-	2,600
26	1	20010	06	JVE0535			-	22,895
27	1	20010	07	29194			-	2,429
28	1	20010	07	33986			-	650
29	1	20010	07	JVE0535			-	(22,895)
30	1	20010	07	JVE0535			-	7,942
31	1	20010	08	JVE0821			-	965
32	<u>1</u>	20010	08	45194			-	240
33	1	20010	08	36722			-	1,750
	<u>44</u>						<u>439,372</u>	<u>244,891</u>
				Total combined cost			684,263	
				Less items already questioned at allowable cost criteria			80,706	
				Less items for contracts raised as findings in PY but with no questioned cost, due to competition not being maximized (items 3, 4 and 5)			<u>240,111</u>	
				Net Questioned cost			<u>\$363,446</u>	

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No.: 2008-04, Continued
 Federal Agency: U.S. Department of Education
 CFDA Program: 84.027 Special Education – Grants to States
 Grant Number: H027A070005, H027B030002-04
 Requirement: Allowable Costs/Cost Principles
 Questioned Costs: \$261,275
 Requirement: Procurement and Suspension and Debarment
 Questioned Costs: \$118,555

Conditions, Continued:

3. For 11 (or 39%) of 28 payroll samples tested, we noted that (1) pay rates per the system and PAFs differed, or (2) either partial or no financial records (i.e., PAF, approved timesheet, etc.) were provided to substantiate the transaction, as follows:

<u>No.</u>	<u>Employee#</u>	<u>System</u>	<u>PAF</u>	<u>Diff</u>	<u>Approx error</u>
1	6223	10.58	9.87	0.70	\$ 1,464
2	58469	9.76	10.33	(0.57)	(1,190)
3	24090	4.14	3.35	0.79	1,639
4	29444	4.74	3.32	1.42	2,958
5	35318	4.74	4.27	0.47	971
6	51567	4.89	3.54	1.34	2,796
7	801677	3.36	2.69	0.67	1,398
8	58370	3.87	3.10	0.77	1,610
9	64999	4.43	3.54	0.89	1,843
10	800536	3.18	2.54	0.64	1,323
11	54094	3.942	3.186	0.756	<u>1,572</u>
					\$ <u>16,384</u>

Cause: The Government did not maintain sufficient documentation to substantiate compliance with applicable allowable costs/cost principles requirements and procurement requirements.

Effect: The Government appears to be in noncompliance with applicable allowable costs/cost principles requirements and procurement requirements; questioned costs result.

Regarding Condition 1 for items 3, 4 and 5, the Government is not fully in compliance with the criteria. No costs have been questioned as we were able to verify that the services were received and the effort made to procure the services. However, management’s understanding of the adequacy of the procurement efforts was not sufficient to maximize potential competition.

Recommendation: The Government should retain sufficient documentation on file to support compliance with applicable allowable costs/cost principles requirements and procurement requirements. Regarding items 3, 4, and 5, the National Government should consider procuring such services on a multi-year basis to maximize competition among interested parties. Additionally, given the specialized nature of the procured services, we recommend that the Government consider use of a Request for Interest to establish listings of eligible parties and to ensure that RFP preparation considers input received from those parties.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No.: 2008-04, Continued
Federal Agency: U.S. Department of Education
CFDA Program: 84.027 Special Education – Grants to States
Grant Number: H027A070005, H027B030002-04
Requirement: Allowable Costs/Cost Principles
Questioned Costs: \$261,275
Requirement: Procurement and Suspension and Debarment
Questioned Costs: \$118,555

Auditee Response and Corrective Action Plan: For conditions 1 and 2, we agree with this finding and recommendation.

Item nos. 1-2, 8, 13-17 and 21 are expenditures made at FSM Field Office in Chuuk and Kosrae States. We have requested the field offices to provide the supporting documentation to support the expenditures and the procurement of services no later than September 30, 2009.

Items nos. 3-7, 9-12, 19-20, and 22-33 are expenditures made in central office Palikir Pohnpei. We will provide the supporting documents to support the expenditures no later than September 30, 2009.

For condition 3 variances in the rate per system as against the personnel action form. This has been discussed with personnel division and requested to review and verify the rates as reported by the auditor. Personnel division will conduct a review to all the rates of the FSMNG employees against the personnel action form to ensure that proper rates are recorded in the system.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No.: 2008-05
Federal Agency: U.S. Department of the Interior
U.S. Department of Education
CFDA Program: 15.875 Economic, Social and Political Development of the Territories
84.027 Special Education – Grants to States
Grant Number: DOI Other Technical Assistance Grants, DOI Compact Sector
Requirement: Reporting
Questioned Costs: \$0

Criteria: In accordance with OMB Circular A-133, Financial Status Reports (FSR's), SF 270 Request for Advance or Reimbursement, SF-271 Outlay Report and Request for Reimbursement for Construction Programs and/or its equivalent report, as applicable to the program, should be correctly completed and submitted in accordance with the grant terms and conditions. Submitted reports should reconcile with underlying records.

Condition: For the following programs, FSR's, SF 270 Requests for Advance or Reimbursement and/or equivalent reports, as applicable were not provided.

15.875 – DOI Technical Assistance Grants
15.875 – Compact Sector Grants
84.027 – Special Education

For the Special Education program, Report of Children and Youth with Disabilities Receiving Special Education under Part B of the Individuals with Disabilities Education Act, as amended (OMB No. 1820-0043) and/or its equivalent report, as applicable to the program, was not provided, as well.

Therefore, we could not ensure that the data in the reports agree with underlying financial or programmatic records.

Cause: The Government did not prepare the required reports.

Effect: Noncompliance with reporting requirements results from this condition. We are unable to quantify resulting questioned costs, if any.

Recommendation: The Government should ensure that the responsible personnel prepares the required reports and maintains underlying records to substantiate reported amounts.

Auditee Response and Corrective Action Plan: We agree with this finding and recommendation. We will submit the complete and reconciled reports no later than September 30, 2009.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No.: 2008-06
 Federal Agency: U.S. Department of the Interior
 CFDA Program: 15.875 Economic, Social and Political Development of the Territories
 Grant Number: CSG-FSM-2007 – EDU, ENV, HLT, PSD, CAP; 2004 Carryover Grants
 Requirement: Reporting
 Questioned Costs: \$113,489

Criteria: In accordance with OMB Circular A-133, Financial Status Reports (FSR's), SF 270 Request for Advance or Reimbursement, SF-271 Outlay Report and Request for Reimbursement for Construction Programs and/or its equivalent report, as applicable to the program, should be correctly completed and submitted in accordance with the grant terms and conditions. Moreover, reports submitted should reconcile with underlying records.

Condition: Per letter dated March 27, 2007, the Grantor indicated the final status reports for the FY04 carryover grants should be received by December 31, 2007. The National Government was not able to provide these reports.

An analysis of the FY07 Grant final reconciliation was made, as documented in the table below. In our comparison of the National Government's expenditures reflected in the FY07 Cash Recon Report downloaded from the Compact Sector website (www.uscompact.org) against the general ledger expenditure balances, we noted discrepancies, as indicated in the table below.

Included in our analysis was the determination of the amount to be returned by the National Government sector operating to the Compact Sector Holding account and ultimately to US DOI. It appears there was an understatement of the amount returned by the National Government sector operating account to the Compact Sector Holding Account of \$113,489. Additionally, the National Government's share of the amount returned to U.S. DOI appears to be overstated by \$262,534 as a result of the difference in expenditures reported.

The National Government was not able to provide a reconciliation of the noted differences.

<u>Sector</u>	<u>Per Website Obligated</u>	<u>Per Investment Schedule Obligated</u>	<u>Per Audit Drawdown</u>
Education	\$ 602,877	\$ 491,834	\$ 604,147
Health	790,449	766,018	824,161
Public capacity	338,553	124,033	261,285
Chuuk capacity adm by NG			375,000
Private Sector			
Environment	-	-	-
	1,731,879	1,381,885	2,064,593
Expenditures per GL	<u>1,644,418</u>	<u>1,644,418</u>	<u>1,644,418</u>
Difference in expenditures	<u>\$ 87,461</u>	<u>\$ 262,534</u>	
Cash back from NG			420,175
Cash returned by the NG to the Sector Holding account			<u>306,685</u>
Remaining amount that should be returned to the Holding account			<u>\$ 113,489</u>

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No.: 2008-06, Continued
Federal Agency: U.S. Department of the Interior
CFDA Program: 15.875 Economic, Social and Political Development of the Territories
Grant Number: CSG-FSM-2007 – EDU, ENV, HLT, PSD, CAP; 2004 Carryover Grants
Requirement: Reporting
Questioned Costs: \$113,489

Cause: The Government did not monitor its reporting process for compliance with applicable reporting requirements.

Effect: Noncompliance with reporting requirements results from this condition. A questioned cost of \$113,489 exists.

Recommendation: The final reports of the FY04 carryover grant should be readily available. If an extension was again authorized for these grants, such should be readily available for verification.

The Government should comply with the criteria. Reports submitted to the Grantor should be reconciled to the general ledger records.

Auditee Response and Corrective Action Plan: The grant in the FY04 carry over did not indicate any expiration date; hence it is the FSM National Government understanding that this grant does not lapse. Although, the grantor indicated to close the grant, this did not materialize because the FY04 carry over has been obligated. An informal communication has been made to grantor not to close the grant which was approved.

As to the understatement of the amount returned by National Government sector operating account, Investment Division will prepare an analysis to verify the claim of the auditor. We will provide the reconciled amounts no later than September 30, 2009.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No.: 2008-07
Federal Agency: U.S. Department of Health and Human Services
CFDA Program: 93.268 Immunization Grants
Grant Number: CH23/CCH922505-05
Requirement: Allowable Costs/Cost Principles
Requirement: Procurement and Suspension and Debarment
Questioned Costs: \$25,913

Criteria: Expenditures should be supported by purchase requisitions, purchase orders, vendor invoices, receiving reports, contracts, journal vouchers, procurement documents and other underlying supporting documentation to substantiate compliance with applicable allowable costs/cost principles requirements and procurement requirements. Furthermore, such records should be kept on file and made available for review.

Condition: Insufficient competitive procurement records and underlying documentation (i.e. receiving report, invoice, payment documents, grantor's approval, and grant award) were provided for the following transaction:

<u>CC</u>	<u>YR</u>	<u>Detail</u>	<u>Ref</u>	<u>Amount</u>
21040	07	Nissan Vehicle	N80044	\$25,913

Cause: The Government did not maintain sufficient documentation to substantiate compliance with applicable allowable costs/cost principles requirements and procurement requirements.

Effect: The Government appears to be in noncompliance with applicable allowable costs/cost principles requirements and procurement requirements; questioned costs result.

Recommendation: The Government should retain sufficient documentation on file to support compliance with applicable allowable costs/cost principles requirements and procurement requirements. In addition, the basis of payments made on contracts should be determinable from contract terms.

Auditee Response and Corrective Action Plan: We disagree with this finding. Treasury records show that competitive procurement documentation exist and underlying documentation like receiving report, invoice, and payment documents are on file.

Per records on file, following price comparison was made:

Nissan Motor Corporation	\$ 25,913
Triple J auto Group	37,095
AK Guam.com	41,499

We will provide to Deloitte & Touche the above documents to clear this finding no later than July 30, 2009.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No.: 2008-08
Agency: U.S. Department of the Interior, US Department of Transportation Federal Aviation Administration, US Department of Education,

CFDA Program: 15.875 Compact Sector Grants
15.875 Technical Assistance
20.106 Airport Improvement Projects
84.027 Special Education

CFDA No.: 15.875
Grantor Agency: U.S. Department of the Interior
Program Name: Compact Sector Grants
Requirement: Contract Provisions
Questioned Cost: \$0

CFDA No.: 20.106
Grantor Agency: U.S. Department of Transportation
Program Name: Airport Improvement Projects
Requirement: Contract Provisions
Questioned Cost: \$0

CFDA No.: 84.027 Cluster
Grantor Agency: U.S. Department of Education
Program Name: Special Education
Requirement: Contract Provisions
Questioned Cost: \$0

Criteria: For all contracts, the following provisions should be included as applicable:

- (i) For contracts in excess of \$100,000, administrative, contractual, or legal remedies in instances where contractors violate or breach contract terms, and the provision of such sanctions and penalties as appropriate;
- (ii) For contracts in excess of \$100,000, termination for cause and for convenience by the Grantee or Sub-Grantee including the manner by which it will be effected and the basis for settlement;
- (iii) Compliance with local statutes regarding kickbacks and corrupt practices;
- (iv) Access by the Government of the Federated States of Micronesia and its Sub-Grantees, the Government of the United States, or any of their duly authorized representatives to any books, documents, papers, and records of the contractor which are directly pertinent to the contract for the purpose of making audit, examination, excerpts, and transcriptions;
- (v) Retention of all required records for three years after Grantees or Sub-Grantees make final payments and all other pending matters are closed; and
- (vi) Compliance with all applicable standards, orders, or requirements issued under local environmental laws.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No.: 2008-08, Continued
Agency: U.S. Department of the Interior, US Department of Transportation Federal Aviation Administration, US Department of Education,

CFDA Program: 15.875 Compact Sector Grants
15.875 Technical Assistance
20.106 Airport Improvement Projects
84.027 Special Education

Condition: Certain contracts entered into by National Government do not include all of the contract provisions set forth in the criteria.

Cause: There appears to be lack of internal control over ensuring that compliance with the criteria occurs.

Effect: The Government appears to be in noncompliance with the criteria.

The condition is solely related to contract provisions and does not extend to expenditures associated with the contracts and therefore no questioned costs result from this finding.

Recommendation: We recommend that the National Government over ensuring that comply with the condition set forth in the criteria.

Auditee Response and Corrective Action Plan: The contract provision has been applied in FY2008. All contracts executed beginning October 2007 has the applicable provisions. We believe the auditors are referring to the prior to FY07 contract which has no contract provisions.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No: 2008-09
Federal Agency: U.S. Department of the Interior
CFDA Program: 15.904 Historic Preservation Fund Grants-In-Aid
Grant Number: 64-07-21666
Requirement: Procurement and Suspension and Debarment
Questioned Costs: \$18,200

Criteria: In accordance with applicable procurement requirements, procurements shall provide for full and open competition among vendors and allowable exceptions should be approved and documented in procurement files.

Condition: Insufficient competitive procurement records were provided for the following transaction:

<u>CC</u>	<u>YR</u>	<u>Detail</u>	<u>Ref</u>	
24201	07	Purchase of MV, Nissan Truck, Frontier- YR2006	JVE0587	\$18,200

Cause: The Government did not implement controls to ensure compliance with applicable procurement requirements.

Effect: The Government appears to be in noncompliance with the criteria and questioned costs result.

Recommendation: We recommend that the FSM National Government comply with grant requirements.

Auditee Response and Corrective Action Plan: We disagree with this finding. Treasury records show that competitive procurement documentation exist and underlying documentation like receiving report, invoice, and payment documents are on file.

Per records on file, following price comparison was made:

Nissan Motor Corporation	\$ 18,200	brand new
Senny's Enterprises	22,500	brand new
M& R Business	6,500	used car

We will provide to Deloitte & Touche the above documents to clear this finding no later than July 30, 2009.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No.: 2008-10
Federal Agency: U.S. Department of Transportation
CFDA Program: 20.106 Airport Improvement Project
Grant Number: Various
Requirement: Equipment and Real Property Management
Questioned Costs: \$0

Criteria: In accordance with applicable equipment management requirements, tangible, nonexpendable, personal property having a useful life of more than one year and an acquisition cost of \$5,000 or more per unit meets the definition of equipment and should be accounted for and maintained in the fixed asset register.

Condition: Per the terms of Contract CD0179, all equipment purchased is the property of the National Government. Office equipment and vehicles purchased per this contract were not capitalized in the fixed asset register.

Cause: The Government appeared to lack awareness of the applicable equipment management requirements.

Effect: The Government appears to be in noncompliance with the criteria. There is a potential error in the fixed asset account at the Government wide level.

Recommendation: The FSM National Government should comply with grant requirements.

Auditee Response and Corrective Action Plan: We agree with this finding. The procurement and supply is currently conducting the inventory of all Government assets to ensure that assets purchased are properly recorded in the fixed assets register.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No.: 2008-11
 Agency: U.S. Department of the Interior
 CFDA Program: 15.875 – Compact Sector Grants
 Grant #: CSG-FSM 2008 Grants, CSG-FSM-2007 Grants, CSG-FSM-2006 Grants, 2004 Carryover Grants
 Requirement: Procurement and Allowable Costs/Cost Principles
 Questioned Costs: \$563,091

Criteria: Expenditures should be necessary and reasonable for program needs and should be in accordance with program requirements. Furthermore, financial and programmatic records should be maintained on file for at least three years. Procurements shall provide full and open competition among vendors, and allowable exceptions should be approved and documented in procurement file. Cost analysis of change orders and additional tasks should be documented.

Condition:

1. For 19 (or 20%) of 95 samples tested for the Compact Sector Programs, there was either insufficient documentation or none was provided to support competitive procurement requirements.
2. For 5 (or 5%) of 95 transactions tested, there was either only partial or no financial and/or programmatic records (i.e., contracts, receiving reports, invoices, boarding passes, etc.) on file to substantiate the following transactions.
3. For additional task orders on infrastructure projects, we noted no documentation to show the price negotiation made between the National Government and the contract to ensure an advantageous price proposal was agreed.

Item	Sam Eqv	FD	CC	APV	Reference	Ck No	Proc	Allowable Cost
1	1	Infra	NB600A	800978701	L8028102		\$ -	\$ 2,080
2	2	Infra	C68C1B	800568801	CE010802	1407	-	34,823
3	1	Infra	K68C2B	800148101	CD0208	1074	5,729	-
4	1	Infra	K68C2B	800843301	CD020801	1618	6,116	-
5	2	Infra	K68C2B	800930601	CD020801	1696	8,069	-
6	1	Infra	ND803B	800314101	CE010801	1221	-	15,069
7	1	Health	NE320A	800441301	CE017601		30,400	-
8	1	Capacity	NA506C	850122701	ME4142		9,795	-
9	1	Capacity	NE200Q	800890201	CE027601	1666	31,515	-
10	1	Capacity	NE403D	820150101	C8C00101		326	-
11	1	Capacity	NE403D	820321501	C8C00801		4,583	-
12	1	Capacity	NE403D	820513801	C8C00601		10,000	-
13	1	Capacity	NE403D	820754001	C8C00301		1,361	-
14	1	Capacity	NE403D	820944501	C8C00601		10,000	-
15	1	Infrastructure	73020	32307	CE0188		54,000	-
16	2	Infrastructure	73020	32735	CE0188		126,948	-
17	1	Infra	73212	31802	31802/ CD00208	67-100060-1	6,107	-
18	1	Infra	73212	33924			4,032	73,989
19	1	Infra	74203	32400	32400/ CE0220	91-100089	105,365	-
20	1	Infra	75203	34474	34474/ CE0157	355-100246	<u>26,816</u>	-
							<u>441,162</u>	125,961
Combined questioned cost							567,123	
Less: item questioned as allowable cost (item 18)							<u>4,032</u>	
Net Questioned cost							<u>\$563,091</u>	

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No.: 2008-11, Continued
Agency: U.S. Department of the Interior
CFDA Program: 15.875 – Compact Sector Grants
Grant #: CSG-FSM 2008 Grants, CSG-FSM-2007 Grants, CSG-FSM-2006 Grants, 2004
Carryover Grants
Requirement: Procurement and Allowable Costs/Cost Principles
Questioned Costs: \$563,091

Cause: There appears to be a lack of control over ensuring compliance with the criteria.

Effect: The Government appears to be in noncompliance with the criteria and questioned costs result.

Recommendation: The Government should comply with grant requirements and should retain sufficient documentation on file to support compliance with those requirements.

Price negotiation on additional task orders be documented to show the manner in obtaining the most advantageous contract cost.

Auditee Response and Corrective Action Plan: Expenditures under the capacity sector are supervised by CFCC. The supporting documents such as contract, check, invoice, APV were forwarded to Deloitte & Touche Office at Kolonia for review on June 25, 2009.

Audit findings and questioned costs for infrastructure will be forwarded to Project Management Unit to provide the procurement documents for the task orders.

Auditor's Response: The documents provided did not include procurement documentation.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No.: 2008-12
 Federal Agency: U.S. Department of Transportation, Federal Aviation Administration
 Grant #: Various
 CFDA #: 20.106
 Program Name: Airport Improvement Program
 Requirement: Procurement and Allowable Costs/Cost Principles
 Questioned Costs: \$1,175,981

Criteria: Expenditures should be necessary and reasonable for program needs and should be in accordance with program requirements. Furthermore, financial and programmatic records should be maintained on file for at least three years. Procurements shall provide full and open competition among vendors, and allowable exceptions should be approved and documented in procurement file.

Condition:

- For 1 (or .7%) of 140 samples tested for the Airport Improvement Program, we noted insufficient competitive procurement documents were made available to support the following payment.

Samp Eqv	REF 1	PRG	Program Name	Oblig Doc No	Check No	Amount
1	800064801	AH5002	YAP AIRPORT IMP. PROJECT	CC0051	75560	\$45,273

- For 12 (or 8.6%) of 140 samples tested, there were either partial or no financial and/or programmatic records (contracts, receiving reports, invoices, boarding passes, etc.) on file to substantiate the following transactions.

Samp Eqv	REF 1	CC	Program Name	Oblig Doc No	Amount
1	800572801	KH7003	KOSRAE INTERNATIONAL AIRPORT	CE012702	\$ 106,284
1	800723202	KH7003	KOSRAE INTERNATIONAL AIRPORT	CB016633	102,125
4	800523701	AH7003	YAP INTERNATIONAL AIRPORT	CE012801	389,500
3	800823001	AH7003	YAP INTERNATIONAL AIRPORT	CE012801	314,537
2	800779901	AH6003	YAP APRON REHABILITATE(DESIGN)	CC018001	212,283
1	800028301	PH6004	PNI REHABIL. RUNWAY-PHASE I	ME0340	5,979
total					\$1,130,708

Cause: There appears to be a lack of control over ensuring compliance with the criteria.

Effect: The Government appears to be in noncompliance with the criteria and questioned costs result.

Recommendation: The FSM National Government should comply with the criteria.

Auditee Response and Corrective Action Plan: We will discuss this audit finding and questioned costs with the Department of Transportation and Communication and clear this finding before September 30, 2008.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No. 2008-13 – Accounts Payable

Criteria: System subsidiary ledgers should be timely reconciled with related general ledger balances. Abnormal balances and discrepancies should be timely identified and reconciled. Financial records to substantiate balances should be kept and be readily available for verification.

Condition:

1. There is a significant difference between the accounts payable subsidiary ledger and the general ledger. There does not appear to be timely reconciliation of the account. A manually prepared subsidiary detail was provided to support the following general ledger balances recorded in account # 3110 Accounts Payable:

<u>FD</u>	<u>FUND_NAME</u>	<u>Per TB</u>	<u>Per SL</u>	<u>Difference</u>
01	General Fund	\$ 427,384	\$1,185,159	\$ (757,776)
07	Cmpt I other Fund	-	908	(908)
10	Cmpt II Ed Fund	12,700	12,481	219
11	Cmpt II Hlth Fund	27,191	25,494	1,697
12	Cmpt II Environ Fund	14,406	12,704	1,702
13	Cmpt II Private Sctr Fund	5,438	6,309	(871)
14	Cmpt II Pblc Cpcty Fund	18,686	35,350	(16,664)
15	Cmpt II SEG Fund	16,652	16,652	0
19	Cmpt II Infrstret Fund	373,557	372,271	1,286
20	US Grants thru FSM Fund	3,060,230	3,007,528	52,702
23	Non-US Grants Fund	65,863	64,754	1,109
25	CFSM Grants Fund	906,564	1,299,308	(392,744)
29	Sea Transportation Fund	19,188	38,461	(19,274)
31	Passport Fund	3,649	3,649	0
33	Fisheries Observation Fund	3,472	3,472	0
39	Scholarship Fund	1,000	1,000	0
91	ADB Loan Fund	9,555	580,717	(571,162)
96	Payroll Fund	508,888	784,730	(275,842)
97	Reimbursable Fund	30,078	31,018	(941)
99	Treasury Fund	11,678	187,162	(175,484)
51	CIP Old Cmpt Fund	-	338	(338)
		<u>\$5,516,177</u>	<u>\$7,669,464</u>	<u>\$(2,153,287)</u>

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No. 2008-13 – Accounts Payable, Continued

2. For the FY09 checks enumerated below, the underlying documentation was not available for verification.

<u>CK RUN</u>	<u>DATE</u>	<u>NET AMOUNT</u>
804861- 916	02/05/2009	\$ 1,656
400041- 455	10/02/2008	3,728
801537- 325	10/16/2008	4,771
201657- 1010	01/31/2009	6,007
802324- 448	11/14/2008	9,026
801430- 283	10/10/2008	15,000
801657- 338	10/17/2008	15,992
400154- 645	12/12/2008	17,350
801862- 380	10/28/2008	48,124
803802- 722	12/31/2008	173,200
200714- 491	10/15/2008	3,842
4006878- 466	10/17/2008	<u>2,803</u>
		\$ <u>301,500</u>

Cause: The National Government implemented a new system in August 2008. The Government could not specifically provide the rationale for the above differences as such may pertain to the system configuration.

Effect: Accounts payable balances could be erroneous.

Recommendation: We recommend that payable subsidiary ledgers be reconciled with the general ledger. Underlying documentation should be kept on file and be readily available for verification.

Auditee Response and Corrective Action Plan: For condition 1, we agree with the significant difference between the Accounts Payable Subsidiary and General Ledger, however, we disagree with the conclusion that account balances could be erroneous because National Treasury was able to reconcile the balances by doing the manual reconciliation and preparing a manual schedule. The difference was due to system configuration.

The Project Manager will bring this up with Kintera Fundware to properly configure the system in order that Accounts Payable Subsidiary Ledger and General ledger is reconciled.

For condition 2, FY09 could have been misplaced, but the Accounts Payable Manager has been instructed to locate the checks and file it to appropriate filing folder.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No. 2008-14 – Timely Reconciliation of Accounts

Criteria: Reconciliation of accounts should be timely performed.

Condition: The National Government provided several adjusting entries in May 2009 to correct and reconcile various accounts including accounts payable, accounts receivable, loans payable, fixed assets and fund balance beginning.

Additionally, account 01-3299 “Unidentified deposit” reflects a balance of \$250,119 which is awaiting identification for appropriate recognition in the Statement of Activities and which includes a wire transfer from BOH Branch 28, which we understand is the National Government federal holding account. As the funds originated from the federal government, such should be specifically identified.

During fiscal year 2008, the National Government wrote off \$230,349 of stale-dated checks as general fund income. The National Government was not able to determine the amount funded by federal and sector grants that should revert to the originating fund source.

During fiscal year 2008, the National Government wrote-off prior year unidentified wire transfers of \$347,156 to general fund income. We could not determine if a consideration was whether the unidentified wire transfers represent payables to the states. Moreover, approximately \$7,900 of the wire transfers came from the US Department of the Interior.

During fiscal year 2008, the National Government wrote-off approximately \$350,000 of unidentified deferred revenue from the Non US Grants Fund to general fund income. In addition, approximately \$189,320 of deferred revenue are either non-moving since prior years and/or the grant made no stipulation of the return of funds upon completion of the project/activity. Moreover, there was insufficient documentation (cash receipt or grant award) to fully determine the validity of these balances. It was further noted that several deferred revenue program account have not yet been transferred to Fundware.

Cause: Timely reconciliation of the accounts did not occur and reconciling items were not identified as to their nature. For deferred revenue, it does not appear to be a policy of the National Government to determine grantor stipulations prior to determining whether deferral of revenue is appropriate.

Effect: The effect of this condition is potential erroneous account balances.

Recommendation: We recommend that the FSM National Government perform reconciliations of accounts on a monthly basis to promptly identify reconciling items and to allow for appropriate recording. Reconciliations should be reviewed by appropriate management to ensure that timely action is taken to identify and correct discrepancies.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. During FY2008, FSMNG changed its Financial Management Information System (FMIS) from “Focus” to “Fundware”. Before, during and after the installation and implementation, accounting and treasury staff concentrated in providing the chart of accounts and other information to the Kintera fundware team and attending the necessary training to enable them to fully understand the new FMIS system.

Beginning October 1, 2008, treasury and accounting staff work together to perform the reconciliation of accounts on a monthly basis to promptly identify any reconciling items and appropriately record this in the new system.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No.: 2008-15
CFDA Program: All Major
Requirement: Fixed Asset Reconciliation/Equipment and Real Property Management
Questioned Costs: \$0

Criteria: Fixed asset records should be periodically reconciled and timely recorded. Construction projects capitalized should be supported by Engineer's certification reports as to completion.

Assets that are deeded to other governments should be subject to formal agreements and adequate maintenance of fixed assets should occur.

Condition:

1. The National Government capitalized approximately \$2 million of CFSM completed infrastructure projects located in various locations in the states. Of this amount, approximately \$1.6 million was incurred and may have been completed in prior years. For all of these projects, the National Government could not provide a project engineer's completion report.

Included in the completed project is the construction of a classroom for a private institution of approximately \$99,000. The National Government could not provide documentation to indicate whether the project is the property of the Government, considering the project is built on a private institution's premises.

2. The National Government initially capitalized as completed projects some \$8.2 million of infrastructure projects funded by the Airport Improvement Project and by Compact Sector Infrastructure. Of this amount, \$1.1 million pertains to payments on project design which should still be classified as construction in progress. This matter was subsequently corrected through a proposed audit adjustment. The National Government was not able to provide a completion report for these projects certified by a project engineer to determine their status of completion.

Included in the completed projects is equipment for Weno Emergency Projects. The specific details (part numbers, asset details) were not readily available to allow for verification of the assets. In addition, it is our understanding that these assets are not yet tagged, as such is pending a determination as to property ownership.

3. The National Government capitalized approximately \$10.8 million of ARFF vehicles and related equipment utilized by the States of Kosrae, Chuuk and Yap. There were no receiving reports for these assets and it is our understanding that these assets are not yet tagged as a determination as to ownership has not yet been made.
4. There appears to be an absence of documentation formalizing the turnover of assets purchased by the National Government to the recipient states and/or component units.
5. The National Government capitalized approximately \$17 million of construction in progress during the year. Of this amount, approximately \$10 million was incurred in prior years. The percentages of completion certified by the project engineer are not readily determinable.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No.: 2008-15, Continued

6. No formal maintenance procedures for equipment are established and we could not determine the manner in which maintenance responsibilities are carried out.
7. Fiscal year 2008 capital expenditures were not reconciled to the fixed asset register.

Total capital assets per Expenditure Details	\$ <u>1,627,942</u>
Fund 19 (Infrastructure related) capital assets	401,102
Land in Chuuk	90,000
Net additions	1,136,840
Additions per register, net of donations	<u>786,804</u>
Difference	\$ <u>350,036</u>

8. The following fixed assets were not available for verification.

<u>Item</u>	<u>Tag #</u>	<u>Description</u>	<u>NBV</u>	<u>Location</u>	<u>Department</u>
1	7961	AIRCRAFT, BEECH	\$ 146,735	POHNPEI	CIA
2	9551	LAPTOP, HP	\$ 1,593	PALIKIR	EDUCATION
3	9948	BOAT	\$ 3,908	YAP	IMMUNIZATION

Cause: For conditions 1 to 3, it appears that the compilation of completed projects and construction-in-progress data, the project engineer's estimate, project completion reports, and asset receiving reports were not sufficiently utilized to determine appropriateness and accuracy of underlying financial reports.

The absence of a formal transfer of assets to the States and component units has been a recurring audit concern as has absence of adequate maintenance procedures and the reconciliation of capital expenditures to the fixed asset register.

Effect: The effect of this condition is that inadequate accounting for fixed assets occurs and that complications between the National Government and the States result due to potential misunderstandings concerning ownership and accountability over fixed assets. Additionally, noncompliance has resulted with federal compliance requirements applicable to equipment maintenance.

Recommendation: Quarterly reconciliations of the fixed asset register should occur. A formal document should be utilized to convey ownership of assets provided to the States or to component units. A formal maintenance program should also be developed.

Auditee Response and Corrective Action Plan: We agree with this finding and recommendation. The procurement and Supply will ensure that quarterly reconciliation of the fixed assets register will occur.

We will set a meeting with the Department of Transportation and Department of Justice to discuss the possible formal transfer of the fixed assets to the states and to component units no later than September 30, 2009.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No. 2008-16 – ADB Loans

Criteria: All loan transactions should be appropriately and timely recorded in the financial statements. Timely reconciliation between the States and National Government should occur for all loan draw downs and for all repayments.

Condition: Timely recording of all loan transactions and reconciliation of loan balance activity between the States and the National Government did not occur. The State Finance Officers were not made aware of certain loan movements, particularly when the National Government paid vendors on behalf of the States and the Special Drawing Rights (SDR) adjustments.

During the year, the National Government recorded an SDR adjustment resulting in an increase in loans payable of approximately \$6 million, of which approximately \$4.2 million was distributed to the States. In our perusal of correspondence pertaining to the ADB Loan SDR adjustment, dated September 11, 2008, this was a result of an agreement entered between the FSM and ADB on December 20, 2007. However, a copy of the agreement was not available.

During the year, loan payments for ADB Loan Number 1459 FSM (SF) - Water Supply and Sanitation Project Loan were made in the amount of \$182,090. The National Government allocated these loans to the three states and the National Government. Consequently, the National Government may have an equitable share in the loan amortization. However, the entire principal amortization for ADB Loan number 1459 (SF) was paid solely by three states.

The prior year understatement of loan proceeds, which was recorded as accounts receivable – general, was not reconciled during the year. In the current year, there is a recorded proceeds amount of approximately \$50,000, and there was no available loan drawdown authorization or other supporting documentation in support of the amount.

Cause: Monitoring and reconciliation of payments and draw downs of ADB loans against the records of ADB and investigation of differences does not appear to occur in a timely manner.

For loan draw downs, there appears to be untimely and insufficient communication among departments, with ADB personnel and with the States and the National Government to ensure that applicable transactions are captured, recorded; and issues, if any, are timely resolved.

For the ADB Loan 1459, it is our understanding that loan allocations made to the National Government resulted from unaccounted for loan proceeds in prior years. As such, no allocation has been made to the National Government for loan payments.

Effect: Due to non-reconciliation of payments to ADB's records, there could be erroneous application of loan payments without the National Government's knowledge.

Recommendation: We recommend that timely monitoring and communications of ADB loan transactions be coordinated by the National Government with the States and ADB personnel.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No. 2008-16 – ADB Loans, Continued

Recommendation, Continued:

Reconciliation of payments made against ADB's records and investigation of differences should be conducted in accordance with loan terms. This is to ensure loan payments are appropriately applied to correct loan balances.

For the ADB Loan 1459 the National Government may consider obtaining a formal agreement with the States, related to repayment terms.

Auditee Response and Corrective Action Plan: We do not agree as to the untimely recording of loan transactions of FSMNG as it has been recorded timely for the fiscal year 2008. The detail transactions and schedule for FSM states had been provided to the States Director of Finance thru email before they closed their books in FY08. However, we do agree on the untimely recording of the SDR adjustments as this has to be verified and consulted with ADB and among the staff and to the Assistant Secretary of Investment and International Finance and National Treasury.

For fiscal year 2009, it was decided that a formal communication be provided to the FSM States for any loan transaction that will arise and a periodic reconciliation be made to enable both the state and FSMNG to periodically review and reconcile its accounts.

For Loan No. 1459 (Water Supply and Sanitation Project loan), It is the FSMNG understanding that this loan should be allocated only to the states and that prior expenses recorded to the FSMNG should be properly transferred and allocated to the states. We will obtain a final report and confirmation from ADB Manila to properly transfer and allocate the prior year's expenditures recorded to the FSMNG. A formal communication will be made to the FSM states for any result we obtain from ADB.

The prior year understatement of loan proceeds for which a corresponding receivable-general was recorded will be identified in FY09 and proper allocation and recording of expenditures will make.

Auditor's Response: The initial loan schedule provided had differences upon comparison to audited imprest fund reports. Additional entry was provided in April 2009 to reconcile with the imprest fund audit report.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No.: 2008-17
CFDA Program: All Major
Requirement: Cash Management (Federal Holding Bank Account)
Questioned Costs: \$0

Criteria: Grants drawdowns received in the Federal Holding Bank Account should be timely identified and be disbursed to the entitled State. Furthermore, financial and programmatic records should be maintained on file for at least three years.

Condition: Timely reconciliation of the federal holding account does not occur. A schedule indicating the distribution of the current year federal holding cash was provided in February 2009.

As has been the case in prior years, cash and accounts payable were only updated by reverting prior balances and by recording the ending balance; the transactions in this cash account were not completely recorded in the National Government's books.

Efforts have been made to reconcile the federal holding account in the current year. A schedule was provided showing the distribution of federal holding withdrawals per State; however, underlying documentation (expenditure reports, drawdown requests and correspondence) to allow verification of the distribution was not completely provided. The FSM National Government procedures call for a monthly statement of revenue and expenditures to be provided per program per month to support draw downs. A majority of these detailed statements could not be located based on samples tested, although we were able to substantially agree year-end State reports to National Government records.

As reported in prior years, there has not been a prior reconciliation of this account. The approach taken by the National Government was on a prospective basis. In the current year, a reconciliation between the States and the National Government was undertaken. As a result, certain settlements were proposed to be made with the States for reconciling items removed from the federal holding account. The program source of the unidentified federal holding cash balance was no longer identified but was instead applied as payments of reconciling items. This process facilitated resolution as of September 30, 2008, but did not allow for reconciliation of earlier balances.

Cause: It appears that reconciliation and identification of prior year cash account transactions will not be undertaken as balances have been agreed as of September 30, 2008 and therefore, reconciliations will only be performed prospectively.

Effect: The effect of this condition is that adjustments were made in fiscal year 2008 to facilitate agreement with State records, but those adjustments are not supported by specific expenditures.

Recommendation: Reconciliations should periodically occur to ensure that the National Government records agree with those of its States.

Auditee Response and Corrective Action Plan: We agree with this finding. Cash and accounts payable was only updated at the end of the Fiscal Year 2008 by reverting the prior balance and recording the ending balance.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No.: 2008-17, Continued

Auditee Response and Corrective Action Plan, Continued:

This method has been changed in FY09. Beginning October 2008, all cash credits/deposit and cash debit/withdrawal reflected in the bank statements are now properly accounted per State government and FSMNG. These transactions are now being recorded in the books. The supporting documents like expense report, bank statement, and drawdown request are also attached to the Journal Voucher. This is being done on a monthly basis to allow reconciliation of the federal holding account. A procedure in recording the deposits/drawdown and withdrawal is now in place.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No. 2008-18 - Encumbrances

Criteria: Encumbrance balances should reflect the remaining unliquidated balance in the contract, purchase order or travel authorization. The listing should be periodically reviewed as to its validity.

Conditions:

1. In comparison of travel related encumbrances against outstanding travel advances, the amount encumbered is higher by \$392,007. This difference appears to indicate invalid encumbrances.

Total travel related encumbrances	\$ 2,102,786
Travel encumbrances at 80%	\$ 1,682,229
Total travel advance - all funds	\$ 1,290,222
Estimated invalid encumbrances	\$ 392,007

2. For the following encumbrances, there was either insufficient documentation provided or there was no rationale for differences between the recalculation and the general ledger balance.

<u>FD</u>	<u>ORG OBL</u>	<u>DATE1</u>	<u>BAL</u>	<u>VENDOR NAME</u>	<u>ENC NO</u>
91	30299	07/31/2008	\$9,733	DEVELOPMENT AS	CC00521

<u>Seln</u>	<u>Enc Ref</u>	<u>ORG OBL</u>	<u>BAL</u>	<u>PO/Contract</u>		<u>Variance</u>
				<u>FD</u>	<u>Date</u>	
1	TKE086	33631	\$ 467	01		\$ -
2	CC01161	27271	466	01	3/14/2006	(466)
3	CD01291	28334	60,000	01	1/9/2007	-
4	CK70101	28982	65,000	25		-
5	L703441	28336	150,000	01		(150,000)
6	LC81321	28925	4,995	25		-
7	ME45111	27476	625	01	2/27/2008	(1,578)
8	N700331	28950	9,300	25		-
9	TD16471	28154	3,117	01	8/1/2007	-
10	TD17421	27131	339	01	8/21/2007	-
11	TE04231	28314	13,221	01	1/15/2008	-
12	TE04231		-		12/6/2007	-
13	TE08361	28305	9,659	01	3/25/2008	-
14	TE10401	28194	3,957	01	4/28/2008	-
15	TE13901	28042	<u>2,092</u>	01	6/20/2008	-
			<u>\$323,236</u>			<u>\$(152,044)</u>

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

Finding No. 2008-18 - Encumbrances, Continued

<u>Seln</u>	<u>ENC NO</u>	<u>Per System</u>	<u>Per DTT calculation</u>	<u>Under (Over)</u>
1	CB0166CB0277CB0458CD0153	\$ 1,000,177	\$ 1,247,635	\$247,458
6	CB0423	797,157	411,659	(385,498)
8	CD0179	493,666	732,216	238,550
12	CE0210	77,954	35,000	42,954
18	C8C0081	-	-	-
20	CC01031	783,000	527,000	(256,000)
21	CC01731	73,823	51,419	(22,404)
22	CC01801	1,173,278	992,810	(180,468)
35	CE01092	639,867	292,578	(347,289)
40	CE01281	7,476,868	8,199,081	722,212
52	T8C2121	-	-	-
53	TE09421	-	-	-
		<u>\$12,515,790</u>	<u>\$12,489,397</u>	<u>\$59,516</u>

Cause: There appears to be a lack of controls over ensuring compliance with the criteria.

Effect: The encumbrance balance could be erroneous.

Recommendation: We recommend that the FSM National Government periodically review the validity of encumbrances.

Auditee Response and Corrective Action Plan: We disagree with the analysis made in Condition 1 simply because the analysis treated travel obligation with having one vendor but the fact is, there are two vendors in one travel obligation.

In travel obligation, the travel agency/airline and the employee/person traveling are the two vendors. If the person traveling and has filed the travel voucher, this does not mean that the travel obligation has to be closed if the travel agency has not been paid. A travel obligation can only be considered closed if the two vendors are fully paid and liquidated.

For Condition 2, the staff has been instructed to reconcile and verify the encumbrance and make the necessary adjustment to provide the correct balances in Fiscal Year 2009.

Auditor's Response: Granted the airfare portion maybe outstanding, the \$392,000 difference could pertain to travel already incurred thus should have been accrued as expenditure upon travel liquidation by the employee and unpaid portion recorded as accounts payable instead of encumbrances.

**FEDERATED STATES OF MICRONESIA
NATIONAL GOVERNMENT**

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

The following is a summary of unresolved federal questioned costs for the National Government.

	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>
Unresolved Questioned Costs FY 03	\$ 201,997	\$ 201,997	\$ -
Unresolved Questioned Costs FY 04	129,343	129,343	-
Unresolved Questioned Costs FY 05	966,012	966,012	-
Unresolved Questioned Costs FY 06	1,395,618	363,179	1,032,439
Unresolved Questioned Costs FY 07	<u>4,139,445</u>	<u>435,310</u>	<u>3,704,135</u>
	<u>\$ 6,832,415</u>	<u>\$ 2,095,841</u>	4,736,574
Questioned Costs FY 08			<u>2,372,041</u>
			<u>\$ 7,115,095</u>

Of the \$2,095,841 resolved during fiscal year 2008, \$1,142,533 was resolved per OMB Circular A-133, Section .315(b)(4). The remaining balance was resolved through specific rulings issued by grantor agencies.

The status of prior year findings is forth in the accompanying Schedule of Findings and Questioned Costs (pages 85-117).