

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

**REPORT ON THE AUDIT OF  
FINANCIAL STATEMENTS IN ACCORDANCE  
WITH OMB CIRCULAR A-128**

**YEAR ENDED SEPTEMBER 30, 1996**

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Year Ended September 30, 1996

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**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA  
INDEPENDENT AUDITORS' REPORT ON  
GENERAL PURPOSE FINANCIAL STATEMENTS  
YEAR ENDED SEPTEMBER 30, 1996**



**INDEPENDENT AUDITORS' REPORT**

Honorable Moses Mackwelung  
Governor, State of Kosrae  
Federated States of Micronesia:

We have audited the accompanying general purpose financial statements of the State of Kosrae, as of September 30, 1996, and for the year then ended, as set forth in Section II of the foregoing table of contents. These general purpose financial statements are the responsibility of the management of the State of Kosrae. Our responsibility is to express an opinion on these general purpose financial statements based on our audit.

Except as discussed in the following paragraphs, we conducted our audit in accordance with generally accepted auditing standards and 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 general purpose financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the general purpose financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall general purpose financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

The State of Kosrae has not adequately updated its General Fixed Assets Account Group during the year ended September 30, 1996, nor were we able to apply sufficient alternative procedures to assure ourselves as to the correctness of the balances set forth in the accompanying general purpose financial statements. Accordingly, a statement of changes in general fixed assets has not been included within the accompanying general purpose financial statements.

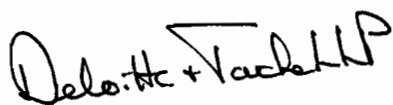
The general purpose financial statements referred to above do not include the Component Units - Governmental Funds, comprised entirely of the Kosrae Community Action Program (KCAP), which, in our opinion, should be included to conform with generally accepted accounting principles. KCAP was unable to produce financial statements and the effect on the accompanying general purpose financial statements is unknown.

We were not able to perform audit procedures on the Governmental Fund Type - Expendable Trust Funds financial statements as such financial statements were not available for our review.

In our opinion, except for the effects on the general purpose financial statements of such adjustments, if any, as might have been determined to be necessary had we been able to assure ourselves as to the propriety of the General Fixed Assets Account Group, the omission of the Component Units - Governmental Funds and our inability to audit the Governmental Fund Type - Expendable Trust Funds, discussed in the third through fifth paragraphs above, such general purpose financial statements, as set forth in Section II of the table of contents, with the exception of the General Fixed Assets Account Group upon which we are unable to express an opinion because of the matters set forth in the third paragraph above, present fairly, in all material respects, the financial position of the State of Kosrae as of September 30, 1996, and the results of its operations and the cash flows of its proprietary funds for the year then ended in conformity with generally accepted accounting principles.

Our audit was conducted for the purpose of forming an opinion on the general purpose financial statements taken as a whole. The combining and individual fund financial statements and schedules listed in Section III of the foregoing table of contents, which are also the responsibility of the management of the State of Kosrae, are presented for purposes of additional analysis and are not a required part of the general purpose financial statements of the State of Kosrae. Such additional information has been subjected to the auditing procedures applied in our audit of the general purpose financial statements and, except for the effects of the item described in the fifth paragraph above, in our opinion, is fairly stated in all material respects when considered in relation to the general purpose financial statements taken as a whole.

In accordance with Government Auditing Standards, we have also issued a report dated May 17, 1997 on our consideration of the State of Kosrae's internal control structure and a report dated May 17, 1997 on its compliance with laws and regulations.

Delo-Hc + Vach HP

May 17, 1997



STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA

Combined Balance Sheet - All Fund Types, Account Groups and Discretely Presented Component Units, Continued  
September 30, 1996  
(With comparative totals as of September 30, 1995)

	Governmental Fund Types			Proprietary Fund Type	Fiduciary Fund Type	Account Groups		Totals Primary Government (Memorandum Only)	Component Unit Kosrae Utilities Authority	Totals Reporting Entity (Memorandum Only)	
	General	Special Revenue	Capital Projects	Internal Service	Expendable Trust	General Fixed Assets	General Long-Term Debt			1996	1995
<b>ASSETS</b>											
Cash and equivalents (note 2)	\$ 287,674	\$ 6,967	\$ 544,572	\$ -	\$ -	\$ -	\$ -	\$ 839,213	\$ 1,210,003	\$ 2,049,216	\$ 1,235,281
Other term deposits (note 2)	542,720	-	761,187	-	-	-	-	1,303,907	-	1,303,907	2,193,988
Investments (note 2)	1,379,638	-	21,753	-	-	-	-	1,401,391	-	1,401,391	1,277,190
Equity investments (note 5)	-	-	1,212,033	-	-	-	-	1,212,033	-	1,212,033	1,538,380
Receivables from federal agencies	195,358	1,187,737	504,755	-	-	-	-	1,887,850	93,729	1,981,579	501,906
Receivables from other governments	-	11,550	1,408,171	-	-	-	-	1,419,721	-	1,419,721	1,819,085
General receivables, net (note 4)	174,205	181,355	-	-	7,911	-	-	363,471	498,876	862,347	1,412,560
Advances (note 4)	329,399	343,250	288,507	-	-	-	-	961,156	-	961,156	853,463
Loans receivable, net (note 4)	-	-	125,000	-	455,944	-	-	580,944	-	580,944	822,532
Due from other funds (note 8)	1,798,533	653,366	2,194,788	-	418,999	-	-	5,065,686	-	5,065,686	3,893,459
Inventory, at cost	-	-	-	59,555	-	-	-	59,555	281,549	341,104	196,767
Interest receivable	17,033	-	-	-	-	-	-	17,033	-	17,033	13,997
Prepayments	-	-	-	-	-	-	-	-	-	-	13,538
Fixed assets, net	-	-	-	-	-	1,264,375	-	1,264,375	4,299,906	5,564,281	4,710,644
Amount to be provided for retirement of long-term debt	-	-	-	-	-	-	1,055,287	1,055,287	-	1,055,287	1,832,509
<b>Total assets</b>	<b>\$ 4,724,560</b>	<b>\$ 2,384,225</b>	<b>\$ 7,060,766</b>	<b>\$ 59,555</b>	<b>\$ 882,854</b>	<b>\$ 1,264,375</b>	<b>\$ 1,055,287</b>	<b>\$ 17,431,622</b>	<b>\$ 6,384,063</b>	<b>\$ 23,815,685</b>	<b>\$ 22,315,299</b>

See accompanying notes to financial statements.

STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA

Combined Balance Sheet - All Fund Types, Account Groups and Discretely Presented Component Units, Continued  
September 30, 1996  
(With comparative totals as of September 30, 1995)

	Governmental Fund Types			Proprietary	Fiduciary	Account Groups		Totals	Component	Totals	
	General	Special	Capital	Fund Type	Fund Type	General	General	Primary	Unit	Reporting Entity	
		Revenue	Projects	Internal	Expendable	Fixed	Long-Term	Government	Kosrae	(Memorandum Only)	
				Service	Trust	Assets	Debt	(Memorandum Only)	Utilities Authority	1996	1995
<b>LIABILITIES AND FUND EQUITY (DEFICIENCY)</b>											
<b>Liabilities:</b>											
Bank overdraft	\$ 830,562	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 830,562	\$ -	\$ 830,562	\$ -
Accounts payable	106,738	295,758	278,582	9,727	42,581	-	-	733,386	109,591	842,977	498,788
Accrued payroll and others	305,797	15,223	3,060	-	-	-	-	324,080	17,865	341,945	280,526
Due to other funds (note 8)	273,982	2,730,004	1,917,203	144,497	-	-	-	5,065,686	-	5,065,686	3,893,459
Deferred revenues	-	28,095	-	-	-	-	-	28,095	-	28,095	28,095
Due to other governments	180,636	-	-	-	-	-	-	180,636	-	180,636	180,636
Long-term notes payable (note 10)	-	-	-	-	-	-	336,429	336,429	-	336,429	1,373,163
Vacation leave accrual	-	-	-	-	-	-	718,858	718,858	27,387	746,245	474,831
Other payables	269,965	-	-	-	-	-	-	269,965	-	269,965	324,429
<b>Total liabilities</b>	<b>1,967,680</b>	<b>3,069,080</b>	<b>2,198,845</b>	<b>154,224</b>	<b>42,581</b>	<b>-</b>	<b>1,055,287</b>	<b>8,487,697</b>	<b>154,843</b>	<b>8,642,540</b>	<b>7,053,927</b>
<b>Fund equity (deficiency):</b>											
Investment in general fixed assets	-	-	-	-	-	1,264,375	-	1,264,375	-	1,264,375	1,264,375
Retained earnings (deficit)	-	-	-	(94,669)	-	-	-	(94,669)	2,015,560	1,920,891	1,175,462
Contributed capital	-	-	-	-	-	-	-	-	4,213,660	4,213,660	3,424,671
<b>Fund balances (deficit):</b>											
<b>Reserved for:</b>											
Related assets	4,155,501	-	1,337,033	-	455,944	-	-	5,948,478	-	5,948,478	4,568,377
Encumbrances	224,739	462,706	1,565,376	-	149,892	-	-	2,402,713	-	2,402,713	1,969,894
Continuing appropriations (note 9)	50,680	226,296	3,196,647	-	-	-	-	3,473,623	-	3,473,623	5,766,285
Unreserved	(1,674,040)	(1,373,857)	(1,237,135)	-	234,437	-	-	(4,050,595)	-	(4,050,595)	(2,907,692)
<b>Total fund equity (deficiency)</b>	<b>2,756,880</b>	<b>(684,855)</b>	<b>4,861,921</b>	<b>(94,669)</b>	<b>840,273</b>	<b>1,264,375</b>	<b>-</b>	<b>8,943,925</b>	<b>6,229,220</b>	<b>15,173,145</b>	<b>15,261,372</b>
<b>Contingencies (note 6)</b>											
<b>Total liabilities and fund equity (deficiency)</b>	<b>\$ 4,724,560</b>	<b>\$ 2,384,225</b>	<b>\$ 7,060,766</b>	<b>\$ 59,555</b>	<b>\$ 882,854</b>	<b>\$ 1,264,375</b>	<b>\$ 1,055,287</b>	<b>\$ 17,431,622</b>	<b>\$ 6,384,063</b>	<b>\$ 23,815,685</b>	<b>\$ 22,315,299</b>
See accompanying notes to financial statements.											

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Combined Statement of Revenues, Expenditures and Changes in Fund Balances (Deficit)  
All Governmental Fund Types and Expendable Trust Funds  
Year Ended September 30, 1996  
(With comparative totals for the year ended September 30, 1995)

	Governmental Fund Types			Fiduciary Fund Type Expendable Trust	Totals Reporting Entity (Memorandum Only)	
	General	Special Revenue	Capital Projects		1996	1995
<b>Revenues:</b>						
Compact of Free Association:						
Base amount	\$ 2,791,740	\$ 1,839,392	\$ 2,445,960	\$ -	\$ 7,077,092	\$ 7,052,301
Inflation adjustment	1,340,035	336,000	1,174,061	-	2,850,096	2,731,342
U.S. Department of the Interior grants	-	-	243,432	-	243,432	967,296
Revenue sharing	832,964	-	-	-	832,964	796,132
Federal contributions	-	1,972,995	-	-	1,972,995	1,192,642
Taxes and licenses	168,752	-	-	-	168,752	147,896
Investment income (note 2)	355,907	-	-	-	355,907	383,401
Other	451,135	80,733	1,185,748	370,254	2,087,870	1,622,623
<b>Total revenues</b>	<b>5,940,533</b>	<b>4,229,120</b>	<b>5,049,201</b>	<b>370,254</b>	<b>15,589,108</b>	<b>14,893,633</b>
<b>Expenditures:</b>						
General government	1,841,229	1,986,175	-	-	3,827,404	3,566,009
Education	645,925	1,282,972	-	-	1,928,897	1,767,879
Health services	901,470	201,802	-	-	1,103,272	1,144,812
Economic development	724,623	561,125	-	-	1,285,748	1,139,486
Public works	423,286	-	-	-	423,286	454,372
Public safety	351,379	-	-	-	351,379	370,269
Community affairs	317,773	57,103	-	-	374,876	769,224
Capital projects	-	-	5,082,857	-	5,082,857	2,861,470
Other	111,431	263,049	-	606,339	980,819	1,098,919
<b>Total expenditures</b>	<b>5,317,116</b>	<b>4,352,226</b>	<b>5,082,857</b>	<b>606,339</b>	<b>15,358,538</b>	<b>13,172,440</b>
<b>Excess (deficiency) of revenues     over (under) expenditures</b>	<b>623,417</b>	<b>(123,106)</b>	<b>(33,656)</b>	<b>(236,085)</b>	<b>230,570</b>	<b>1,721,193</b>
<b>Other financing sources (uses):</b>						
Bond principal repayments (note 10)	-	-	(1,000,000)	-	(1,000,000)	(1,000,000)
Bond interest expense (note 10)	-	-	(41,850)	-	(41,850)	(123,229)
Operating transfers out (note 11)	-	(485,019)	-	-	(485,019)	(407,000)
Equity loss on investment (note 5)	-	-	(326,346)	-	(326,346)	(187,717)
Equity earnings on investment	-	-	-	-	-	232,202
<b>Total other financing sources (uses), net</b>	<b>-</b>	<b>(485,019)</b>	<b>(1,368,196)</b>	<b>-</b>	<b>(1,853,215)</b>	<b>(1,485,744)</b>
<b>Excess (deficiency) of revenues and other     financing sources over (under) expenditures     and other financing uses</b>	<b>623,417</b>	<b>(608,125)</b>	<b>(1,401,852)</b>	<b>(236,085)</b>	<b>(1,622,645)</b>	<b>235,449</b>
<b>Fund balances (deficit) at   beginning of year</b>	<b>2,133,463</b>	<b>(76,730)</b>	<b>6,263,773</b>	<b>1,076,358</b>	<b>9,396,864</b>	<b>8,736,415</b>
<b>Equity contribution</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>425,000</b>
<b>Fund balances (deficit) at end of year</b>	<b>\$ 2,756,880</b>	<b>\$ (684,855)</b>	<b>\$ 4,861,921</b>	<b>\$ 840,273</b>	<b>\$ 7,774,219</b>	<b>\$ 9,396,864</b>

See accompanying notes to financial statements.

**STATE OF KOSRAE**  
**FEDERATED STATES OF MICRONESIA**

Combined Statement of Revenues, Expenditures and Changes in Fund Balance  
Budgetary Basis - General Fund  
Year Ended September 30, 1996

	<u>Budget</u>	<u>Actual</u>	<u>Variance</u>
<b>Revenues:</b>			
Compact funding:			
Base amount	\$ 2,791,740	\$ 2,791,740	\$ -
Inflation adjustment	1,228,366	1,340,035	111,669
Revenue sharing	555,000	832,964	277,964
State taxes and licenses	151,200	168,752	17,552
Investment income	100,000	355,907	255,907
Miscellaneous	543,500	451,135	(92,365)
	<u>5,369,806</u>	<u>5,940,533</u>	<u>570,727</u>
<b>Expenditures:</b>			
General government	1,935,451	1,849,484	85,967
Education	1,056,112	670,235	385,877
Health services	941,960	907,912	34,048
Economic development	772,998	698,847	74,151
Public works	471,899	423,591	48,308
Public safety	359,410	346,834	12,576
Community affairs	355,696	359,105	(3,409)
Others	-	111,431	(111,431)
	<u>5,893,526</u>	<u>5,367,439</u>	<u>526,087</u>
Excess (deficiency) of revenues over (under) expenditures	(523,720)	573,094	1,096,814
Unreserved fund balance at beginning of year	1,005,693	1,005,693	-
Other changes in unreserved fund balance:			
Decrease in reserve for continuing appropriations	-	34,812	34,812
Increase in reserve for related assets	-	(3,287,639)	(3,287,639)
Unreserved fund balance at end of year	<u>\$ 481,973</u>	<u>\$ (1,674,040)</u>	<u>\$ (2,156,013)</u>

See accompanying notes to financial statements.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Combined Statement of Revenues, Expenses, and Changes in Fund Equity -  
All Proprietary Fund Types and Discretely Presented Component Units  
Year Ended September 30, 1996  
(With comparative totals for the year ended September 30, 1995)

	Proprietary Fund Type Internal Service	Totals Primary Government (Memorandum Only)	Component Unit Kosrae Utilities Authority	Totals Reporting Entity (Memorandum Only)	
				1996	1995
Operating revenues:					
Charges for services	\$ 34,654	\$ 34,654	\$ 1,311,198	\$ 1,345,852	\$ 1,494,200
Operating expenses:					
Personnel services	-	-	338,032	338,032	340,686
Supplies and materials	29,114	29,114	-	29,114	90,167
Fuel	-	-	702,047	702,047	746,244
Depreciation	-	-	330,062	330,062	323,108
Bad debt expense	-	-	-	-	147,842
Other	-	-	158,948	158,948	313,727
Total operating expenses	29,114	29,114	1,529,089	1,558,203	1,961,774
Operating income (loss)	5,540	5,540	(217,891)	(212,351)	(467,574)
Nonoperating revenues:					
Operating transfers in (note 11)	-	-	578,748	578,748	407,000
Others	-	-	84,812	84,812	203,207
Total nonoperating revenues	-	-	663,560	663,560	610,207
Net income	5,540	5,540	445,669	451,209	142,633
Add depreciation on fixed assets acquired by capital contributions that reduce contributed capital	-	-	294,220	294,220	292,612
Increase in retained earnings	5,540	5,540	739,889	745,429	435,245
Retained earnings (deficit) at beginning of year	(100,209)	(100,209)	1,275,671	1,175,462	861,223
Restatement for prior year Kosrae Utilities Authority overstatement of receivables	-	-	-	-	(121,006)
Retained earnings (deficit) at end of year	(94,669)	(94,669)	2,015,560	1,920,891	1,175,462
Contributed capital at beginning of year	-	-	3,424,671	3,424,671	3,717,283
Contributions	-	-	1,083,209	1,083,209	-
Less amortization of contributed capital	-	-	(294,220)	(294,220)	(292,612)
Contributed capital at end of year	-	-	4,213,660	4,213,660	3,424,671
Fund equity at end of year	\$ (94,669)	\$ (94,669)	\$ 6,229,220	\$ 6,134,551	\$ 4,600,133

See accompanying notes to financial statements.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Combined Statement of Cash Flows  
All Proprietary Fund Types and Discretely Presented Component Units  
Year Ended September 30, 1996  
(With comparative totals for the year ended September 30, 1995)

	Proprietary Fund Type	Totals Primary Government (Memorandum Only)	Component Unit Kosrae Utilities Authority	Totals Reporting Entity (Memorandum Only)	
	Internal Service			1996	1995
Cash flows from operating activities:					
Operating income (loss)	\$ 5,540	\$ 5,540	\$ (217,891)	\$ (212,351)	\$ (467,574)
Adjustment to reconcile operating income (loss) to net cash provided by (used for) operating activities:					
Depreciation	-	-	330,062	330,062	323,108
Bad debt expense	-	-	-	-	147,842
Interest income	-	-	63,921	63,921	-
Other income	-	-	20,891	20,891	16,258
	<u>5,540</u>	<u>5,540</u>	<u>196,983</u>	<u>202,523</u>	<u>19,634</u>
Changes in assets and liabilities:					
General receivables, net	1,218	1,218	(67,972)	(66,754)	(64,209)
Inventory	-	-	(182,748)	(182,748)	68,142
Prepayments	-	-	13,537	13,537	(5,694)
Other assets	-	-	-	-	(55,964)
Accounts payable	9,727	9,727	100,981	110,708	(113,068)
Accrued payroll and others	-	-	29,767	29,767	(13,312)
Due to other funds	(16,485)	(16,485)	-	(16,485)	-
Other payables	-	-	-	-	15,485
	<u>(5,540)</u>	<u>(5,540)</u>	<u>(106,435)</u>	<u>(111,975)</u>	<u>(168,620)</u>
Net cash provided by (used for) operating activities	<u>-</u>	<u>-</u>	<u>90,548</u>	<u>90,548</u>	<u>(148,986)</u>
Cash flows from noncapital financing activities:					
Operating and other transfers in (note 11)	<u>-</u>	<u>-</u>	<u>578,748</u>	<u>578,748</u>	<u>593,949</u>
Net cash provided by noncapital financing activities	<u>-</u>	<u>-</u>	<u>578,748</u>	<u>578,748</u>	<u>593,949</u>
Cash flows from capital and related financing activities:					
Additions to fixed assets	-	-	(86,871)	(86,871)	(65,463)
Construction work in progress	-	-	(1,096,799)	(1,096,799)	-
Capital contribution from Kosrae State Government	-	-	1,083,209	1,083,209	-
Net cash used for capital and related financing activities	<u>-</u>	<u>-</u>	<u>(100,461)</u>	<u>(100,461)</u>	<u>(65,463)</u>
Net increase in cash and equivalents	<u>-</u>	<u>-</u>	<u>568,835</u>	<u>568,835</u>	<u>379,500</u>
Cash and equivalents at beginning of year	<u>-</u>	<u>-</u>	<u>641,168</u>	<u>641,168</u>	<u>261,668</u>
Cash and equivalents at end of year	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,210,003</u>	<u>\$ 1,210,003</u>	<u>\$ 641,168</u>

See accompanying notes to financial statements.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 1996

(1) Summary of Significant Accounting Policies

The general purpose financial statements of the State of Kosrae have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of the State of Kosrae's accounting policies are described below.

A. Reporting Entity

As required by generally accepted accounting principles, the general purpose financial statements of the State of Kosrae present the government and its component units; entities for which the government is considered to be financially accountable. Blended component units, although legally separate entities, are, in substance, part of the government's operations so data from these units are combined with data of the primary government. Discretely presented component units, on the other hand, are reported in a separate column in the general purpose financial statements to emphasize that they are legally separate from the government. There are no blended component units attributable to Kosrae State and only one discretely presented component unit is presented in the accompanying general purpose financial statements.

Discretely Presented Component Unit

Kosrae Utilities Authority (KUA) is responsible for providing power services for the State which includes the government's jurisdiction. The members of the governing board are appointed by the governor with the consent of the state legislature. The government is potentially liable for the operating deficit (to date, KUA has not experienced an operating deficit) and would be secondarily liable for any debt issuances of KUA (currently, there is no debt outstanding). KUA is presented as a component unit - proprietary fund.

B. Fund Accounting

The State of Kosrae uses funds and account groups to report on its financial position and the results of its operations. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain Kosrae State functions or activities.

A fund is a separate accounting entity with a self-balancing set of accounts. An account group, on the other hand, is a financial reporting device designed to provide accountability for certain assets and liabilities that are not recorded in the funds because they do not directly affect net expendable available financial resources. They are concerned only with the measurement of financial position and are not involved with measurement of results of operations.

Funds are classified into three categories: governmental, proprietary and fiduciary. Each category, in turn, is divided into separate "fund types."

Governmental funds are used to account for all or most of a government's general activities, including the collection and disbursement of earmarked monies (special revenue funds) and the acquisition or construction of general fixed assets (capital projects funds). The general fund is used to account for all activities of the general government not accounted for in some other fund.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 1996

(1) Summary of Significant Accounting Policies, Continued

B. Fund Accounting, Continued

Proprietary funds are used to account for activities similar to those found in the private sector, where the determination of net income is necessary or useful to sound financial administration. Goods or services from such activities can be provided either to outside parties (enterprise funds) or to other departments or agencies primarily within the government (internal service funds).

The Internal Service Fund is used to account for the stock supply operation of a self-sustaining state agency rendering services to other state agencies on a cost reimbursement basis.

Fiduciary funds are used to account for assets held on behalf of outside parties, including other governments, or on behalf of other funds within the State of Kosrae. When these assets are held under the terms of a formal trust agreement, either a pension trust fund, a nonexpendable trust fund or an expendable trust fund is used. The terms "nonexpendable" and "expendable" refer to whether or not the State of Kosrae is under an obligation to maintain the trust principal.

There are two account groups. The General Fixed Assets Account Group is used to account for fixed assets not accounted for in proprietary funds. The General Long-Term Debt Account Group is used to account for general long-term debt and certain other liabilities that are not specific liabilities of proprietary funds.

C. Basis of Presentation

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. All governmental funds and expendable trust funds are accounted for using a current financial resources measurement focus. With this measurement focus, only current assets and current liabilities generally are included on the balance sheet. Operating statements of these funds present increases (i.e., revenues and other financing sources) and decreases (i.e., expenditures and other financing uses) in net current assets.

All proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operation of these funds are included on the balance sheet. Fund equity (i.e., net total assets) is segregated into contributed capital and retained earnings components. Proprietary fund type operating statements present increases (i.e., revenues) and decreases (i.e., expenses) in net total assets.

The modified accrual basis of accounting is used by all governmental fund types and expendable trust funds. Under the modified accrual basis of accounting, revenues are recognized when susceptible to accrual (i.e., when they become both measurable and available). "Measurable" means the amount of the transaction can be determined and "available" means collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period.



**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 1996

(1) Summary of Significant Accounting Policies, Continued

C. Basis of Presentation, Continued

The State of Kosrae considers all revenues available if they are collected within sixty days after year end. Expenditures are recorded when the related fund liability is incurred, except for unmatured interest on general long-term debt which is recognized when due, and certain compensated absences and claims and judgments which are recognized when the obligations are expected to be liquidated with expendable available financial resources.

Taxes, licenses and interest are susceptible to accrual. Sales taxes collected and held by the state at year end on behalf of the government are also recognized as revenue. Other receipts and taxes become measurable and available when cash is received by the government and are recognized as revenue at that time.

The accrual basis of accounting is utilized by proprietary fund types. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

D. Budgetary Process

Legislation requires the Governor to present a budget proposal to the Legislature at the beginning of each annual session. The Legislature then appropriates operating budgets which are limited in total by estimated fund revenues. Before signing an Appropriations Bill, the Governor may veto or reduce any specific appropriation; this veto is also subject to legislative override.

Encumbrance accounting is utilized for budgetary control purposes. Encumbrances outstanding at year end are reported as reservations of fund balance, and remain reservations of fund balance until becoming expended or canceled. Amounts included on the Statement of Revenues, Expenditures and Changes in Fund Balance - Budget and Actual - General Fund (which are presented on a non-GAAP budgetary basis) are reconciled to unreserved fund balance of the combined balance sheet within the other changes in unreserved fund balance section of that statement.

During fiscal year 1996, supplemental appropriations were made for both operating and capital purposes, to reflect revised financial priorities of Kosrae State Government.

Budgetary control is maintained at the departmental level. Budget revisions during the year, reflecting program changes or intra-departmental transfers of an administrative nature, may be effected with Executive and Legislative branch approval.

Unencumbered appropriations normally lapse at the end of each fiscal year unless designated as continuing appropriations.

E. Receivables

Receivables in the State's governmental funds consist primarily of taxes and federal revenues. Since few governmental fund type revenues are susceptible to accrual prior to receipt, most taxes, licenses, fees, permits and similar items are recognized on the cash basis.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 1996

(1) Summary of Significant Accounting Policies, Continued

F. Interfund Transactions

The State of Kosrae utilizes three types of potential interfund transactions:

1. The majority of the State's financial operations are centrally administered, and this administration is facilitated by the use of a "pooled" cash account; for practical purposes, cash is primarily maintained in a single bank account which is considered to be an asset of the State's general fund. As a result of this cash pooling practice, cash transactions normally include entries which adjust the relative balances of affected funds' interfund asset/liability accounts; each fund's interfund balance therefore represents a net interest in the State's actual cash.
2. Operating appropriations/subsidies which are accounted for as operating transfers of resources between funds.
3. Residual equity transfers which record the transfer of residual fund balances upon the termination of a fund's operations. These transfers are accounted for as additions to or deductions from governmental type fund balances or proprietary fund type fund equities.

For all funds, the combining balance sheet separately classifies interfund activity with the General Fund.

G. Inventory

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

H. Investments

Investments are generally carried at the lower of cost or market.

I. Fixed Assets

Governmental general fixed assets are carried in the General Fixed Assets Account Group. No depreciation is provided for on these assets. Assets are stated at cost or estimated cost. Fixed assets of Kosrae State Government also include capital infrastructure. The State has not recorded additions or deletions to this Account Group in recent years and therefore, no statement of changes in general fixed assets is included in the accompanying general purpose financial statements.

Fixed assets of the Kosrae Utilities Authority, a component unit - proprietary fund, are comprised of various utility plant assets which are depreciated by the straight-line method over the estimated useful lives, as follows:

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 1996

(1) Summary of Significant Accounting Policies, Continued

I. Fixed Assets, Continued

	<u>Estimated Useful Lives</u>	
Production plant	5 - 40 years	\$ 2,438,041
Distribution plant	5 - 30 years	1,459,062
General plant	3 - 20 years	<u>257,930</u>
Electric plant in service		4,155,033
Less accumulated depreciation		<u>(951,926)</u>
		3,203,107
Construction in progress		<u>1,096,799</u>
		\$ <u>4,299,906</u>

J. Actual Expenditures Contrasted With Budgetary Expenditures

Actual expenditures are charges which represent the total of all current year liabilities incurred which were attributable to operations; such liabilities may represent liquidations of either current or prior year encumbrances.

In contrast, budgetary expenditures represent current charges against appropriations; current charges consist of all current year liquidated and unliquidated encumbrances. Budgetary expenditures are determined by subtracting both current year liquidations of prior year encumbrances and unliquidated prior year encumbrances from the combined total of current year actual expenditures and all unliquidated encumbrances. When viewed in relation to respective budgets, budgetary expenditures provide the principal means of evaluating current year operating performance and management stewardship.

K. Fund Balance Reserves

The State's fund balance reserves represent those portions of fund balance (1) not appropriable for expenditure or (2) legally segregated for a specific future use. Reserves for related assets such as inventories and long-term receivables are examples of the former. Reserves for encumbrances, continuing appropriations and other specific purposes are examples of the latter.

Reserves for related assets in the general purpose financial statements at September 30, 1996, are generally as follows:

General Fund:

General receivables and advances	\$ 343,013
Federal assistance fund (deficit)	251,998
Compact special block grant (deficit)	585,302
Kosrae Transportation Fund receivable	162,563
Compact scholarship (deficit)	83,127

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 1996

(1) Summary of Significant Accounting Policies, Continued

K. Fund Balance Reserves, Continued

General Fund, Continued:

O&M assistance fund (deficit)	52,149
Non-U.S. grant (deficit)	106,932
Due from other governments-CFSM fund	1,281,737
Due from other governments-Federal grants fund	782,995
Due from other governments-Operation and maintenance	159,476
Due from other governments-TTPI CIP fund	<u>346,209</u>
	\$ <u>4,155,501</u>

Capital Projects Funds:

Equity investments	\$ 1,212,033
Loan receivable	<u>125,000</u>
	\$ <u>1,337,033</u>

Expendable Trust Funds:

Loans receivable	\$ <u>455,944</u>
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L. Cash and Equivalents

The State defines cash and equivalents as cash on deposit in banks including time certificates of deposit with an initial maturity of ninety days or less.

M. Compensated Absences

Vested or accumulated vacation leave that is expected to be liquidated with expendable available financial resources is reported as an expenditure and a fund liability of the governmental fund that will pay it. Amounts of vested or accumulated vacation leave that are not expected to be liquidated with expendable available financial resources are reported in the general long-term debt account group. The liability as of September 30, 1996 is \$718,858. No expenditure is reported for these amounts.

N. Totals - Memorandum Only

The "Totals - Memorandum Only" columns represent an aggregate of the individual combined financial statements. The total column is presented for overview informational purposes and does not represent consolidated financial information.

O. Management Estimates

The preparation of financial statements in conformity with generally accepted accounting principles 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 expenses during the reporting period. Actual results could differ from those estimates.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 1996

(2) Cash and Investments

The State has adopted the by-laws of the Federated Development Authority as the agency to establish the overall development goals, policies and strategies of funds received and invested pursuant to the Compact of Free Association. The Federated States of Micronesia, Secretary of Finance, maintains such accounting system and records as are necessary to account for investment funds placed with the Authority on behalf of Kosrae State.

The Federated Development Authority has selected investment managers who are given authority to buy and sell securities as follows:

- A. Investment managers may invest in stocks, bonds and cash equivalents. Minimum standards of quality for investments at the time of purchase shall be:
  - 1. 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.
  - 2. Bonds - Confined to issues rated "A" or higher by a national rating service, except in the case of U.S. Treasury or Agency securities which are not rated.
  - 3. Cash and equivalents - The manager may engage in all normally accepted short-term investment practices including, but not limited to: U.S. Treasury and Agency securities, bankers acceptances, certificates of deposit, commercial paper and repurchase agreements using any of the foregoing as collateral. The following restrictions apply:
    - a. Commercial paper must be rated A-1/P-1 or higher by Standard & Poors Corporation and Moodys Investor Services.
    - b. Certificates of deposit must be from FDIC insured banks of which must have assets in excess of two billion dollars. Deposits in smaller institutions are acceptable, but must not exceed the amount of the insurance unless collateralized by U. S. Treasury Securities at 102%.
- B. The equity portfolio shall be diversified among issues and industry classifications. No more than 25% of the equity portfolio may be invested in any single classification, as described by the Standard and Poors 500 Index, unless prior approval is received from the Secretary of Finance.
- C. 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.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 1996

(2) Cash and Investments, Continued

Funds invested with Hawaiian Trust Co. on behalf of Kosrae State as of September 30, 1996, are summarized below:

<u>Cash and Equivalents</u>	<u>Carrying Amount</u>	<u>Market Value</u>
Certificates of deposit	\$ 839,213	\$ 839,213
<u>Investments</u>		
Pooled investment securities	<u>1,401,391</u>	<u>1,606,161</u>
Total investments	\$ <u>2,240,604</u>	\$ <u>2,445,374</u>

It is the policy of the State that earnings from pooled cash and investments generally accrue to the General Fund.

The State does not require collateralization of its bank deposits. The Primary Government has \$300,000 of cash and equivalents subject to FDIC insurance; \$200,000 for the Kosrae Utilities Authority. The remaining balances of cash and equivalents are uncollateralized. At September 30, 1996, the State had deposits as follows (in each situation, cost approximates market value):

General Fund

Cash on deposit with Hawaiian Trust Co.	\$ <u>287,674</u>
Certificate of deposit with FDIC insured bank	\$ <u>542,720</u>

Special Revenue Funds

Cash on deposit with Hawaiian Trust Co.	\$ <u>6,937</u>
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Capital Projects Funds

Certificate of deposit with FDIC insured bank	\$ 761,187
Cash on deposit with Hawaiian Trust	\$ <u>544,572</u>
	\$ <u>1,305,759</u>

Credit risk associated with investments is categorized into three levels generally described as follows:

- Category 1 - Insured or registered, or securities held by the State or its agent in the State's name.
- Category 2 - Uninsured and unregistered, or securities held by a party other than the State or its agent, but in the State's name.
- Category 3 - Uninsured and unregistered, with securities held by a party other than the State and not in the State's name.

All investments held by the State or Trustee have been classified as category 2 investments in accordance with GASB #3 as all investments are held in the name of the Federated Development Authority.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 1996

(2) Cash and Investments, Continued

Investment income for the year ended September 30, 1996, is comprised of the following items:

Gross investment gains	\$ 44,630
Interest and dividends	347,262
Management and other fees	(24,998)
Interest on deposits	<u>(10,987)</u>
	\$ <u>355,907</u>

(3) Receivables From Other Governments and Federal Agencies

Amounts due from other governments include those funds which are earned and have yet to be reimbursed by the FSM National Government for U. S. federal assistance programs, U.S. Department of the Interior Capital Projects Grant, and those grants received from the Congress of the Federated States of Micronesia for capital projects.

Amounts due from federal agencies are funds which are reimbursed directly from U. S. federal agencies.

(4) Receivables

Various Expendable Trust Funds have loans and other receivables of \$455,944 and \$7,911, respectively. These balances are fully reserved within the related asset component of fund balance in the applicable funds.

The Capital Project Funds has a \$125,000 loan receivable from the Pacific Tuna Industries, a related party (See Note 5) at 3 percent to be repaid in eight installments beginning September, 1995.

The General Fund, Special Revenue Funds and Capital Project Funds, have \$329,399, \$343,250, and \$288,507, respectively, of advances made to State government employees and medical referral patients for travel related expenditures. These advances are to be liquidated by submission of vouchers following the completion of travel.

General fund general receivables consist of general and miscellaneous receivables. The amount in the accompanying financial statements is net of an allowance for doubtful accounts of \$40,000, with the net balance being fully reserved in the related asset component of fund balance.

Receivables of the Kosrae Utilities Authority are for utility services rendered and are not net of an allowance for doubtful accounts.

(5) Other Investments

During the year ended September 30, 1996, the State has 50,000 ordinary shares in the Bank of the Federated States of Micronesia for a total cost of \$500,000. The Government's 50,000 shares represent approximately 5% of the Bank's total shares at September 30, 1996. This investment is recorded at cost, is considered long-term and has been fully reserved in the related asset component of fund balance. As of September 30, 1996, Kosrae State Government has \$761,187 in certificates of deposit with the bank.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 1996

(5) Other Investments, Continued

The appropriation to fund the acquisition of the first 25,000 shares originated in the year ended September 30, 1990. The Attorney General of the State of Kosrae is of the opinion that this appropriation lapsed as of September 30, 1990 and the State's acquisition of these shares was therefore without legal basis. Management of the State is currently addressing this issue and cannot predict the ultimate outcome of this matter. Until this matter is resolved, management has elected to record this investment as described in the preceding paragraph.

Kosrae State Government acquired 100% of the stock of Pacific Tuna Industries (PTI), a for profit corporation organized under the laws of the Federated States of Micronesia. The investment is accounted for using the equity method. For the year ended September 30, 1996, audited financial statements have been provided by Pacific Tuna Industries and adjustments have been made by Kosrae State as follows:

Carrying value at October 1, 1995	\$ 276,097
State's share of PTI's net earnings	<u>(144,549)</u>
Carrying value at September 30, 1996	\$ <u>131,548</u>

The FSM National Government contributed \$850,000 for Kosrae State Government's 50% share in Kosrae Sea Venture (KSVI) as mandated by FSM Public Law 7-107. The investment is recorded using the equity method and has been fully reserved for as a related asset of the capital projects funds. Kosrae Sea Venture commenced operations in fiscal year 1994. For the year ended September 30, 1996, audited financial statements have been provided by KSVI and adjustments have been made by Kosrae State as follows:

Carrying value at October 1, 1995	\$ 662,283
State's share of KSVI's net loss for the year ended September 30, 1996	<u>(181,797)</u>
Carrying value at September 30, 1996	\$ <u>480,486</u>

During the year ended September 30, 1996, Kosrae State made an investment of \$100,000 in Pacific Island Development Bank. The investment is recorded in the Capital Improvement Project Fund. The market value of these shares is difficult to assess as they are not publicly traded so a market versus cost analysis could not be performed. This investment in stock has therefore been carried at cost. Since the investment is considered unavailable to finance expenditures for the ensuing fiscal year, the investment is restricted in the reserve for related assets component of the fund balance.

(6) Contingencies

The State participates in a number of U.S. federally assisted programs. These programs are subject to financial and compliance audits to ascertain if Federal laws and guidelines have been followed. In 1996, for operations of grant programs, \$274,360 of questioned costs have been raised and \$513,810 of cumulative questioned costs remain unresolved for fiscal years 1985 through 1996. If these questioned costs are ultimately disallowed, the General Fund may bear responsibility for absorbing the amounts so disallowed.



**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 1996

(6) Contingencies, Continued

Pursuant to Title I, Section 105 of United States Public Law 99-239 (Compact of Free Association), the Government of the Federated States of Micronesia (FSM) 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. Due to an inability to predict the ultimate outcome of this matter, no provision for any liability that may result has been made in the accompanying general purpose financial statements.

Sick Leave

It is the policy of the State of Kosrae to record the cost of sick leave when leave is actually taken and a liability is actually incurred. The accumulated estimated amount of unused sick leave at September 30, 1996, was \$2,040,500.

Litigation

The State of Kosrae is party to numerous legal proceedings, many of which are normal recurrences in governmental operations. The Attorney General of the State of Kosrae is of the opinion that the probable outcome of suits existing at September 30, 1996, is not predictable but will have no material impact on the accompanying general purpose financial statements.

Additionally, as described in Note 5, the State acquired an investment which was not made in accordance with local laws. It is not possible to assess the ultimate impact of this matter on the accompanying general purpose financial statements.

(7) Material Fund Deficits

The following funds reflect material fund deficits as of September 30, 1996. If operations of these funds cannot recover prior losses, the State's General Fund may have to absorb these amounts or a portion thereof.

Internal Service Fund	\$ <u>94,669</u>
U.S. Department of the Interior Fund	\$ <u>52,149</u>
Federal Grants Assistance	\$ <u>251,998</u>
CFSM Capital Projects Fund	\$ <u>49,924</u>
Compact Scholarship Fund	\$ <u>83,127</u>
Foreign Assistance	\$ <u>106,932</u>
Compact Special Block Grant 221 (b)	\$ <u>585,302</u>

Of the above, the total fund deficits for the Federal Grants Assistance, Compact Special Block Grant, Compact Scholarship, U.S. Department of the Interior and the Foreign Assistance funds have been reserved in the General Fund as related assets since the interfund due to the General Fund relating to the aforementioned fund deficits may not be collectible within the following year.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 1996

(8) Interfund Receivables and Payables

As of September 30, 1996, interfund receivables and payables resulting from various interfund transactions are as follows:

	Due to other Funds	Due from other Funds
General Fund	\$ 273,982	\$ 1,798,533
Special Revenue Funds:		
Compact-Special Block	637,134	-
Compact-Health and Medical	-	78,649
Compact Post Secondary Education	258,813	-
Fishermen's Revolving Fund	-	1,026
U.S. Department of the Interior Fund	161,021	-
Federal Grants Assistance Fund	1,550,187	-
Compact Energy	-	293,513
Compact Special Development	-	280,178
Foreign Assistance Fund	122,849	-
Capital Project Funds:		
TTG - Capital Project Fund	411,411	334,405
CFSM State Projects	1,505,792	-
Compact Capital Projects Fund	-	1,860,383
Expendable Trust Funds:		
Production Loan Fund	-	1,495
Scholarship Revolving Fund	-	37,854
Housing Revolving Fund	-	269,325
Airport Trust Fund	-	101,271
Aluminum Recycling Fund	-	9,054
Internal Service Fund	<u>144,497</u>	<u>-</u>
	<u>\$ 5,065,686</u>	<u>\$ 5,065,686</u>

(9) Continuing Appropriations

Continuing appropriations as of September 30, 1996, are summarized as follows:

General Fund

New Broadcast Facility	\$ 1,390
Communication Network	1,146
Vehicle License Plate	1,195
Printing of State Laws	280
Population Housing Census	3,623
Peritoneal Dialysis Program	38,256
Medical Cost Senior Citizens	4,000
Second Constitutional Convention	78
Payment of legal obligations	<u>712</u>
	<u>\$ 50,680</u>

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements  
September 30, 1996

(9) Continuing Appropriations, Continued

Special Revenue Funds

Kosraen Chants	\$ 4,478
KUA Establishment	21,941
Power systems	<u>199,877</u>
	\$ <u>226,296</u>

Capital Project Funds

Compact of Free Association Capital Account -	
Various State approved projects	\$ 2,113,915
Various State approved projects	<u>1,082,732</u>
	\$ <u>3,196,647</u>

(10) Notes Payable

During fiscal year ended September 30, 1995, Kosrae State Government borrowed \$386,000 from Bank of Hawaii for the purchase of a residential property for its medical referral program in Honolulu. Monthly installment of \$5,101 are to be paid over 10 years. The note is collateralized by mortgage on the residential property and assignment of tenant lease rental income; security interest in all of the property's furniture, fixtures and equipment used in connection with the property. The outstanding notes payable balance as of September 30, 1996 is \$336,429.

During 1991, Kosrae State issued five notes for \$5,000,000 to finance the construction of a cold storage facility and for other fisheries development projects. The last note was repaid during the year ended September 30, 1996.

(11) Operating Transfers Out

Operating transfers out for the year ended September 30, 1996, are as follows:

Transfer from Special Revenue Fund to KUA	\$ <u>485,019</u>
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Additionally, KUA received \$93,729 of U.S. Department of the Interior operations and maintenance program (OMIP) grants.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Combining Schedule of Expenditures by Account -  
All Governmental Fund Types and Expendable Trust Funds  
Year Ended September 30, 1996  
(With comparative totals for the year ended September 30, 1995)

	Governmental Fund Types			Fiduciary Fund Type	Totals	
	General	Special Revenue	Capital Projects	Expendable Trust	(Memorandum Only)	
					1996	1995
Expenditures:						
Personnel	\$ 4,135,304	\$ 1,644,910	\$ 503,677	\$ -	\$ 6,283,891	\$ 5,871,270
Travel	212,437	190,952	108,701	-	512,090	751,383
POL	1,322	64,027	25,393	-	90,742	73,865
Capital outlay	56,891	124,300	161,522	-	342,713	402,609
Other	911,162	2,328,037	4,283,564	606,339	8,129,102	6,073,313
Total expenditures	<u>\$ 5,317,116</u>	<u>\$ 4,352,226</u>	<u>\$ 5,082,857</u>	<u>\$ 606,339</u>	<u>\$ 15,358,538</u>	<u>\$ 13,172,440</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

General Fund  
September 30, 1996

The general fund is used to account for resources traditionally associated with government which are not required legally or by sound financial management to be accounted for in another fund.

The State of Kosrae maintains separate and distinct general funds as required by local law. The operations of the Executive Branch are accounted for primarily in the U.S. Grants Fund, while the operations of the Legislative Branch are accounted for in the State Revenue Fund.

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Combining Balance Sheet - General Fund  
September 30, 1996  
(With comparative totals as of September 30, 1995)

<u>ASSETS</u>	<u>U.S. Grant</u>	<u>State Revenue</u>	<u>Totals</u>	
			<u>1996</u>	<u>1995</u>
Cash and equivalents	\$ 287,674	\$ -	\$ 287,674	\$ 522,598
Other term deposits	500,000	42,720	542,720	42,720
Investments	1,379,638	-	1,379,638	1,255,437
Receivables from other governments	180,636	14,722	195,358	213,465
General receivables, net	29,076	145,129	174,205	238,693
Advances	2,861	326,538	329,399	302,404
Due from other funds	1,115,759	682,774	1,798,533	914,970
Interest receivable	17,033	-	17,033	13,997
Total assets	<u>\$ 3,512,677</u>	<u>\$ 1,211,883</u>	<u>\$ 4,724,560</u>	<u>\$ 3,504,284</u>
 <u>LIABILITIES AND FUND BALANCES</u>				
Liabilities:				
Bank overdraft	\$ 830,562	\$ -	\$ 830,562	\$ -
Accounts payable	94,249	12,489	106,738	45,451
Accrued payroll and others	300,118	5,679	305,797	272,575
Due to other funds	273,982	-	273,982	557,090
Due to other governments	180,636	-	180,636	180,636
Other payables	269,965	-	269,965	315,069
Total liabilities	<u>1,949,512</u>	<u>18,168</u>	<u>1,967,680</u>	<u>1,370,821</u>
Fund balances:				
Reserved for:				
Related assets	3,679,001	476,500	4,155,501	867,861
Encumbrances	162,932	61,807	224,739	174,417
Continuing appropriations	7,634	43,046	50,680	85,492
Unreserved	<u>(2,286,402)</u>	<u>612,362</u>	<u>(1,674,040)</u>	<u>1,005,693</u>
Total fund balances	<u>1,563,165</u>	<u>1,193,715</u>	<u>2,756,880</u>	<u>2,133,463</u>
Total liabilities and fund balances	<u>\$ 3,512,677</u>	<u>\$ 1,211,883</u>	<u>\$ 4,724,560</u>	<u>\$ 3,504,284</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE**  
**FEDERATED STATES OF MICRONESIA**

Combining Statement of Revenues, Expenditures by Function  
and Changes in Fund Balances - General Fund  
Year Ended September 30, 1996  
(With comparative totals for the year ended September 30, 1995)

	<u>U.S. Grant</u>	<u>State Revenue</u>	<u>Totals</u>	
			<u>1996</u>	<u>1995</u>
<b>Revenues:</b>				
<b>Compact of Free Association:</b>				
Base amount	\$ 2,791,740	\$ -	\$ 2,791,740	\$ 2,791,740
Inflation adjustment	1,340,035	-	1,340,035	1,284,201
Revenue sharing	-	832,964	832,964	796,132
Taxes and licenses	-	168,752	168,752	147,896
Investment income	232,486	123,421	355,907	383,401
Other	102,134	349,001	451,135	1,075,290
<b>Total revenues</b>	<u>4,466,395</u>	<u>1,474,138</u>	<u>5,940,533</u>	<u>6,478,660</u>
<b>Expenditures:</b>				
General government	729,152	1,112,077	1,841,229	1,862,591
Education	634,605	11,320	645,925	829,949
Health services	851,837	49,633	901,470	947,458
Economic development	692,059	32,564	724,623	564,656
Public works	423,286	-	423,286	454,372
Public safety	351,379	-	351,379	370,269
Community affairs	4,802	312,971	317,773	624,407
Other	111,431	-	111,431	1,013,210
<b>Total expenditures</b>	<u>3,798,551</u>	<u>1,518,565</u>	<u>5,317,116</u>	<u>6,666,912</u>
Excess (deficiency) of revenues over (under) expenditures	667,844	(44,427)	623,417	(188,252)
<b>Fund balances at beginning of year</b>	<u>895,321</u>	<u>1,238,142</u>	<u>2,133,463</u>	<u>2,321,715</u>
<b>Fund balances at end of year</b>	<u>\$ 1,563,165</u>	<u>\$ 1,193,715</u>	<u>\$ 2,756,880</u>	<u>\$ 2,133,463</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE**  
**FEDERATED STATES OF MICRONESIA**

Combining Statement of Revenues, Expenditures by Account and  
Changes in Fund Balances - General Fund  
Year Ended September 30, 1996  
(With comparative totals for the year ended September 30, 1995)

	<u>U.S. Grant</u>	<u>State Revenue</u>	<u>Totals</u>	
			<u>1996</u>	<u>1995</u>
<b>Revenues:</b>				
Compact of Free Association:				
Base amount	\$ 2,791,740	\$ -	\$ 2,791,740	\$ 2,791,740
Inflation adjustment	1,340,035	-	1,340,035	1,284,201
Revenue sharing	-	832,964	832,964	796,132
Taxes and licenses	-	168,752	168,752	147,896
Investment income	232,486	123,421	355,907	383,401
Other	102,134	349,001	451,135	1,075,290
<b>Total revenues</b>	<u>4,466,395</u>	<u>1,474,138</u>	<u>5,940,533</u>	<u>6,478,660</u>
 <b>Expenditures:</b>				
Personnel	3,209,515	925,789	4,135,304	4,201,381
Travel	76,676	135,761	212,437	351,880
POL	322	1,000	1,322	2,931
Capital outlay	32,144	24,747	56,891	133,121
Other	479,894	431,268	911,162	1,977,599
<b>Total expenditures</b>	<u>3,798,551</u>	<u>1,518,565</u>	<u>5,317,116</u>	<u>6,666,912</u>
Excess (deficiency) of revenues over (under) expenditures	667,844	(44,427)	623,417	(188,252)
 Fund balances at beginning of year	<u>895,321</u>	<u>1,238,142</u>	<u>2,133,463</u>	<u>2,321,715</u>
 Fund balances at end of year	<u>\$ 1,563,165</u>	<u>\$ 1,193,715</u>	<u>\$ 2,756,880</u>	<u>\$ 2,133,463</u>

See Accompanying Independent Auditors' Report.



STATE OF KOSRAE  
**FEDERATED STATES OF MICRONESIA**  
Combining Statement of Revenues, Expenditures and Changes in  
Fund Balances, Budgetary Basis - General Fund  
Year Ended September 30, 1996

	U.S. Grant Fund			State Revenue Fund			Total General Fund		
	Budget	Actual	Variance	Budget	Actual	Variance	Budget	Actual	Variance
<b>Revenues:</b>									
Compact funding:									
Base amount	\$ 2,791,740	\$ 2,791,740	\$ -	\$ -	\$ -	\$ -	\$ 2,791,740	\$ 2,791,740	\$ -
Inflation adjustment	1,228,366	1,340,035	111,669	-	-	-	1,228,366	1,340,035	111,669
Revenue sharing	-	-	-	555,000	832,964	277,964	555,000	832,964	277,964
State taxes and licenses	-	-	-	151,200	168,752	17,552	151,200	168,752	17,552
Investment income	-	232,486	232,486	100,000	123,421	23,421	100,000	355,907	255,907
Miscellaneous	256,000	102,134	(153,866)	287,500	349,001	61,501	543,500	451,135	(92,365)
Total revenues	4,276,106	4,466,395	190,289	1,093,700	1,474,138	380,438	5,369,806	5,940,533	570,727
<b>Expenditures:</b>									
General government	793,448	741,845	51,603	1,142,003	1,107,639	34,364	1,935,451	1,849,484	85,967
Education	1,043,490	663,045	380,445	12,622	7,190	5,432	1,056,112	670,235	385,877
Health services	884,182	857,414	26,768	57,778	50,498	7,280	941,960	907,912	34,048
Economic development	772,998	698,847	74,151	-	-	-	772,998	698,847	74,151
Public works	471,899	423,591	48,308	-	-	-	471,899	423,591	48,308
Public safety	359,410	346,834	12,576	-	-	-	359,410	346,834	12,576
Community affairs	-	5,515	(5,515)	355,696	353,590	2,106	355,696	359,105	(3,409)
Others	-	111,431	(111,431)	-	-	-	-	111,431	(111,431)
Total expenditures	4,325,427	3,848,522	476,905	1,568,099	1,518,917	49,182	5,893,526	5,367,439	526,087
Excess (deficiency) of revenues over (under) expenditures	(49,321)	617,873	667,194	(474,399)	(44,779)	429,620	(523,720)	573,094	1,096,814
Unreserved fund balances at beginning of year	(305,590)	263,309	568,899	21,336	742,384	721,048	(284,254)	1,005,693	1,289,947
Other changes in unreserved fund balances:									
Decrease in reserve for continuing appropriations	-	34,812	34,812	-	-	-	-	34,812	34,812
Increase in reserve for related assets	-	(3,202,396)	(3,202,396)	-	(85,243)	(85,243)	-	(3,287,639)	(3,287,639)
Unreserved fund balances at end of year	\$ (354,911)	\$ (2,286,402)	\$ (1,931,491)	\$ (453,063)	\$ 612,362	\$ 1,065,425	\$ (807,974)	\$ (1,674,040)	\$ (866,066)

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Combined Statement of Revenues, Expenditures by Function and Department  
and Changes in Fund Balance - General Fund  
Year Ended September 30, 1996  
(With comparative totals for the year ended September 30, 1995)

	1996		1995
<b>Revenues:</b>			
<b>Compact of Free Association:</b>			
Base amount	\$ 2,791,740		\$ 2,791,740
Inflation adjustment	1,340,035		1,284,201
FSM revenue sharing	832,964		796,132
<b>State taxes and licenses:</b>			
Cigarette tax	\$ 9,955		\$ 10,661
General sales tax	67,842		63,634
Alcohol	57,612		40,380
Motor vehicle sales tax	9,164		9,681
Licenses and fees	17,181		16,778
Court fines	6,998	168,752	6,762
			147,896
<b>Other revenues:</b>			
Transportation collection	-		119,828
Medical and dental services	91,382		138,800
Miscellaneous	359,753	451,135	816,662
Investment income		355,907	1,075,290
			383,401
<b>Total revenues</b>		<b>5,940,533</b>	<b>6,478,660</b>
<b>Expenditures:</b>			
<b>General government:</b>			
Governor and staff		230,965	156,710
<b>Department of Administration</b>			
Director of Administration	40,681		-
Division of Planning and Statistics	65,712		268,377
Division of Finance & Budget	196,426		232,651
Division of Construction & Engineering	91,521		-
Division of Personnel and Employment	58,977	453,317	50,421
			551,449
<b>Kosrae State Court</b>			
Court Operations		134,499	129,005
<b>Legislative Branch</b>			
Legislative members	286,029		287,793
Standing committees	48,272		76,889
Staff	341,467	675,768	368,569
			733,251
<b>Land commission</b>		172,692	179,764
<b>Municipal operations</b>		48,039	112,412
<b>Legislative appropriations-election</b>		125,949	-
<b>Total general government</b>		<b>1,841,229</b>	<b>1,862,591</b>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Combined Statement of Revenues, Expenditures by Function and Department  
and Changes in Fund Balance - General Fund, Continued  
Year Ended September 30, 1996  
(With comparative totals for the year ended September 30, 1995)

	1996		1995
Expenditures by department, continued:			
Department of Education:			
Director's Office	81,586		87,883
Division of Instructional Services	216,355		170,202
Division of Curriculum Development	189,114		357,561
Facilities Special Services	92,571		212,703
Community Development	54,979		-
Legislative appropriations-education	11,320		1,600
		645,925	829,949
Department of Health Services:			
Director of Health Services	78,448		231,494
Division of Hospital Services	590,339		529,178
Division of Sanitation	56,309		73,314
Division of Dental Services	58,359		48,841
Division of Public Health	68,382		58,915
Chip in conference - legislative	-		5,716
Legislative appropriations-health services	49,633		-
		901,470	947,458
Department of Fisheries and Marines			
Director of Fisheries and Marines	46,136		-
Division of Fisheries and Surveillance	25,765		-
Division of Marine Resources	28,852	100,753	84,722
			84,722
Department of Agriculture and Land			
Director of Agriculture and Land	64,655		150,591
Division of Crop Production & Research	125,641		-
Division of Livestock Prod. & Research	36,312		-
Division of Land Management and Pres.	55,382		148,062
Division of Surveying and Mapping	107,342	389,332	-
			298,653
Department of Commerce and Industry:			
Director of Commerce and Industry	44,495		60,388
Division of Market and Research	15,571		32,928
Division of Housing C & I	42,291		-
Division of Industrial Development	30,538		-
Division of Consumer Services	32,648		-
Division of Tourism	36,431		87,965
Legislative appropriations-economic dev.	32,564	234,538	-
			181,281
Total economic development		724,623	564,656

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Combined Statement of Revenues, Expenditures by Function and Department  
and Changes in Fund Balance - General Fund, Continued  
Year Ended September 30, 1996  
(With comparative totals for the year ended September 30, 1995)

	<u>1996</u>	<u>1995</u>
Expenditures by department, continued:		
Department of Transportation /Utility:		
Director of Transportation/Utility	68,598	312,887
Division of Road and Public Trans.	255,598	53,010
Division of Water and Wastewater	47,563	88,475
Division of Airport/Dock/Harbot	<u>51,527</u>	<u>-</u>
Total transportation/utility	423,286	454,372
Department of Justice		
Director of Justice	36,917	-
Police Division	198,212	219,338
Division of Law	111,238	148,356
'92 Police COM Network NE	5,012	-
License plate	<u>-</u>	<u>2,575</u>
Total justice	351,379	370,269
Community Affairs:		
Political Affairs	-	74,479
Community Development	-	58,676
Sports Council - legislative	38,350	42,228
Executive Service Appeals Board	-	1,105
Scholarship Board - legislative	-	5,537
Election commission - legislative	-	11,075
KCAP Operations - legislative	40,099	35,893
FY96 agriculture conference	1,989	-
FY96 court settlement	20,298	-
Division of law	7,681	-
FY94 Census Pop/Housing	4,801	15,037
Board of Education	-	2,421
Hiring of Grant Writer - legislative	38,604	5,555
95 ConCon Ed. and Referendum	-	23,255
Broadcast facility	-	466
FY-95 Graham Sigrah	-	22,500
FY-96 ConCon overtime	11,477	-
Development Review Commission	-	10,835
Development Review Comm. - legislative	-	15,260
Micro basketball	29,868	-
Foreign Investment Board - legislative	-	16,756
Parole Board	1,094	825
FY-95 Legislative appropriations	-	3,330
FY-95 Inauguration - Legislative	-	9,699
FY-94 Second ConCon - Legislative	-	2,058
FY-95 Second ConCon - Legislative	-	40,115
FY-95 Retirements - 5-216 - Legislative	-	91,328
FY-95 Workman's Comp - Legislative	<u>-</u>	<u>32,000</u>
Subtotal community affairs	<u>194,261</u>	<u>520,433</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE**  
**FEDERATED STATES OF MICRONESIA**

Combined Statement of Revenues, Expenditures by Function and Department  
and Changes in Fund Balance - General Fund, Continued  
Year Ended September 30, 1996  
(With comparative totals for the year ended September 30, 1995)

	1996	1995
Expenditures by department, continued:		
Community Affairs, balance forwarded	194,261	520,433
MLSC Operations	34,500	34,500
FY-94 E.C. Construction Con. - Legislative	-	20
Board of Education - Legislative	-	772
Broadcast Authority - Legislative	70,012	68,682
MICA/IDC fees	19,000	-
	<hr/>	<hr/>
Total community affairs	317,773	624,407
Uncollectible reimburseable grants	-	948,025
Other	111,431	65,185
	<hr/>	<hr/>
Total expenditures	5,317,116	6,666,912
	<hr/>	<hr/>
Excess (deficiency) of revenues over (under) expenditures	623,417	(188,252)
Fund balances at beginning of year	2,133,463	2,321,715
	<hr/>	<hr/>
Fund balances at end of year	\$ 2,756,880	\$ 2,133,463
	<hr/>	<hr/>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Special Revenue Funds  
September 30, 1996

Specific revenues that are legally restricted to expenditures for particular purposes are accounted for in Special Revenue Funds. A brief discussion of Kosrae State's Special Revenue Funds as of September 30, 1996, follows:

Compact - Special Block Grant - Health and Education, Title Two, Article I, Section 221 (b)

This fund accounts for the funds granted under the Compact of Free Association with the United States, specifically restricted for health and education programs.

Compact 216 (a) 2 - Health and Medical

This fund is restricted for health and medical programs including referrals to hospital and treatment centers.

Compact 216 (a) 3 - Post Secondary Education

This fund is restricted for scholarship funds or funds to support the post secondary education of FSM citizens.

Fishermen's Revolving Fund

This fund was established on May 1, 1987, by State Law 4-8 to account for the sale of fishing supplies to local fishermen on a non-profit basis.

U.S. Department of the Interior

This fund accounts for all U.S. Congressional appropriations for specified project operation and maintenance subsidies which are granted through the U.S. Department of the Interior.

Federal Grants Assistance Fund

This fund accounts for all activities of United States special federal assistance grants utilized by the State of Kosrae to finance general governmental operations.

Compact 214 - Energy Block Grant

This fund accounts for the funds granted under the Compact of Free Association with the United States, specifically restricted for the purchase of fuel to operate the State's power generating facilities and other energy related projects.

Compact 212 - Special Development Assistance

This fund accounts for the funds granted under the Compact of Free Association with the United States, specifically restricted for economic development projects.

Foreign Assistance

This fund accounts for financial transactions related to federal assistance from other countries received directly by the State of Kosrae.

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

**SPECIAL REVENUE FUNDS  
Combining Balance Sheet  
September 30, 1996  
(With comparative totals as of September 30, 1995)**

<u>ASSETS</u>	Compact Special Block Grant 221(B)	Compact Health and Medical 216(A)(2)	Compact Scholarship 216(A)(3)	Compact Energy Block Grant 214	Compact Special Development 212(B)	Fishermen's Revolving	U.S. Department of the Interior	Federal Grants Assistance	Foreign Assistance	<u>Totals</u>	
										1996	1995
Cash and equivalents	\$ -	\$ 2	\$ -	\$ -	\$ 6,965	\$ -	\$ -	\$ -	\$ -	\$ 6,967	\$ 15,016
Receivables from:											
Federal agencies	-	-	-	-	-	-	143,286	1,044,451	-	1,187,737	-
Other Governments	-	-	-	-	-	-	-	-	11,550	11,550	583,990
General receivables, net	(17,391)	-	175,686	-	-	-	16,190	6,870	-	181,355	186,024
Advances	39,175	23,911	-	4,718	19,635	-	36,826	215,187	3,798	343,250	270,905
Due from other funds	-	78,649	-	293,513	280,178	1,026	-	-	-	653,366	621,798
<b>Total assets</b>	<b>\$ 21,784</b>	<b>\$ 102,562</b>	<b>\$ 175,686</b>	<b>\$ 298,231</b>	<b>\$ 306,778</b>	<b>\$ 1,026</b>	<b>\$ 196,302</b>	<b>\$ 1,266,508</b>	<b>\$ 15,348</b>	<b>\$ 2,384,225</b>	<b>\$ 1,677,733</b>
<b><u>LIABILITIES AND FUND BALANCES (DEFICIT)</u></b>											
Liabilities:											
Accounts payable	\$ (39,177)	\$ 1,633	\$ -	\$ 306,371	\$ 5,940	\$ -	\$ 58,784	\$ (37,206)	\$ (587)	\$ 295,758	\$ 58,394
Accrued payroll and others	9,129	-	-	-	-	-	551	5,525	18	15,223	7,148
Due to other funds	637,134	-	258,813	-	-	-	161,021	1,550,187	122,849	2,730,004	1,660,826
Deferred revenues	-	-	-	-	-	-	28,095	-	-	28,095	28,095
<b>Total liabilities</b>	<b>607,086</b>	<b>1,633</b>	<b>258,813</b>	<b>306,371</b>	<b>5,940</b>	<b>-</b>	<b>248,451</b>	<b>1,518,506</b>	<b>122,280</b>	<b>3,069,080</b>	<b>1,754,463</b>
Fund balances (deficit):											
Reserved for:											
Encumbrances	18,757	35,410	-	8,544	18,134	-	127,701	247,442	6,718	462,706	971,519
Continuing appropriations	-	-	-	-	-	-	226,296	-	-	226,296	226,296
Unreserved	(604,059)	65,519	(83,127)	(16,684)	282,704	1,026	(406,146)	(499,440)	(113,650)	(1,373,857)	(1,274,545)
<b>Total fund balances (deficit)</b>	<b>(585,302)</b>	<b>100,929</b>	<b>(83,127)</b>	<b>(8,140)</b>	<b>300,838</b>	<b>1,026</b>	<b>(52,149)</b>	<b>(251,998)</b>	<b>(106,932)</b>	<b>(684,855)</b>	<b>(76,730)</b>
<b>Total liabilities and fund balances (deficit)</b>	<b>\$ 21,784</b>	<b>\$ 102,562</b>	<b>\$ 175,686</b>	<b>\$ 298,231</b>	<b>\$ 306,778</b>	<b>\$ 1,026</b>	<b>\$ 196,302</b>	<b>\$ 1,266,508</b>	<b>\$ 15,348</b>	<b>\$ 2,384,225</b>	<b>\$ 1,677,733</b>

See Accompanying Independent Auditors' Report

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

**SPECIAL REVENUE FUNDS**  
Combining Statement of Revenues, Expenditures by Function and Changes in Fund Balances (Deficit)  
Year Ended September 30, 1996  
(With comparative totals for the year ended September 30, 1995)

	Compact Special Block Grant 221(B)	Compact Health and Medical 216(A)(2)	Compact Scholarship 216(A)(3)	Compact Energy Block Grant 214	Compact Special Development 212(B)	Fishermen's Revolving	U.S. Department of the Interior	Federal Grants Assistance	Foreign Assistance	Totals	
										1996	1995
<b>Revenues:</b>											
Compact grants:											
Base amount	\$ 875,000	\$ 112,122	\$ 152,270	\$ 450,000	\$ 250,000	\$ -	\$ -	\$ -	\$ -	\$ 1,839,392	\$ 1,814,601
Inflation adjustment	-	-	-	216,000	120,000	-	-	-	-	336,000	322,000
U.S. Department of the											
Interior grants	-	-	-	-	-	-	-	-	-	-	510,776
Federal contributions	-	-	-	-	-	-	160,676	1,812,319	-	1,972,995	1,192,642
Other	-	-	-	-	-	-	-	-	80,733	80,733	70,191
Total revenues	<u>875,000</u>	<u>112,122</u>	<u>152,270</u>	<u>666,000</u>	<u>370,000</u>	<u>-</u>	<u>160,676</u>	<u>1,812,319</u>	<u>80,733</u>	<u>4,229,120</u>	<u>3,910,210</u>
<b>Expenditures:</b>											
General government	-	-	-	-	13,180	-	160,676	1,812,319	-	1,986,175	1,703,418
Education	1,130,702	-	152,270	-	-	-	-	-	-	1,282,972	937,930
Health services	114,993	86,809	-	-	-	-	-	-	-	201,802	197,354
Economic development	-	-	-	468,824	92,301	-	-	-	-	561,125	574,830
Community affairs	-	-	-	-	-	-	-	-	57,103	57,103	144,817
Other	-	-	-	-	250,000	13,049	-	-	-	263,049	-
Total expenditures	<u>1,245,695</u>	<u>86,809</u>	<u>152,270</u>	<u>468,824</u>	<u>355,481</u>	<u>13,049</u>	<u>160,676</u>	<u>1,812,319</u>	<u>57,103</u>	<u>4,352,226</u>	<u>3,558,349</u>
Excess (deficiency) of											
revenues over (under) expenditures	(370,695)	25,313	-	197,176	14,519	(13,049)	-	-	23,630	(123,106)	351,861
<b>Other financing uses:</b>											
Operating transfers out	-	-	-	(485,019)	-	-	-	-	-	(485,019)	(407,000)
Excess (deficiency) of revenues over (under)											
expenditures and other financing uses	(370,695)	25,313	-	(287,843)	14,519	(13,049)	-	-	23,630	(608,125)	(55,139)
Fund balances (deficit) at beginning of year	(214,607)	75,616	(83,127)	279,703	286,319	14,075	(52,149)	(251,998)	(130,562)	(76,730)	(21,591)
Fund balances (deficit) at end of year	<u>\$ (585,302)</u>	<u>\$ 100,929</u>	<u>\$ (83,127)</u>	<u>\$ (8,140)</u>	<u>\$ 300,838</u>	<u>\$ 1,026</u>	<u>\$ (52,149)</u>	<u>\$ (251,998)</u>	<u>\$ (106,932)</u>	<u>\$ (684,855)</u>	<u>\$ (76,730)</u>

See Accompanying Independent Auditors' Report.



**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

**SPECIAL REVENUE FUNDS**  
Combining Statement of Revenues, Expenditures by Account and Changes in Fund Balances (Deficit)  
Year ended September 30, 1996  
(With comparative totals for the year ended September 30, 1995)

	Compact Special Block Grant 221(B)	Compact Health and Medical 216(A)(2)	Compact Scholarship 216(A)(3)	Compact Energy Block Grant 214	Compact Special Development 212(B)	Fishermen's Revolving	U.S. Department of the Interior	Federal Grants Assistance	Foreign Assistance	Totals	
										1996	1995
<b>Revenues:</b>											
Compact grants:											
Base amount	\$ 875,000	\$ 112,122	\$ 152,270	\$ 450,000	\$ 250,000	\$ -	\$ -	\$ -	\$ -	\$ 1,839,392	\$ 1,814,601
Inflation adjustment	-	-	-	216,000	120,000	-	-	-	-	336,000	322,000
U.S. Department of the											
Interior grants	-	-	-	-	-	-	-	-	-	-	510,776
Federal contributions	-	-	-	-	-	-	160,676	1,812,319	-	1,972,995	1,192,642
Other	-	-	-	-	-	-	-	-	80,733	80,733	70,191
<b>Total revenues</b>	<b>875,000</b>	<b>112,122</b>	<b>152,270</b>	<b>666,000</b>	<b>370,000</b>	<b>-</b>	<b>160,676</b>	<b>1,812,319</b>	<b>80,733</b>	<b>4,229,120</b>	<b>3,910,210</b>
<b>Expenditures:</b>											
Personnel	1,130,702	-	-	-	-	-	12,500	479,077	22,631	1,644,910	1,282,111
Travel	-	32,286	-	-	13,180	-	(132)	145,618	-	190,952	272,528
POL	-	-	-	-	63,675	-	-	352	-	64,027	46,560
Capital outlay	1,700	-	-	-	-	-	20,098	101,917	585	124,300	147,281
Other	113,293	54,523	152,270	468,824	278,626	13,049	128,210	1,085,355	33,887	2,328,037	1,809,869
<b>Total expenditures</b>	<b>1,245,695</b>	<b>86,809</b>	<b>152,270</b>	<b>468,824</b>	<b>355,481</b>	<b>13,049</b>	<b>160,676</b>	<b>1,812,319</b>	<b>57,103</b>	<b>4,352,226</b>	<b>3,558,349</b>
Excess (deficiency) of revenues over (under) expenditures	(370,695)	25,313	-	197,176	14,519	(13,049)	-	-	23,630	(123,106)	351,861
<b>Other financing uses:</b>											
Operating transfers out	-	-	-	(485,019)	-	-	-	-	-	(485,019)	(407,000)
Excess (deficiency) of revenues over (under) expenditures and other financing uses	(370,695)	25,313	-	(287,843)	14,519	(13,049)	-	-	23,630	(608,125)	(55,139)
<b>Fund balances (deficit) at beginning of year</b>	<b>(214,607)</b>	<b>75,616</b>	<b>(83,127)</b>	<b>279,703</b>	<b>286,319</b>	<b>14,075</b>	<b>(52,149)</b>	<b>(251,998)</b>	<b>(130,562)</b>	<b>(76,730)</b>	<b>(21,591)</b>
<b>Fund balances (deficit) at end of year</b>	<b>\$ (585,302)</b>	<b>\$ 100,929</b>	<b>\$ (83,127)</b>	<b>\$ (8,140)</b>	<b>\$ 300,838</b>	<b>\$ 1,026</b>	<b>\$ (52,149)</b>	<b>\$ (251,998)</b>	<b>\$ (106,932)</b>	<b>\$ (684,855)</b>	<b>\$ (76,730)</b>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Capital Projects Funds  
September 30, 1996

The acquisition and construction of major capital facilities, other than those financed by proprietary funds and trust funds are accounted for in Capital Projects Funds. A brief discussion of Kosrae State's Capital Projects Funds as of September 30, 1996, follows:

TTG - Capital Projects

This fund accounts for various capital projects received under grant awards from the Trust Territory Government.

CFSM State Projects

This fund accounts for the various capital projects funded by the Congress of the Federated States of Micronesia.

Compact Capital Projects

This fund is used to account for various capital projects funded by the Compact of Free Association with the United States, Title Two, Article 1, Section 211.

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

**CAPITAL PROJECTS FUNDS  
Combining Balance Sheet  
September 30, 1996  
(With comparative totals as of September 30, 1995)**

	Compact Capital Projects	CFSM Capital Projects	TTG Capital Projects	Totals	
				1996	1995
<b><u>ASSETS</u></b>					
Cash and equivalents	\$ 544,572	\$ -	\$ -	\$ 544,572	\$ -
Other term deposits	761,187	-	-	761,187	2,151,268
Investments	21,753	-	-	21,753	21,753
Equity investments	1,212,033	-	-	1,212,033	1,538,380
Receivables from U.S.					
Department of the Interior	-		504,755	504,755	501,906
Receivables from FSM Gov't	-	1,408,171	-	1,408,171	965,666
General receivables, net	-	-	-	-	506,301
Advances	190,018	84,224	14,265	288,507	280,154
Loans receivable, net	125,000	-	-	125,000	150,000
Due from other funds	1,860,383	-	334,405	2,194,788	2,009,267
Total assets	\$ 4,714,946	\$ 1,492,395	\$ 853,425	\$ 7,060,766	\$ 8,124,695
<b><u>LIABILITIES AND FUND BALANCES (DEFICIT)</u></b>					
<b>Liabilities:</b>					
Accounts payable	\$ 129,540	\$ 35,715	\$ 113,327	\$ 278,582	\$ 355,913
Accrued payroll and others	(3,304)	812	5,552	3,060	803
Due to other funds	-	1,505,792	411,411	1,917,203	1,503,429
Other payables	-	-	-	-	777
Total liabilities	126,236	1,542,319	530,290	2,198,845	1,860,922
<b>Fund balances (deficit):</b>					
Reserved for:					
Related assets	1,337,033	-	-	1,337,033	2,930,287
Encumbrances	1,340,934	224,465	(23)	1,565,376	733,608
Continuing appropriations	1,349,655	1,082,732	764,260	3,196,647	5,454,497
Unreserved	561,088	(1,357,121)	(441,102)	(1,237,135)	(2,854,619)
Total fund balances (deficit)	4,588,710	(49,924)	323,135	4,861,921	6,263,773
Total liabilities and fund balances (deficit)	\$ 4,714,946	\$ 1,492,395	\$ 853,425	\$ 7,060,766	\$ 8,124,695

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

**CAPITAL PROJECTS FUNDS**  
Combining Statement of Revenues, Expenditures by Function and Changes in Fund Balances (Deficit)  
Year Ended September 30, 1996  
(With comparative totals for the year ended September 30, 1995)

	Compact Capital Projects	CFSM Capital Projects	TTG Capital Projects	Totals	
				1996	1995
<b>Revenues:</b>					
<b>Compact of Free Association:</b>					
Base amount	\$ 2,445,960	\$ -	\$ -	\$ 2,445,960	\$ 2,445,960
Inflation adjustment	1,174,061	-	-	1,174,061	1,125,141
U.S. Department of the					
Interior grants	-	-	243,432	243,432	456,520
FSM Nat'l Gov't Contribution	-	1,185,748	-	1,185,748	315,886
<b>Total revenues</b>	<b>3,620,021</b>	<b>1,185,748</b>	<b>243,432</b>	<b>5,049,201</b>	<b>4,343,507</b>
<b>Expenditures:</b>					
Capital projects	3,653,677	1,185,748	243,432	5,082,857	2,861,470
<b>Total expenditures</b>	<b>3,653,677</b>	<b>1,185,748</b>	<b>243,432</b>	<b>5,082,857</b>	<b>2,861,470</b>
Excess (deficiency) of revenues over (under) expenditures	(33,656)	-	-	(33,656)	1,482,037
<b>Other financing sources (uses):</b>					
Bond principal repayments	(1,000,000)	-	-	(1,000,000)	(1,000,000)
Bond interest expense	(41,850)	-	-	(41,850)	(123,229)
Equity loss on investment	(326,346)	-	-	(326,346)	(187,717)
Equity earnings on investment	-	-	-	-	232,202
<b>Total other financing sources (uses), net</b>	<b>(1,368,196)</b>	<b>-</b>	<b>-</b>	<b>(1,368,196)</b>	<b>(1,078,744)</b>
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	(1,401,852)	-	-	(1,401,852)	403,293
<b>Fund balances (deficit) at   beginning of year</b>	<b>5,990,562</b>	<b>(49,924)</b>	<b>323,135</b>	<b>6,263,773</b>	<b>5,435,480</b>
<b>Equity contribution</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>425,000</b>
<b>Fund balances (deficit) at end of year</b>	<b>\$ 4,588,710</b>	<b>\$ (49,924)</b>	<b>\$ 323,135</b>	<b>\$ 4,861,921</b>	<b>\$ 6,263,773</b>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

**CAPITAL PROJECTS FUNDS**  
Combining Statement of Revenues, Expenditures by Account and Changes in Fund Balances (Deficit)  
Year Ended September 30, 1996  
(With comparative totals for the year ended September 30, 1995)

	Compact Capital Projects	CFSM Capital Projects	TTG Capital Projects	Totals	
				1996	1995
<b>Revenues:</b>					
Compact of Free Association:					
Base amount	\$ 2,445,960	\$ -	\$ -	\$ 2,445,960	\$ 2,445,960
Inflation adjustment	1,174,061	-	-	1,174,061	1,125,141
U.S. Department of the					
Interior grants	-	-	243,432	243,432	456,520
FSM National Gov't contribution	-	1,185,748	-	1,185,748	315,886
<b>Total revenues</b>	<b>3,620,021</b>	<b>1,185,748</b>	<b>243,432</b>	<b>5,049,201</b>	<b>4,343,507</b>
<b>Expenditures:</b>					
Personnel	436,968	66,709	-	503,677	387,778
Travel	99,585	9,116	-	108,701	126,975
POL	23,266	2,127	-	25,393	24,374
Capital outlay	86,253	75,269	-	161,522	122,207
Other	3,007,605	1,032,527	243,432	4,283,564	2,200,136
<b>Total expenditures</b>	<b>3,653,677</b>	<b>1,185,748</b>	<b>243,432</b>	<b>5,082,857</b>	<b>2,861,470</b>
Excess (deficiency) of revenues over (under) expenditures	(33,656)	-	-	(33,656)	1,482,037
<b>Other financing sources (uses):</b>					
Bond principal repayments	(1,000,000)	-	-	(1,000,000)	(1,000,000)
Bond interest expense	(41,850)	-	-	(41,850)	(123,229)
Equity loss on investment	(326,346)	-	-	(326,346)	(187,717)
Equity earnings on investment	-	-	-	-	232,202
<b>Total other financing sources (uses), net</b>	<b>(1,368,196)</b>	<b>-</b>	<b>-</b>	<b>(1,368,196)</b>	<b>(1,078,744)</b>
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	(1,401,852)	-	-	(1,401,852)	403,293
<b>Fund balances (deficit) at beginning   of year</b>	<b>5,990,562</b>	<b>(49,924)</b>	<b>323,135</b>	<b>6,263,773</b>	<b>5,435,480</b>
<b>Equity contribution</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>425,000</b>
<b>Fund balances (deficit) at end of year</b>	<b>\$ 4,588,710</b>	<b>\$ (49,924)</b>	<b>\$ 323,135</b>	<b>\$ 4,861,921</b>	<b>\$ 6,263,773</b>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Expendable Trust Funds  
September 30, 1996

Expendable trust funds are used to account for assets held by a government unit in a trustee capacity for individuals, private organizations, or other governmental units, whose resources, including both principal and earnings, may be expended. Expendable trust funds are accounted for in essentially the same manner as governmental funds. A brief discussion of the State's Expendable Trust Funds follows:

Agriculture Revolving Fund

This fund accounts for the sale of agriculture feed and livestock to farmers.

Production Loan Fund

This fund accounts for low interest loans made to individuals for the purpose of economic development

Scholarship Revolving Loan Fund

This fund accounts for low interest loans made to eligible post-secondary students.

Housing Revolving Fund

This fund accounts for low interest loans which improve housing conditions on Kosrae.

Airport Trust Fund

This fund accounts for the airport departure fee.

Aluminum Recycling Fund

This fund was established for the Aluminum Can Recycling Project.

Tourism Revolving Fund

This fund accounts for sales of post cards, books, handicrafts, and other tourism material.

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

**EXPENDABLE TRUST FUNDS  
Combining Balance Sheet  
September 30, 1996  
(With comparative totals as of September 30, 1995)**

	Airport Trust	Agriculture Revolving	Production Loan	Scholarship Revolving Loan	Housing Revolving	Aluminum Recycling	Tourism Revolving	Totals	
								1996	1995
<b><u>ASSETS</u></b>									
Cash and equivalents	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 56,499
General receivables, net	7,911	-	-	-	-	-	-	7,911	11,655
Loans receivable, net	-	-	-	-	455,944	-	-	455,944	672,532
Due from other funds	101,271	-	1,495	37,854	269,325	9,054	-	418,999	347,424
Inventory, at cost	-	-	-	-	-	-	-	-	38,410
<b>Total assets</b>	<b>\$ 109,182</b>	<b>\$ -</b>	<b>\$ 1,495</b>	<b>\$ 37,854</b>	<b>\$ 725,269</b>	<b>\$ 9,054</b>	<b>\$ -</b>	<b>\$ 882,854</b>	<b>\$ 1,126,520</b>
<b><u>LIABILITIES AND FUND BALANCES</u></b>									
<b>Liabilities:</b>									
Accounts payable	\$ 1,039	\$ -	\$ -	\$ 9,487	\$ 32,055	\$ -	\$ -	\$ 42,581	\$ 39,030
Due to other funds	-	-	-	-	-	-	-	-	11,132
<b>Total liabilities</b>	<b>1,039</b>	<b>-</b>	<b>-</b>	<b>9,487</b>	<b>32,055</b>	<b>-</b>	<b>-</b>	<b>42,581</b>	<b>50,162</b>
<b>Fund balances:</b>									
<b>Reserved for:</b>									
Related assets	-	-	-	-	455,944	-	-	455,944	770,229
Encumbrances	6,252	-	-	-	143,640	-	-	149,892	90,350
Unreserved	101,891	-	1,495	28,367	93,630	9,054	-	234,437	215,779
<b>Total fund balances</b>	<b>108,143</b>	<b>-</b>	<b>1,495</b>	<b>28,367</b>	<b>693,214</b>	<b>9,054</b>	<b>-</b>	<b>840,273</b>	<b>1,076,358</b>
<b>Total liabilities and fund balances</b>	<b>\$ 109,182</b>	<b>\$ -</b>	<b>\$ 1,495</b>	<b>\$ 37,854</b>	<b>\$ 725,269</b>	<b>\$ 9,054</b>	<b>\$ -</b>	<b>\$ 882,854</b>	<b>\$ 1,126,520</b>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

**EXPENDABLE TRUST FUNDS  
Combining Statement of Revenues, Expenditures and Changes in Fund Balances (Deficit)  
Year Ended September 30, 1996  
(With comparative totals for the year ended September 30, 1995)**

	Airport Trust	Agriculture Revolving	Production Loan	Scholarship Revolving Loan	Housing Revolving	Aluminum Recycling	Tourism Revolving	Totals	
								1996	1995
<b>Revenues:</b>									
Sales	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 75,453	\$ -	\$ 75,453	\$ 62,304
Others	54,242	-	-	10,905	229,654	-	-	294,801	98,952
<b>Total revenues</b>	<b>54,242</b>	<b>-</b>	<b>-</b>	<b>10,905</b>	<b>229,654</b>	<b>75,453</b>	<b>-</b>	<b>370,254</b>	<b>161,256</b>
<b>Expenditures:</b>									
Cost of sales	-	-	-	-	-	55,267	-	55,267	29,990
Others	35,617	47,718	92,909	12,478	331,271	-	31,079	551,072	55,719
<b>Total expenditures</b>	<b>35,617</b>	<b>47,718</b>	<b>92,909</b>	<b>12,478</b>	<b>331,271</b>	<b>55,267</b>	<b>31,079</b>	<b>606,339</b>	<b>85,709</b>
<b>Excess (deficiency) of revenues over (under) expenditures</b>	<b>18,625</b>	<b>(47,718)</b>	<b>(92,909)</b>	<b>(1,573)</b>	<b>(101,617)</b>	<b>20,186</b>	<b>(31,079)</b>	<b>(236,085)</b>	<b>75,547</b>
<b>Fund balances (deficit) at beginning of year</b>	<b>89,518</b>	<b>47,718</b>	<b>94,404</b>	<b>29,940</b>	<b>794,831</b>	<b>(11,132)</b>	<b>31,079</b>	<b>1,076,358</b>	<b>1,000,811</b>
<b>Fund balances at end of year</b>	<b>\$ 108,143</b>	<b>\$ -</b>	<b>\$ 1,495</b>	<b>\$ 28,367</b>	<b>\$ 693,214</b>	<b>\$ 9,054</b>	<b>\$ -</b>	<b>\$ 840,273</b>	<b>\$ 1,076,358</b>

See Accompanying Independent Auditors' Report.



**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

**INDEPENDENT AUDITORS' REPORTS ON COMPLIANCE  
WITH LAWS AND REGULATIONS**

**YEAR ENDED SEPTEMBER 30, 1996**



**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE**  
**BASED ON THE AUDIT OF GENERAL PURPOSE FINANCIAL STATEMENTS**

Honorable Moses Mackwelung  
Governor, State of Kosrae  
Federated States of Micronesia:

We have audited the general purpose financial statements of the State of Kosrae as of and for the year ended September 30, 1996, and have issued our report thereon dated May 17, 1997. Our report on the audit of the general purpose financial statements was modified due to; 1) our inability to determine the effects of not updating the General Fixed Assets Account Group; 2) the omission of the Component Units - Governmental Funds from the general purpose financial statements; and 3) our inability to audit the Governmental Fund Type - Expendable Trust Funds.

We conducted our audit in accordance with generally accepted auditing standards and 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 general purpose financial statements are free of material misstatement.

Compliance with laws, regulations, contracts, and grants applicable to the State of Kosrae is the responsibility of the State of Kosrae's management. As part of obtaining reasonable assurance about whether the general purpose financial statements are free of material misstatement, we performed tests of the State of Kosrae's compliance with certain provisions of laws, regulations, contracts, and grants. However, the objective of our audit of the general purpose financial statements was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

The results of our tests disclosed a material instance of noncompliance that is required to be reported herein under Government Auditing Standards, which is described in the accompanying Schedule of Findings and Questioned Costs in Federal finding number 2, the effects of which have not been corrected in the 1996 general purpose financial statements of the State of Kosrae.

We considered this material instance of noncompliance in forming our opinion on whether the 1996 general purpose financial statements are presented fairly, in all material respects, in conformity with generally accepted accounting principles, and this report does not affect our report dated May 17, 1997 on those general purpose financial statements.

We also noted certain immaterial instances of noncompliance that we have reported to the management of the State of Kosrae in the accompanying Schedule of Findings and Questioned Costs (pages 70 through 75) in Federal finding numbers 1 and 3 and local finding numbers 1 -3 .

We also noted matters including compliance with laws and regulations related to federal financial assistance, which we reported to the State of Kosrae's management in our reports dated May 17, 1997 on compliance related to federal financial assistance programs.

This report is intended for the information of the State of Kosrae and the cognizant audit and other federal agencies. However, this report is a matter of public record and its distribution is not limited.

*Deloitte & Touche LLP*

May 17, 1997



**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH SPECIFIC REQUIREMENTS**  
**APPLICABLE TO MAJOR FEDERAL FINANCIAL ASSISTANCE PROGRAMS**

Honorable Moses Mackwelung  
Governor, State of Kosrae  
Federated States of Micronesia:

We have audited the general purpose financial statements of the State of Kosrae as of and for the year ended September 30, 1996, and have issued our report thereon dated May 17, 1997. Our report on the audit of the general purpose financial statements was modified due to; 1) our inability to determine the effects of not updating the General Fixed Assets Account Group; 2) the omission of the Component Units - Governmental Funds from the general purpose financial statements; and 3) our inability to audit the Governmental Fund Type - Expendable Trust Funds.

We have also audited the State of Kosrae's compliance with the requirements governing the Compact of Free Association; types of services allowed or unallowed; eligibility; reporting; special tests and provisions related to the U.S. Environmental Protection Agency Wastewater Construction Project; and claims for advances and reimbursements that are applicable to each of its major federal financial assistance programs, which are identified in the accompanying Schedule of Federal Financial Assistance (pages 53 through 66), for the year ended September 30, 1996. The management of the State of Kosrae is responsible for the State of Kosrae's compliance with those requirements. Our responsibility is to express an opinion on compliance with those requirements based on our audit.

We conducted our audit of compliance with these requirements in accordance with generally accepted auditing standards; Government Auditing Standards, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Circular A-128, "Audits of State and Local Governments". Those standards and OMB Circular A-128 require that we plan and perform the audit to obtain reasonable assurance about whether material noncompliance with the requirements referred to above occurred. An audit includes examining, on a test basis, evidence about the State of Kosrae's compliance with those requirements. We believe that our audit provides a reasonable basis for our opinion.

The results of our audit procedures disclosed immaterial instances of noncompliance with the requirements referred to above, which are described in the accompanying Schedule of Findings and Questioned Costs (pages 70 through 75) in Federal finding numbers 1 - 3. We considered these instances of noncompliance in forming our opinion on compliance, which is expressed in the following paragraph.

In our opinion, the State of Kosrae complied, in all material respects, with the requirements governing the Compact of Free Association; types of services allowed or unallowed; eligibility; reporting; special tests and provisions related to the U.S. Environmental Protection Agency Wastewater Construction Project; and claims for advances and reimbursements that are applicable to each of its major federal financial assistance programs for the year ended September 30, 1996.

This report is intended for the information of the State of Kosrae and the cognizant audit and other federal agencies. However, this report is a matter of public record and its distribution is not limited.

May 17, 1997

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH THE GENERAL  
REQUIREMENTS APPLICABLE TO FEDERAL FINANCIAL ASSISTANCE**

Honorable Moses Mackwelung  
Governor, State of Kosrae  
Federated States of Micronesia:

We have audited the general purpose financial statements of the State of Kosrae as of and for the year ended September 30, 1996, and have issued our report thereon dated May 17, 1997. Our report on the audit of the general purpose financial statements was modified due to; 1) our inability to determine the effects of not updating the General Fixed Assets Account Group; 2) the omission of the Component Units - Governmental Funds from the general purpose financial statements; and 3) our inability to audit the Governmental Fund Type - Expendable Trust Funds. We have also audited the State of Kosrae's compliance applicable to requirements of major federal financial assistance programs and have issued our report thereon dated May 17, 1997.

We have applied procedures to test the State of Kosrae's compliance with the following requirements applicable to its federal financial assistance programs, which are identified in the Schedule of Federal Financial Assistance (pages 53 through 66), for the year ended September 30, 1996: cash management, federal financial reports, allowable costs/cost principles, Drug-Free Workplace Act, and administrative requirements.

The requirements of political activity, Davis-Bacon Act, civil rights and relocation assistance and real property acquisition are not applicable to the federal financial assistance programs of the State of Kosrae, which are identified in the Schedule of Federal Financial Assistance.

Our procedures were limited to the applicable procedures described in the Office of Management and Budget's Compliance Supplement for Single Audits of State and Local Governments. Our procedures were substantially less in scope than an audit, the objective of which is the expression of an opinion on the State of Kosrae's compliance with the requirements listed in the second paragraph of this report. Accordingly, we do not express such an opinion.

With respect to the items tested, the results of those procedures disclosed no material instances of noncompliance with the requirements listed in the second paragraph of this report. With respect to items not tested, nothing came to our attention that caused us to believe that the State of Kosrae had not complied, in all material respects, with those requirements. However, the results of our procedures disclosed one immaterial instance of noncompliance with those requirements, which is described in the accompanying Schedule of Findings and Questioned Costs (pages 70 through 76) in Federal finding number 1.

We also noted matters involving compliance with laws and regulations related to our audit of the general purpose financial statements and with requirements related to major and nonmajor federal financial assistance programs that we reported to the State of Kosrae's management in our reports dated May 17, 1997.

This report is intended for the information of the State of Kosrae and the cognizant audit and other federal agencies. However, this report is a matter of public record and its distribution is not limited.

*Deloitte + Touche LLP*

May 17, 1997



**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE  
WITH REQUIREMENTS APPLICABLE TO NONMAJOR  
FEDERAL FINANCIAL ASSISTANCE PROGRAM TRANSACTIONS**

Honorable Moses Mackwelung  
Governor, State of Kosrae  
Federated States of Micronesia:

We have audited the general purpose financial statements of the State of Kosrae as of and for the year ended September 30, 1996, and have issued our report thereon dated May 17, 1997. Our report on the audit of the general purpose financial statements was modified due to; 1) our inability to determine the effects of not updating the General Fixed Assets Account Group; 2) the omission of the Component Units - Governmental Funds from the general purpose financial statements; and 3) our inability to audit the Governmental Fund Type - Expendable Trust Funds. We have also audited the State of Kosrae's compliance applicable to requirements of major federal financial assistance programs and applied procedures to test compliance with general requirements applicable to federal financial assistance programs and have issued our reports thereon dated May 17, 1997.

In connection with our audit of the 1996 general purpose financial statements of the State of Kosrae and with our consideration of the State of Kosrae's control structure used to administer federal financial assistance programs, as required by Office of Management and Budget (OMB) Circular A-128, "Audits of State and Local Governments", we selected certain transactions applicable to certain nonmajor federal financial assistance programs for the year ended September 30, 1996.

As required by OMB Circular A-128, we have performed auditing procedures to test compliance with the requirements governing types of services allowed or unallowed; eligibility; and reporting that are applicable to those transactions. Our procedures were substantially less in scope than an audit, the objective of which is the expression of an opinion on the State of Kosrae's compliance with these requirements. Accordingly, we do not express such an opinion.

With respect to the items tested, the results of those procedures disclosed no material instances of noncompliance with the requirements listed in the preceding paragraph. With respect to items not tested, nothing came to our attention that caused us to believe that the State of Kosrae had not complied, in all material respects, with those requirements.

This report is intended for the information of the State of Kosrae and the cognizant audit and other federal agencies. However, this report is a matter of public record and its distribution is not limited.

*Deloitte & Touche LLP*

May 17, 1997

**INDEPENDENT AUDITORS' REPORT ON THE INTERNAL CONTROL  
STRUCTURE USED IN ADMINISTERING FEDERAL FINANCIAL ASSISTANCE**

Honorable Moses Mackwelung  
Governor, State of Kosrae  
Federated States of Micronesia:

We have audited the general purpose financial statements of the State of Kosrae as of and for the year ended September 30, 1996, and have issued our report thereon dated May 17, 1997. Our report on the audit of the general purpose financial statements was modified due to; 1) our inability to determine the effects of not updating the General Fixed Assets Account Group; 2) the omission of the Component Units - Governmental Funds from the general purpose financial statements; and 3) our inability to audit the Governmental Fund Type - Expendable Trust Funds. We have also audited the State of Kosrae's compliance with requirements applicable to major federal financial assistance programs and have issued our report thereon dated May 17, 1997.

We conducted our audits in accordance with generally accepted auditing standards; Government Auditing Standards, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Circular A-128, "Audits of State and Local Governments". Those standards and OMB Circular A-128 require that we plan and perform the audits to obtain reasonable assurance about whether the general purpose financial statements are free of material misstatement and about whether the State of Kosrae complied with laws and regulations, noncompliance with which would be material to a major federal financial assistance program.

In planning and performing our audits for the year ended September 30, 1996, we considered the State of Kosrae's internal control structure and assessed control risk in order to determine our auditing procedures for the purpose of expressing our opinions on the State of Kosrae's general purpose financial statements and on its compliance with requirements applicable to major programs and to report on the internal control structure in accordance with OMB Circular A-128. This report addresses our consideration of internal control structure policies and procedures relevant to compliance with requirements applicable to federal financial assistance programs. We have addressed internal control structure policies and procedures relevant to our audit of the general purpose financial statements in a separate report dated May 17, 1997.

The management of the State of Kosrae is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of general purpose financial statements in accordance with generally accepted accounting principles, and that federal financial assistance programs are managed in compliance with applicable laws and regulations. Because of inherent limitations in any internal control structure, errors, irregularities, or instances of noncompliance may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

For the purpose of this report, we have classified the significant internal control structure policies and procedures used in administering federal financial assistance programs in the following categories:

Controls Used in Administering Federal Programs

General Requirements

- Cash management
- Federal financial reports
- Allowable costs/cost principles
- Drug-Free Workplace Act
- Administrative requirements

Specific Requirements

- Compact of Free Association
- Types of services allowed or unallowed
- Eligibility
- Reporting
- Special tests and provisions related to the U.S. Environmental Protection Agency Wastewater Construction Project

Claims for Advances and Reimbursements

Accounting Controls

- Revenue and receipt cycle
- Purchases and disbursement cycle
- Payroll and personnel cycle
- External financial reporting
- Cash and equivalents
- Receivables
- Fixed assets
- Payables and accrued liabilities

For all of the internal control structure categories listed above, we obtained an understanding of the design of relevant policies and procedures and determined whether they have been placed in operation, and we assessed control risk.

During the year ended September 30, 1996, the State of Kosrae expended 89% of its total federal financial assistance under the major federal financial assistance programs listed on page 69.

We performed tests of controls, as required by OMB Circular A-128, to evaluate the effectiveness of the design and operation of internal control structure policies and procedures that we considered relevant to preventing or detecting material noncompliance with specific requirements, general requirements and requirements governing claims for advances and reimbursements that are applicable to each of the State of Kosrae's major federal financial assistance programs, which are identified in the accompanying Schedule of Federal Financial Assistance (pages 53 through 66). Our procedures were less in scope than would be necessary to render an opinion on these internal control structure policies and procedures. Accordingly, we do not express such an opinion.

We noted two matters, which are described in Federal finding numbers 1 and 2 in the accompanying Schedule of Findings and Questioned Costs (pages 70 through 75), involving the internal control structure and its operation that we consider to be a reportable condition under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect Kosrae State's ability to administer federal financial assistance programs in accordance with applicable laws and regulations.



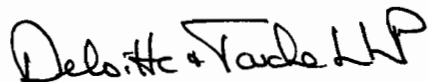
A material weakness is a reportable condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that noncompliance with laws and regulations that would be material to a federal financial assistance program may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control structure policies and procedures used in administering federal financial assistance would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we believe the reportable conditions described above are not material weaknesses.

We also noted matters involving the internal control structure and its operation based on our audit of the general purpose financial statements that we reported to the management of the State of Kosrae in a report dated May 17, 1997.

We also noted one other matter involving the internal control structure and its operation, which is described in the accompanying Schedule of Findings and Questioned Costs in Federal finding number 3, which we have reported to the management of the State of Kosrae.

This report is intended for the information of the State of Kosrae and the cognizant audit and other federal agencies. However, this report is a matter of public record and its distribution is not limited.

A handwritten signature in black ink, appearing to read "Deloitte & Touche LLP", is written in a cursive, stylized script.

May 17, 1997

**INDEPENDENT AUDITORS' REPORT ON THE SUPPLEMENTARY  
SCHEDULE OF FEDERAL FINANCIAL ASSISTANCE**

Honorable Moses Mackwelung  
Governor, State of Kosrae  
Federated States of Micronesia:

We have audited the general purpose financial statements of the State of Kosrae as of and for the year ended September 30, 1996, and have issued our report thereon dated May 17, 1997. Our report on the audit of the general purpose financial statements was modified due to; 1) our inability to determine the effects of not updating the General Fixed Assets Account Group; 2) the omission of the Component Units - Governmental Funds from the general purpose financial statements; and 3) our inability to audit the Governmental Fund Type - Expendable Trust Funds. These general purpose financial statements are the responsibility of the State of Kosrae's management. Our responsibility is to express an opinion on these general purpose financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and 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 general purpose financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the general purpose financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

Our audit was conducted for the purpose of forming an opinion on the general purpose financial statements of the State of Kosrae taken as a whole. The accompanying Schedule of Federal Financial Assistance (pages 53 through 66) for the year ended September 30, 1996, which is also the responsibility of the management of the State of Kosrae, is presented for purposes of additional analysis and is not a required part of the general purpose financial statements. The information in that schedule has been subjected to the auditing procedures applied in our audit of the general purpose financial statements and, in our opinion, is fairly stated in all material respects when considered in relation to the general purpose financial statements taken as a whole.

This report is intended for the information of the State of Kosrae and the cognizant audit and other federal agencies. However, this report is a matter of public record and its distribution is not limited.

May 17, 1997

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Federal Financial Assistance  
U.S. Federal and Other Assistance Fund  
Year Ended September 30, 1996

Grantor	CFDA I.D. #	Kosrae Org. #	Grant Title	1996 Fiscal Year Expenditures
U.S. Dept. of Education	84.027	7743	FY94 Special Education	177
	84.027	7729	FY95 Special Education	463,538
	84.256A	5426	FY95 TFAS Educational Grant	90,476
	84.256A	5846	FY96 TFAS Educational Grant	131,777
	84.994	3932	FY96 Vocational Education PREL	94,573
	84.276	3003	95 Goal 2000 Program	11,365
				<hr/> 791,906
U.S. Dept. of Labor	17.250	3203	FY95 JTPA Administration	8,766
	17.250	3204	FY95 JTPA Adult Program	33,566
	17.250	3205	FY95 JTPA Youth	21,592
	17.250	3214	FY95 JTPA Elderly	14,280
	17.250	3434	FY93 Education Coordinator	14,515
	17.250	3440	FY94 JTPA Administration	34
	17.250	3441	FY94 JTPA Adult Program	18,452
	17.250	3442	FY94 JTPA Youth Program	13,214
	17.250	3443	FY94 JTPA Participation/Support	480
	17.250	3445	FY94 JTPA Elderly	60
	17.250	3446	FY94 Technical Assistance	(87)
				<hr/> 124,872
U.S. Dept. of Agriculture	10.664	7708	FY93 Forestry	3,498
	10.664	7714	FY94 Forestry	3,860
	10.664	7715	FY94 Fire Prevention	6,289
				<hr/> 13,647
U.S. Dept. of Health and Human Services	93.217	3675	FY97 Family Planning	2,339
	93.217	7438	FY96 Family Planning	17,167
	93.991	3645	FY95 Preventive Health	9,090
	93.110	3649	FY96 SSDI (MCH)	4,043
	93.988	3652	FY95 Diabetes Program	1,302
	93.959	3655	FY95 Substance Abuse	37,306
	93.116	3665	FY96 Tuberculosis	15,799
	93.268	3669	FY96 Immunization	3,867
	93.940	3682	FY96 Aids Prevention	4,713
	93.958	7372	FY95 Mental Health Info	3,533
	93.959	7378	FY94 Substance Abuse	1,419
	93.268	7394	FY95 Immunization	163
	93.940	7441	FY95 Aids Prevention	2,200
	93.994	7445	FY95 MCH Program	50,918
	93.116	7448	FY95 TB/AIDS Control	4,742
	93.994	7455	FY93 MCH Dental	35
	93.994	7489	FY94 MCH Program	708
	93.994	7490	FY95 MCH/CSHCN Program	4,821
				<hr/> 164,165
			Subtotal	<hr/> 1,094,590

See accompanying notes to schedule of federal financial assistance.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Federal Financial Assistance, Continued  
U.S. Federal and Other Assistance Fund, Continued  
Year Ended September 30, 1996

			Balance forwarded	\$ 1,094,590
U.S. Environmental Protection Agency	66.418	3585	Waste Water Construction	<u>684,644</u>
U.S. Dept. of the Interior	15.904	3451	FY95 Historic Preservation	17,937
	15.904	7326	FY94 Historic Preservation	<u>9,921</u>
				<u>27,858</u>
Nonfederal - pass through from Pacific Basin Development Council	N/A	3838	Emergency Management Network	<u>4,468</u>
				<u>4,468</u>
			Total federal and other assistance expenditures	<u><u>\$ 1,811,560</u></u>

Note: The above grants are received in a subgrantee capacity through the FSM National Government except for the TFAS program (84.256) and the Pacific Basin Development Council (a nonfederal grant) which were received directly from the grantor.

Reconciliations to financial statements:	
Expenditures above	\$ 1,811,560
TCP Nutrition Program (a non-U.S. program)	<u>759</u>
Balance per financial statements	<u><u>\$ 1,812,319</u></u>

See accompanying notes to schedule of federal financial assistance.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Federal Financial Assistance, Continued  
Foreign Assistance Fund  
Year Ended September 30, 1996

Account Title	CFDA #	Kosrae Org. #	1996 Fiscal Year Expenditures
World Health Organization:			
FY96 Clinical Protocol	N/A	7399	\$ 599
Fruit Fly Project	N/A	7399	891
			<u>1,490</u>
South Pacific Commission Grants:			
Kosrae Anti Substance Abuse	N/A	7315	<u>45,433</u>
UNICEF Grants:			
Family Food Nutrition	N/A	3929	4,045
TCP Nutrition Program	N/A	3913	759
			<u>4,804</u>
Other Grants:			
FY95 Diabetic Project	N/A	3934	2,665
Utwe Sport Equipment	N/A	3936	357
FY96 Walung Water Project	N/A	3934	3,113
			<u>6,135</u>
Total Foreign Assistance Fund			<u><u>\$ 57,862</u></u>

Note: The above grants are received directly from foreign governments and private organizations.

Reconciliations to financial statements:	
Expenditures above	\$ 57,862
Less TCP Nutrition Program	<u>(759)</u>
Balance per financial statements	<u><u>\$ 57,103</u></u>

See accompanying notes to schedule of federal financial assistance.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Federal Financial Assistance, Continued  
TTPI Capital Projects Fund  
Year Ended September 30, 1996

Grantor Account Title	Kosrae Org. #	CFDA I.D. #	1996 Fiscal Year Expenditures
Airport Terminal	6342	15.875	\$ 49,000
Water System Development	6346	15.875	186,728
Kosrae Okat Dock	6350	15.875	9
Tofol Water Treatment	6808	15.875	<u>7,695</u>
Total CFSM CIP			<u>\$ 243,432</u>

Note: The above grants are received in a subgrantee capacity through the Trust Territory of the Pacific Islands (TTPI) Government.

See accompanying notes to schedule of federal financial assistance.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Federal Financial Assistance, Continued  
CFSM Capital Projects Fund  
Year Ended September 30, 1996

<u>Account Title</u>	<u>Kosrae Org. #</u>	<u>1996 Fiscal Year Expenditures</u>
FY95 Kosrae Tourism Development	1176	\$ 31,907
Kosrae State Court	4612	61,482
Joint Law Enforcement	4632	66,624
FY94 Broiler Project	6900	8,425
FY95 Health Programs	9585	86,054
FY95 CFSM Educations	9588	49,018
Procure/Medical Supplies	9590	45,531
FY96 Road Development	9592	66,728
FY96 Police Communication System	9593	19,979
FY96 Fisheries Fuel	9586	500,000
Kosra POL Bulk Plant	9599	250,000
		<hr/>
Total CFSM CIP		\$ 1,185,748
		<hr/>

Note: The above grants are received as a result of appropriations made by the Congress of the Federated States of Micronesia.

See accompanying notes to schedule of federal financial assistance.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Federal Financial Assistance, Continued  
Operations and Maintenance Grants Fund  
Year Ended September 30, 1996

Grantor Account Title	Kosrae Org. #	CFDA I.D. #	1996 Fiscal Year Expenditures
<u>Office of Territorial and International Affairs</u>			
Computer Aided Design	3504	15.875	\$ 12,470
FY95 Local Closeup	3543	15.875	1,538
FY95 Visions and Dreams	3544	15.875	(132)
FY96 Local Closeup	3546	15.875	1,200
Road Maintenance Management Improvement	3625	15.875	44,806
FY95 TAFASEG 5-182	4526	15.875	(10)
FY95 School Maintenance	7320	15.875	65,386
FY95 Reorg. DPW 2nd Year	7330	15.875	13,020
FY95 Jail OMIP Maintenance	7331	15.875	2,398
FY95 Hospital OMIP	7891	15.875	20,000
			<u>\$ 160,676</u>

Note: These grants are received in a subgrantee capacity through the Federated States of Micronesia National Government.

See accompanying notes to schedule of federal financial assistance.



**STATE OF KOSRAE**  
**FEDERATED STATES OF MICRONESIA**

Schedule of Federal Financial Assistance, Continued  
Compact of Free Association Capital Projects Fund  
Section 211 (A) Capital Account  
Year Ended September 30, 1996

Grantor Account Title	Kosrae Org. #	CFDA I.D. #	1996 Fiscal Year Expenditures
<u>Office of Territorial and International Affairs</u>			
Elementary Classrooms	6217	15.875	\$ 18,000
FY95 Power Exp. (Sewerage)	6221	15.875	41,299
Citrus Fumigation	6227	15.875	1,799
Housing Renovation Loan	6354	15.875	362
Poultry & Swine Production	6460	15.875	147
Poultry & Swine Production	6461	15.875	24,490
FY92 Land Acquisition	6464	15.875	5,493
FY92 Medical Equipment	6468	15.875	1,125
FY92 Power Plant Improvements	6486	15.875	6,536
Fisheries Development	6788	15.875	2,423
Tofol Gymnasium	6792	15.875	19,068
Fin. Microfilm Extension	6804	15.875	3,886
Fisheries Development	6807	15.875	45,807
Hospital Admin. Building	6809	15.875	8,475
Elementary Classroom	6813	15.875	6,909
State New Court House	6817	15.875	20,611
FY93 Housing Renovation Loans	6822	15.875	3,465
FY93 Municipal Water Systems	6826	15.875	23,017
FY93 Power Plant Improvements	6827	15.875	465,331
FY93 Consultancy Services	6828	15.875	7,371
FY93 OMIP Matching	6829	15.875	34,260
FY93 Kosrae High School	6830	15.875	5,462
FY93 Land Acquisition	6832	15.875	1,125
FY94 Land Acquisition	6834	15.875	30,485
FY94 Project Administration	6835	15.875	(32)
FY94 Road Pavement	6837	15.875	136,997
FY94 Lelu Power Upgrade	6838	15.875	299,991
FY94 Maintenance Program	6839	15.875	31,063
FY94 Public Safety Matching	6842	15.875	991
FY94 Sansrik Elementary Con.	6843	15.875	9,437
FY94 Consultant Services	6844	15.875	9,932
FY94 School Bus	6845	15.875	(10)
FY95 Man Power Training	6847	15.875	3,192
FY95 Road Development	6848	15.875	713,783
FY95 OMIP Matching	6851	15.875	62,678
FY95 Trochus Development	6853	15.875	237
FY95 Judiciary Building	6854	15.875	100,000
FY95 Security Vault	6856	15.875	4,589
FY95 New Classrooms	6857	15.875	10,000
FY95 Consultancy Services	6859	15.875	2,393
FY95 Project Admin.	6860	15.875	18,112
FY95 Medical Referral Housing Acquisition	6861	15.875	160,324
FY95 Utwe Office Renovation	6862	15.875	5,212
FY95 Malem School Bridge	6865	15.875	6,332
Lelu School Drainage	6866	15.875	7,161
Subtotal			2,359,328

See accompanying notes to schedule of federal financial assistance.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Federal Financial Assistance, Continued  
Compact of Free Association Capital Projects Fund  
Section 211 (A) Capital Account, Continued  
Year Ended September 30, 1996

Grantor Account Title	Kosrae Org. #	CFDA I.D. #	1996 Fiscal Year Expenditures
Balance forwarded			\$ 2,359,328
FY96 Power Plant Improvement	6867	15.875	276,588
FY96 New Classroom	6868	15.875	205,815
FY96 Manpower Development	6869	15.875	52,664
FY96 Road Development	6870	15.875	135,998
FY96 POL Bulk Plant	6871	15.875	20,379
FY96 Slipway	6872	15.875	28,000
FY96 Sports Facilities	6874	15.875	180,483
FY96 Building Maintenance	6875	15.875	105,318
FY96 Project Administration	6876	15.875	48,586
FY96 Land Acquisition	6877	15.875	109,016
FY96 Consultancy Services	6878	15.875	20,000
FY84 Water Resources Development	6879	15.875	11,500
FY96 KSL Renovation/H.R. Dev.	6880	15.875	34,626
FY96 T/A Water Master Plan	6881	15.875	10,871
FY96 Agriculture Lab Facilities	6882	15.875	22,212
FY96 KBD Advisory Centers	6883	15.875	27,853
FY96 Farmers Exchange	6884	15.875	1,816
Trochus G/Snail	6885	15.875	2,624
MTN Repayment	6852	15.875	1,041,850
Total Compact of Free Association Capital Projects Fund - Section 211 (A) Capital Accounts			<u>\$ 4,695,527</u>
Balance per the general-purpose financial statements			\$ 3,653,677
Bond principal repayments	6840		1,000,000
Bond interest	6840		41,850
			<u>\$ 4,695,527</u>

Note: These funds are made available by Title Two, Article I, Section 211 of the Compact of Free Association.

These funds are disbursed through the Office of Territorial and International Affairs (OTIA), U.S. Department of the Interior and bear CFDA No. 15.875. The FSM National Government receives all grant awards on behalf of the FSM and reallots such to the component States.

See accompanying notes to schedule of federal financial assistance.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Federal Financial Assistance, Continued  
Compact of Free Association Section 216(A)(2)  
Health and Medical Programs  
Year Ended September 30, 1996

Grantor Account Title	Kosrae Org. #	CFDA I.D. #	1996 Fiscal Year Expenditures
<u>Office of Territorial and International Affairs</u>			
Medical Referral	2499	15.875	\$ <u>86,809</u>
Total Compact of Free Association Section 216(A)(2)			\$ <u><u>86,809</u></u>

Note: These funds are made available by Title Two, Article I, Section 216(a)(2) of the Compact of Free Association.

These funds are disbursed through the Office of Territorial and International Affairs (OTIA), U.S. Department of the Interior and bear CFDA No. 15.875. The FSM National Government receives all grant awards on behalf of the FSM and reallots such to the component States.

See accompanying notes to schedule of federal financial assistance.

**STATE OF KOSRAE**  
**FEDERATED STATES OF MICRONESIA**

Schedule of Federal Financial Assistance, Continued  
Compact of Free Association Section 212(B)  
Special Development Program  
Year Ended September 30, 1996

<u>Account Title</u>	<u>Kosrae Org. #</u>	<u>1996 Fiscal Year Expenditures</u>
FY95 Centralized Pol.	2819	\$ 92,301
FY96 Governor O&M	2826	13,180
Civic Action Team	N/A	<u>250,000</u>
 Total Compact of Free Association Section 212(B)		 <u>\$ 355,481</u>

Note: These funds are made available by Title Two, Article I, Section 212(b) of the Compact of Free Association.

These funds are disbursed through the Office of Territorial and International Affairs (OTIA), U.S. Department of the Interior and bear CFDA No. 15.875. The FSM National Government receives all grant awards on behalf of the FSM and reallots such to the component States.

See accompanying notes to schedule of federal financial assistance.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Federal Financial Assistance, Continued  
Compact of Free Association Section 216(A)(3)  
Scholarship Program  
Year Ended September 30, 1996

<u>Account Title</u>	<u>Kosrae Org. #</u>	<u>1996 Fiscal Year Expenditures</u>
Compact Scholarship '88	2650	\$ 26,776
FY95&96 Scholarship Grant	2653	<u>125,494</u>
 Total Compact of Free Association Section 216(A)(3)		 <u>\$ 152,270</u>

Note: These funds are made available by Title Two, Article I, Section 216(A)(3) of the Compact of Free Association.

These funds are disbursed through the Office of Territorial and International Affairs (OTIA), U.S. Department of the Interior and bear CFDA No. 15.875. The FSM National Government receives all grant awards on behalf of the FSM and reallots such to the component States.

See accompanying notes to schedule of federal financial assistance.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Federal Financial Assistance, Continued  
Compact of Free Association Section 221(B)  
Special Block Grant Fund  
Year Ended September 30, 1996

Grantor Account Title	Kosrae Org. #	CFDA I.D. #	1996 Fiscal Year Expenditures
<u>Office of Territorial and International Affairs</u>			
Health Special Block Program	2075	15.875	\$ 114,993
Education Special Block Program	2128	15.875	<u>1,130,702</u>
Total Compact of Free Association Section 221(B)			<u>\$ 1,245,695</u>

Note: These funds are made available by Title Two, Article I, Section 221(b) of the Compact of Free Association.

These funds are disbursed through the Office of Territorial and International Affairs (OTIA) U.S. Department of the Interior and bear CFDA No. 15.875. The FSM National Government receives all grant awards on behalf of the FSM and reallots such to the component States.

See accompanying notes to schedule of federal financial assistance.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Federal Financial Assistance, Continued  
Compact of Free Association Section 214(B)  
Energy Programs  
Year Ended September 30, 1996

Account Title	Kosrae Org. #	1996 Fiscal Year Expenditures
Power Generation	2803	\$ 485,019
FY96 Government Power Bill	2806	197,194
Prior Years Power Bills	2832	<u>271,630</u>
Total Compact of Free Association Section 214(b)		<u>\$ 953,843</u>
Balance per the fund financial statements		\$ 468,824
Transfer to Kosrae Utilities Authority	2803	<u>485,019</u>
		<u>\$ 953,843</u>

Note: These funds are made available by Title Two, Article I, Section 214(b) of the Compact of Free Association.

These funds are disbursed through the Office of Territorial and International Affairs (OTIA), U.S. Department of the Interior and bear CFDA No. 15.875. The FSM National Government receives all grant awards on behalf of the FSM and reallots such to the component States.

See accompanying notes to schedule of federal financial assistance.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Federal Financial Assistance, Continued  
Compact of Free Association Section 211(A)  
General Fund Current Account  
Year Ended September 30, 1996

<u>Account Title</u>	<u>Kosrae Org. #</u>	<u>CFDA I.D. #</u>	<u>1996 Fiscal Year Expenditures</u>
General Fund: Current Account	Various	15.875	\$ <u>4,131,775</u>

Note: These funds are made available by Title Two, Article I, Section 211(A) of the Compact of Free Association.

These funds are disbursed through the Office of Territorial and International Affairs (OTIA), U.S. Department of the Interior and bear CFDA No. 15.875. The FSM National Government receives all grant awards on behalf of the FSM and then reallots such to the component States.

See accompanying notes to schedule of federal financial assistance.



**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Schedule of Federal Financial Assistance  
Year Ended September 30, 1996

(1) Scope of Review

The Kosrae State Government is a governmental entity governed by its own Constitution. All significant operations of the State are included in the scope of the OMB Circular A-128 audit (the "Single Audit"). The U.S. Department of the Interior has been designated as the State's cognizant agency for the Single Audit.

A. Programs Subject to Single Audit

- U.S. Department of Agriculture
- U.S. Department of Education
- U.S. Department of Health and Human Services
- U.S. Department of the Interior
- U.S. Department of Labor
- U.S. Environmental Protection Agency
- U.S. Federal Emergency Management Agency

(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.

B. Reporting Entity

The Kosrae State Government, for purpose of the general purpose financial statements, includes all of the funds of the primary government as defined by Governmental Accounting Standards Board (GASB) Statement 14, "The Financial Reporting Entity".

(3) Component Units

The Kosrae Utilities Authority, a component unit - proprietary fund of the State of Kosrae separately satisfies the requirements of OMB Circular A-128. The Kosrae Utilities Authority's Schedule of Federal Financial Assistance is as follows:

<u>Grantor Agency/Program</u>	<u>CFDA#</u>	<u>Fiscal Year 1996 Expenditures</u>
U.S. Department of the Interior:		
Compact of Free Association:		
Energy (214B)	15.875	\$ 485,019
Capital Account funds	15.875	935,031
Operations and Maintenance		
Improvement Programs (OMIP)	15.875	<u>93,729</u>
Total expenditures		\$ <u>1,513,779</u>

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Notes to Schedule of Federal Financial Assistance, Continued  
Year Ended September 30, 1996

(3) Component Units, Continued

The programs are received from the State of Kosrae in a subrecipient capacity. The aforementioned audit did not specify the existence of any questioned costs pertinent to the above expenditures. Funds passed through to the Kosrae Utilities Authority are included within the Schedules of Federal Financial Assistance of Kosrae State.

The Kosrae Community Action Program, a component unit-governmental fund has not separately satisfied audit requirements of OMB Circular A-133. Kosrae State is considered to have responsibility for any questioned costs that could result from Single Audits of this entity.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Programs Selected for  
Audit in Accordance with OMB Circular A-128  
Year Ended September 30, 1996

Grantor	CFDA I.D. #	1996 Fiscal Year Expenditures
Major Programs		
U.S. Dept. of the Interior	15.875	
Compact of Free Association		
211(a) Capital Accounts		\$ 4,695,527
221(b) Block Grant		1,245,695
Health and Medical		86,809
Energy		953,843
Scholarship Program		152,270
Special Development Grant		<u>355,481</u>
Total Major Programs under CFDA# 15.875 excluding Compact of Free Association Section 211(a) Current Account expenditures		7,489,625
U.S. Environmental Protection Agency: Wastewater Construction	66.418	684,644
U.S. Department of Education: Special Education Program	84.027	<u>463,715</u>
Total major program expenditures		<u>\$ 8,637,984</u>
Total U.S. Federal Program expenditures excluding Compact 211(a) Current Account expenditures		<u>\$ 9,706,052</u>
Percentage of Total U.S. Federal Program expenditures covered by Major Programs excluding Compact Section 211(a) Current Account expenditures		<u>89%</u>

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs  
Year Ended September 30, 1996

**Federal Findings**

**Prior Years' Unresolved Findings**

1. Criteria: Findings from prior audit reports should be resolved in a timely manner.

Condition: The following findings from previous years' Single Audit Reports remain unresolved.

<u>Page No.</u>	<u>Finding No.</u>	<u>Description</u>
<b>FISCAL YEAR 1988</b>		
26	5	Federal property standards
<b>FISCAL YEAR 1990</b>		
81	5	Wastewater Facility - Use charge system
<b>FISCAL YEAR 1994</b>		
87	7	Administrative Requirements
<b>FISCAL YEAR 1995</b>		
71	2	Kosrae Waste Water

Cause: The cause of the above condition is unknown.

Effect: Lack of timely resolution of audit findings hinders the effectiveness of Kosrae State's administrative controls over federal financial assistance.

Recommendation: Administrative control findings from previous Single Audit Reports should be satisfactorily resolved in a timely manner.

**Auditee Response and Corrective Action Plan:**

Federal Property Standards (FY1988): Because of limited expertise in the use the of automated system, the property management division did the accounting of all fixed assets manually. We have identified a d-base software currently received by the Budget unit that can accommodate the recording and accounting of all fixed assets that have been manually accounted for. The Property management division and the Budget unit are currently working on this process.

Water Charge System: We have submitted proposed legislation to the State Legislature for enactment that will transfer the operation and management of the State's Water and Wastewater System to the Kosrae Utility Authority (KUA). KUA will eventually establish user's fees as required under the proposed legislation. (Proposed legislation transmitted by the Governor to the Speaker on March 17, 1997).

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs  
Year Ended September 30, 1996

**Federal Findings, Continued**

**Prior Years' Unresolved Findings, Continued**

Auditee Response and Corrective Action Plan:

Administrative Requirements: We agree to this finding. We have identified a d-base software currently received by the Budget unit that can accommodate the recording and accounting of all fixed assets that have been manually accounted for. The Director of Administration by directive will ensure that other required administrative requirements are implemented immediately.

Kosrae Waste Water: We agree with this finding. Please refer to the above response for Water Charge System.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs  
Year Ended September 30, 1996

Federal Findings, Continued

<u>Program</u>	<u>Reason For Questioned Costs</u>	<u>Questioned Costs</u>																														
2. Compact Capital Projects Fund-CFDA # 15.875-Compact of Free Association	<p><u>Criteria:</u> All disbursements must be properly supported by vendor's invoice, timesheets and contracts, etc.</p> <p><u>Condition:</u> The following accounts payable vouchers lacked vendor's invoice.</p> <table> <tr> <th><u>Org. #</u></th><th><u>APV #</u></th><th></th></tr> <tr> <td></td><td>91037</td><td>\$ 18,000</td></tr> <tr> <td></td><td>92360</td><td>72,000</td></tr> <tr> <td></td><td>94763</td><td>24,000</td></tr> <tr> <td></td><td>95180</td><td>24,000</td></tr> <tr> <td></td><td>96558</td><td>78,100</td></tr> <tr> <td></td><td>96539</td><td>18,000</td></tr> <tr> <td></td><td>96539</td><td>22,260</td></tr> <tr> <td></td><td>97142</td><td>18,000</td></tr> <tr> <td></td><td></td><td><u>274,360</u></td></tr> </table>	<u>Org. #</u>	<u>APV #</u>			91037	\$ 18,000		92360	72,000		94763	24,000		95180	24,000		96558	78,100		96539	18,000		96539	22,260		97142	18,000			<u>274,360</u>	
<u>Org. #</u>	<u>APV #</u>																															
	91037	\$ 18,000																														
	92360	72,000																														
	94763	24,000																														
	95180	24,000																														
	96558	78,100																														
	96539	18,000																														
	96539	22,260																														
	97142	18,000																														
		<u>274,360</u>																														
	<u>Cause:</u> The cause of this condition is unknown.																															
	<u>Effect:</u> Potential questioned costs result from this condition.																															
	<u>Recommendation:</u> We recommend that management should ensure that all disbursements are properly supported by vendor's invoice, timesheets, contracts, etc.																															
	<u>Auditee Response:</u> We agreed to this finding. Inquiry will be made to the concerned vendors so that original invoice can be provided.																															
	<u>Corrective Action Plan:</u> The Director of Administration will ensure by directive that all vendor's invoices will be required prior to disbursement of funds.																															
	Total Questioned Costs	\$ <u>274,360</u>																														

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs  
Year Ended September 30, 1996

**Local Findings**

**Prior Years' Unresolved Findings**

1. Criteria: Findings from prior audit reports should be resolved in a timely manner.

Condition: The following findings from previous years' Single Audit Reports remain unresolved.

<u>Page No.</u>	<u>Finding No.</u>	<u>Description</u>
<b>FISCAL YEAR 1990</b>		
82	6	Common stock purchase - Bank of the FSM
<b>FISCAL YEAR 1994</b>		
91	2	Use of Compact Energy Fund

Cause: The cause of the above condition is unknown.

Effect: Lack of timely resolution of audit findings hinders the effectiveness of Kosrae State's administrative controls over federal financial assistance.

Recommendation: Administrative control findings from previous Single Audit Reports should be satisfactorily resolved in a timely manner.

**Auditee Response and Corrective Action Plan:**

Common Stock: After extensive review of our records once again, we decided to disagree with this finding. As stated in the legal opinion released by the Attorney General of the State of Kosrae dated August 13, 1997, the purchase was within the statutory authority granted by State Law No. 4-72.

Use of Compact Energy Fund: This finding is currently under review by the State Attorney General's Office. We will fully respond when review is completed.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs  
Year Ended September 30, 1996

**Local Findings, Continued**

**Compact Energy Funds**

2. Criteria: Kosrae State should ensure that it complies with the intent of the Compact treaty.

Condition: During fiscal year 1996, Kosrae State expended Compact Energy funds aggregating \$197,194 for the State's utility bills. The use of Compact Energy funds in such a manner may be inconsistent with Section 214 of the Compact.

Cause: The cause of this condition is unknown.

Effect: Noncompliance with the Compact treaty could result from this condition.

Recommendation: We recommend that the State management aggressively pursue this issue with the FSM National Government for resolution.

Auditee Response and Corrective Action Plan: This is currently under review by the State Attorney General's Office. We will fully respond when review is completed.



**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs  
Year Ended September 30, 1996

**Local Findings, Continued**

**Unauthorized Expenditure**

3. Criteria: Expenditures must be legally authorized.

Condition: A disbursement of \$250,000 for purchase of fuel was charged against organization 9599 Kosrae Bulk Plant, a fiscal year 1997 CFSM appropriation.

Cause: The cause of this condition is unknown.

Effect: The effect of this condition is an unauthorized expenditure.

Recommendation: We recommend that management ensure that all expenditures are legally appropriated.

Auditee Response and Corrective Action Plan: The disbursement was a required prepaid expense for the on-going project for the Kosrae Bulk Plant in which the State used its cash knowing that the CFSM appropriation will replenish as soon as it is available.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

**Unresolved Prior Years' Questioned Costs  
Year Ended September 30, 1996**

The following is a summary of unresolved questioned costs of the State of Kosrae as of September 30, 1996:

FY85 unresolved questioned costs	\$ 12,838
FY88 unresolved questioned costs	215,383
FY94 unresolved questioned costs	8,246
FY95 unresolved questioned costs	2,983
FY96 unresolved questioned costs	<u>274,360</u>
	\$ <u>513,810</u>

Note: Pursuant to Title I, Section 105 of United States Public Law 99-239 (Compact of Free Association) the Government of the Federated States of Micronesia (FSM) 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 resolved with the U.S. Government.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA  
INDEPENDENT AUDITORS' REPORT ON  
THE INTERNAL CONTROL STRUCTURE  
YEAR ENDED SEPTEMBER 30, 1996**

**INDEPENDENT AUDITORS' REPORT ON THE INTERNAL CONTROL STRUCTURE  
BASED ON THE AUDIT OF THE GENERAL PURPOSE FINANCIAL STATEMENTS**

Honorable Moses Mackwelung  
Governor, State of Kosrae  
Federated States of Micronesia:

We have audited the general purpose financial statements of the State of Kosrae as of and for the year ended September 30, 1996, and have issued our report thereon dated May 17, 1997. Our report on the audit of the general purpose financial statements was modified due to; 1) our inability to determine the effects of not updating the General Fixed Assets Account Group; 2) the omission of the Component Units - Governmental Funds from the general purpose financial statements; and 3) our inability to audit the Governmental Fund Type - Expendable Trust Funds.

We conducted our audit in accordance with generally accepted auditing standards and 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 general purpose financial statements are free of material misstatement.

The management of the State of Kosrae, is responsible for establishing and maintaining the internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of general purpose financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In planning and performing our audit of the general purpose financial statements of the State of Kosrae for the year ended September 30, 1996, we obtained an understanding of the internal control structure. With respect to the internal control structure, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk in order to determine our auditing procedures for the purpose of expressing our opinion on the general purpose financial statements and not to provide an opinion on the internal control structure. Accordingly, we do not express such an opinion.

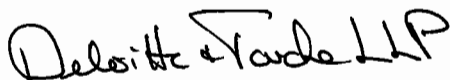
We noted certain matters, which are presented in the accompanying Schedule of Internal Control Findings (pages 80 through 86) in Findings 1 through 5, involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the State of Kosrae's ability to record, process, summarize, and report financial data consistent with the assertions of management in the general purpose financial statements.

A material weakness is a reportable condition in which the design or operation of one or more of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the general purpose financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we believe none of the reportable conditions described above is a material weakness.

We also noted matters involving the internal control structure and its operation used to administer federal financial assistance programs which we reported to the management of the State of Kosrae in a report dated May 17, 1997.

This report is intended for the information of the State of Kosrae and the cognizant audit and other federal agencies. However, this report is a matter of public record and its distribution is not limited.

A handwritten signature in dark ink, appearing to read "Deloitte & Touche LLP", is written in a cursive, flowing style.

May 17, 1997

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

**Schedule of Internal Control Findings  
Year Ended September 30, 1996**

**Prior Year Internal Control Findings**

**Finding No. 1**

**Criteria:** Findings from the Report on Internal Control for prior years should be adequately resolved by Kosrae State management.

**Condition:** The following findings from the Report on Internal Controls for the prior years were found to be unresolved:

<u>Page No.</u>	<u>Finding No.</u>	<u>Description</u>
<b>From September 30, 1988 report:</b>		
8	4	Journal voucher authorization
15	11	Insurance coverage
18	14	External reporting requirements
<b>From September 30, 1989 report:</b>		
4	3	Travel advance accounting
<b>From September 30, 1990 report:</b>		
89	2	Fixed assets subledger
92	6	Payroll files
<b>From September 30, 1991 report:</b>		
91	5	Resolution of disputed liabilities

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Internal Control Findings, Continued  
Year Ended September 30, 1996

**Prior Year Internal Control Findings. Continued**

**Finding No. 1**

**From September 30, 1994 report:**

105	6	Cash and Equivalents
100	15	Payroll Revolving Fund
110	11	Purchases and Disbursement Cycle
116	17	Receivables
117	18	Revenue and Receipt Cycle
118	19	Revenue and Receipt Cycle
119	20	Purchases & Disbursement Cycle
120	21	Revenue and Receipt Cycle
121	22	Receivables
122	23	External Financial Reporting

**Cause:** The cause of the above condition is unknown.

**Effect:** The non-resolution of these prior year findings will continue to hinder the effective maintenance of the State's accounting records.

**Recommendation:** Kosrae State management should take action to resolve these prior year audit findings.

**Auditee Response and Corrective Action Plan:**

**From September 30, 1988 report:**

**Journal Voucher Authorization:** It has been re-emphasized to all employees at the Finance Division that all journal vouchers are to be approved by the Director of Administration or his designee as always.

**Insurance Coverage:** The State is going to upgrade its computer system with new hardware and software during fiscal year 1998. Insurance coverage will be one of the features of the new system.

**External Reporting:** The Director of Administration or his designee will ensure that Kosrae State complies with the external reporting requirements.

**From September 30, 1989 report:**

**Travel Advance Accounting:** With the acquisition of a new computer system, we will be able to improve the recording and reporting of travel advances.

**From September 30, 1990 report:**

**Fixed Assets Subledger:** We have a manual register that is currently updated and we are in the process of transferring it into an automated one.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Internal Control Findings, Continued  
Year Ended September 30, 1996

**Prior Year Internal Control Findings. Continued**

**Finding No. 1**

**From September 30, 1990 report:**

Payroll Master File: The only three personnel currently have access to the file. Only the system operators, whom are also the chief accountants and payroll officer has access.

Resolution of Disputed Liabilities: We agree with this finding. The Office of the Governor and Attorney General will be requested to formally state the State of Kosrae's position concerning the matter.

**From September 30, 1991 report:**

Resolution of Disputed Liabilities: We agree with this finding. The Office of the Governor and Attorney General will be requested to formally state the State of Kosrae's position concerning the matter.

**From September 30, 1994 report:**

We agree with all the unresolved 1994 findings. The proposed financial management regulations, currently under review by the Governor, will help tighten up some of these internal control weaknesses.



**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Internal Control Findings, Continued  
Year Ended September 30, 1996

**Unrecorded Disbursements**

**Finding No. 2**

**Criteria:** Management should ensure that all disbursements, such as bank debit memos, that are not regularly processed through CAPPs be communicated to the accounting division in order for such to be recorded in the accounting system.

**Condition:** We noted that management initiated some payments via bank debit memos but did not communicate such to the accounting division to be recorded in the State's financial records. We found two bank debit memos that were not recorded in the accounting system.

**Cause:** The cause of this condition is unknown.

**Effect:** A misstatement of the financial statements could result from this condition.

**Recommendation:** We recommend that management ensure that accurate reporting of public funds occurs.

**Auditee Response:** We agree to this finding.

**Corrective Action Plan:** The Director of Administration by directive will ensure that all disbursements are properly recorded in the accounting division without exceptions.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Internal Control Findings, Continued  
Year Ended September 30, 1996

**Reconciliation**

**Finding No. 3**

**Criteria:** Treasury fund 955555-125 must be reconciled to the bank balance on a monthly basis.

**Condition:** The Treasury fund account 955555-125 was out of balance by \$2 million as of September 30, 1996.

**Cause:** The cause of this condition is unknown.

**Effect:** A misstatement of the financial statements could result from this condition. However, this matter was corrected in the audit process.

**Recommendation:** We recommend that Kosrae State ensure that a reconciliation of its accounts be performed on a monthly basis.

**Auditee Response:** We agree to the above finding.

**Corrective Action Plan:** The Director of Administration by directive will ensure that the Treasury Fund account(s) are reconciled to the bank balance on a monthly basis immediately.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Internal Control Findings, Continued  
Year Ended September 30, 1996

**Missing APV Files**

**Finding No. 4**

Criteria: All disbursements must be supported by documentary evidence to support the propriety of disbursements.

Condition: We could not examine certain payment vouchers because they were not available during our testing of disbursements.

Cause: Files were not in sequential order and were maintained in a haphazard manner.

Effect: A misstatement of the financial statements could result from this condition.

Recommendation: We recommend that management ensure that payment vouchers are kept to support each disbursement.

Auditee Response: We agree to this finding.

Corrective Action Plan: The Director of Administration by directive will ensure that all files at the Finance Building are kept in sequential and orderly fashion. Periodic follow-ups and inspection will be done.

**STATE OF KOSRAE  
FEDERATED STATES OF MICRONESIA**

Schedule of Internal Control Findings, Continued  
Year Ended September 30, 1996

**Payroll**

**Finding No. 5**

**Criteria:** Payroll expenditures must be recorded in the proper organization.

**Condition:** Our testing of payroll expenditures revealed that the DILOG organization accounts charged do not agree with the payroll register.

**Cause:** The cause of this condition is unknown.

**Effect:** A misstatement of the financial statements could result from this condition.

**Recommendation:** We recommend that management ensure that periodic reconciliation of the payroll records to the general ledger is adequately performed.

**Auditee Response:** We agree to this finding. It may be due to the recent reorganization of the government whereby certain org structures were changed to new ones while some expenditures are still recorded in the old ones.

**Corrective Action Plan:** The Director of Administration by directive will ensure that periodic reconciliation of the payroll records to the general ledger are adequately performed by the appropriate personnel in Finance.