

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

YEAR ENDED SEPTEMBER 30, 1997

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

YEAR ENDED SEPTEMBER 30, 1997

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FEDERATED STATES OF MICRONESIA**

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**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

**INDEPENDENT AUDITORS' REPORT ON
GENERAL PURPOSE FINANCIAL STATEMENTS**

YEAR ENDED SEPTEMBER 30, 1997

**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, 1997, 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 the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the 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, 1997, 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.

For Micronesian Petroleum Company, a Component Unit - Proprietary Fund, we were unable to verify support of \$180,034 of fixed assets and that entity was unable to present a statement of cash flows. Generally accepted accounting principles requires presentation of such a statement.

We were not able to apply sufficient alternative procedures to assure ourselves as to the correctness of travel advance receivables for all Governmental Fund Types as of September 30, 1997.

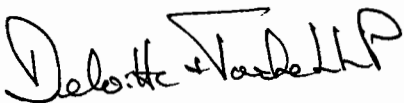
We were not able to obtain financial statements of the Agriculture Revolving Fund, Production Loan Fund or Tourism Revolving Fund - Fiduciary Fund Type - Expendable Trust Funds. In our opinion, presentation of these funds should be included to conform with generally accepted accounting principles.

We were furnished unaudited financial statements in support of Kosrae State Government's investment in Kosrae Sea Ventures, Inc., and Pacific Tuna Industries. Accordingly, we were not able to verify the carrying value of Kosrae State Government's investment in these subsidiaries and whether all disclosures related to these investees have been included in the accompanying financial statements.

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; 1) assure ourselves as to the propriety of the General Fixed Assets Account Group and travel advance receivables of all Governmental Fund Types; 2) examine evidence regarding the investments in Kosrae Sea Ventures, Inc. and Pacific Tuna Industries; 3) obtain financial statements for the Agriculture Revolving Fund, Production Loan Fund and Tourism Revolving Fund - Fiduciary Fund Type - Expendable Trust Funds; and 4) had we been able to verify \$180,034 of fixed asset additions of Micronesian Petroleum Company, a Proprietary Fund Type - Component Unit and had that entity been able to produce a statement of cash flows, discussed in the third, fifth, sixth, seventh and eighth paragraphs above, and the omission of the Component Units - Governmental Funds, discussed in the fourth paragraph, 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 on 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, 1997, 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 our report dated February 19, 1998 on our consideration of the State of Kosrae's (Primary Government only) internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants.



February 19, 1998

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Combined Balance Sheet - All Fund Types, Account Groups and Discretely Presented Component Units
September 30, 1997
(With comparative totals as of September 30, 1996)

	Governmental Fund Types			Proprietary	Fiduciary	Account Groups		Totals	Component Units		Totals	
				Fund Type	Fund Type	General	General	Primary	Kosrae	Micronesia	Reporting Entity	
	General	Special	Capital	Internal	Expendable	Fixed	Long-Term	Government	Utilities	Petroleum	(Memorandum Only)	
		Revenue	Projects	Service	Trust	Assets	Debt	(Memorandum Only)	Authority	Company	1997	1996
ASSETS												
Cash and equivalents (note 2)	\$ 113,581	\$ 8,534	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 122,115	\$ 1,049,435	\$ 72,682	\$ 1,244,232	\$ 2,049,216
Other term deposits (note 2)	49,076	-	890,049	-	-	-	-	939,125	-	-	939,125	1,303,907
Investments (note 2)	1,594,927	93,983	21,754	-	-	-	-	1,710,664	-	-	1,710,664	1,401,391
Equity investments (note 5)	-	-	1,312,268	-	-	-	-	1,312,268	-	-	1,312,268	1,212,033
Receivables from federal agencies (note 3)	-	1,079,137	610,998	-	-	-	-	1,690,135	374,786	-	2,064,921	1,981,579
Receivables from other governments (note 3)	249,807	11,550	1,784,007	-	-	-	-	2,045,364	10,450	-	2,055,814	1,419,721
General receivables, net (note 4)	43,091	155,875	(13,002)	-	50,006	-	-	235,970	354,239	226,739	816,948	862,347
Advances (note 4)	338,774	400,588	317,335	-	(1,642)	-	-	1,055,055	-	7,200	1,062,255	961,156
Loans receivable, net (note 4)	-	-	95,000	-	422,429	-	-	517,429	-	-	517,429	580,944
Due from other funds (note 8)	1,555,559	336,658	2,940,663	-	418,507	-	-	5,251,387	-	-	5,251,387	5,065,686
Inventory, at cost	-	-	-	59,555	-	-	-	59,555	252,920	758,970	1,071,445	341,104
Interest receivable	12,094	-	-	-	-	-	-	12,094	-	-	12,094	17,033
Prepayments	-	-	-	-	-	-	-	-	5,081	-	5,081	-
Fixed assets, net	-	-	-	-	-	1,264,375	-	1,264,375	4,865,947	3,197,336	9,327,658	5,564,281
Amount to be provided for retirement of long-term debt	-	-	-	-	-	-	1,028,899	1,028,899	-	-	1,028,899	1,055,287
Total assets	\$ 3,956,909	\$ 2,086,325	\$ 7,959,072	\$ 59,555	\$ 889,300	\$ 1,264,375	\$ 1,028,899	\$ 17,244,435	\$ 6,912,858	\$ 4,262,927	\$ 28,420,220	\$ 23,815,685

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
September 30, 1997
(With comparative totals as of September 30, 1996)

	Governmental Fund Types			Proprietary	Fiduciary	Account Groups		Totals	Component Units		Totals	
	General	Special Revenue	Capital Projects	Fund Type Internal Service	Fund Type Expendable Trust	General Fixed Assets	General Long-Term Debt	Primary Government (Memorandum Only)	Kosrae Utilities Authority	Micronesia Petroleum Company	Reporting Entity (Memorandum Only)	
											1997	1996
LIABILITIES AND FUND EQUITY (DEFICIENCY)												
Liabilities:												
Bank overdraft	\$ 364,506	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 364,506	\$ -	\$ -	\$ 364,506	\$ 830,562
Accounts payable	287,585	38,327	569,234	(1,258)	2,172	-	-	896,060	57,845	8,966	962,871	842,977
Accrued payroll and others	214,166	21,269	4,417	-	-	-	-	239,852	13,498	-	253,350	341,945
Due to other funds (note 8)	232,878	2,734,754	2,137,746	134,192	11,817	-	-	5,251,387	-	-	5,251,387	5,065,686
Deferred revenues	-	28,095	-	-	-	-	-	28,095	-	-	28,095	28,095
Due to other governments	180,636	-	-	-	-	-	-	180,636	-	-	180,636	180,636
Short-term borrowings	-	-	-	-	-	-	-	-	-	247,712	247,712	-
Long-term notes payable (note 10)	-	-	-	-	-	-	294,021	294,021	-	-	294,021	336,429
Vacation leave accrual	-	-	-	-	-	-	734,878	734,878	24,623	-	759,501	746,245
Other payables	315,063	-	-	-	-	-	-	315,063	-	100,736	415,799	269,965
Total liabilities	1,594,834	2,822,445	2,711,397	132,934	13,989	-	1,028,899	8,304,498	95,966	357,414	8,757,878	8,642,540
Fund equity (deficiency):												
Investment in general fixed assets	-	-	-	-	-	1,264,375	-	1,264,375	-	-	1,264,375	1,264,375
Retained earnings (deficit)	-	-	-	(73,379)	-	-	-	(73,379)	2,378,736	(346,510)	1,958,847	1,920,891
Contributed capital	-	-	-	-	-	-	-	-	4,438,156	4,252,023	8,690,179	4,213,660
Fund balances (deficit):												
Reserved for:												
Related assets	4,787,145	-	1,538,816	-	455,944	-	-	6,781,905	-	-	6,781,905	5,948,478
Encumbrances	220,164	460,920	1,944,004	-	196,157	-	-	2,821,245	-	-	2,821,245	2,402,713
Continuing appropriations (note 9)	65,550	542,196	3,291,883	-	-	-	-	3,899,629	-	-	3,899,629	3,473,623
Unreserved	(2,710,784)	(1,739,236)	(1,527,028)	-	223,210	-	-	(5,753,838)	-	-	(5,753,838)	(4,050,595)
Total fund equity (deficiency)	2,362,075	(736,120)	5,247,675	(73,379)	875,311	1,264,375	-	8,939,937	6,816,892	3,905,513	19,662,342	15,173,145
Contingencies (note 6)												
Total liabilities and fund equity (deficiency)	\$ 3,956,909	\$ 2,086,325	\$ 7,959,072	\$ 59,555	\$ 889,300	\$ 1,264,375	\$ 1,028,899	\$ 17,244,435	\$ 6,912,858	\$ 4,262,927	\$ 28,420,220	\$ 23,815,685
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, 1997
(With comparative totals for the year ended September 30, 1996)

	Governmental Fund Types			Fiduciary	Totals	
	General	Special	Capital	Fund Type	Reporting	
		Revenue	Projects	Expendable	Entity	(Memorandum Only)
				Trust	1997	1996
Revenues:						
Compact of Free Association:						
Base amount	\$ 2,189,600	\$ 1,820,544	\$ 1,918,400	\$ -	\$ 5,928,544	\$ 7,077,092
Inflation adjustment	1,094,800	350,000	959,200	-	2,404,000	2,850,096
U.S. Department of the Interior grants	-	-	538,872	-	538,872	243,432
Revenue sharing	810,661	-	-	-	810,661	832,964
Federal contributions	-	1,286,205	1,576,400	-	2,862,605	1,972,995
Taxes and licenses	157,677	-	-	-	157,677	168,752
Investment income (note 2)	416,107	-	-	-	416,107	355,907
Other	300,122	57,962	-	523,636	881,720	2,087,870
Total revenues	4,968,967	3,514,711	4,992,872	523,636	14,000,186	15,589,108
Expenditures:						
General government	1,855,160	1,406,809	-	-	3,261,969	3,827,404
Education	922,073	1,034,380	-	-	1,956,453	1,928,897
Health services	826,648	191,226	-	-	1,017,874	1,103,272
Economic development	669,616	-	-	-	669,616	1,285,748
Public works	338,746	-	-	-	338,746	423,286
Public safety	312,424	-	-	-	312,424	351,379
Community affairs	288,664	55,666	-	-	344,330	374,876
Capital projects	-	-	3,777,428	-	3,777,428	5,082,857
Other	150,441	381,770	-	488,598	1,020,809	980,819
Total expenditures	5,363,772	3,069,851	3,777,428	488,598	12,699,649	15,358,538
Excess (deficiency) of revenues over (under) expenditures	(394,805)	444,860	1,215,444	35,038	1,300,537	230,570
Other financing sources (uses):						
Bond principal repayments	-	-	-	-	-	(1,000,000)
Bond interest expense	-	-	-	-	-	(41,850)
Equity loss on investment (note 5)	-	-	(249,766)	-	(249,766)	(326,346)
Operating transfers out (note 11)	-	(496,125)	(579,924)	-	(1,076,049)	(485,019)
Total other financing sources (uses), net	-	(496,125)	(829,690)	-	(1,325,815)	(1,853,215)
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	(394,805)	(51,265)	385,754	35,038	(25,278)	(1,622,645)
Fund balances (deficit) at beginning of year	2,756,880	(684,855)	4,861,921	840,273	7,774,219	9,396,864
Fund balances (deficit) at end of year	\$ 2,362,075	\$ (736,120)	\$ 5,247,675	\$ 875,311	\$ 7,748,941	\$ 7,774,219

See accompanying notes to financial statements.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Combined Statement of Revenues, Expenditures and Changes in Fund Balance (Deficit) -
Budgetary Basis - General Fund
Year Ended September 30, 1997

	<u>Budget</u>	<u>Actual</u>	<u>Variance</u>
Revenues:			
Compact funding:			
Base amount	\$ 2,189,600	\$ 2,189,600	\$ -
Inflation adjustment	1,029,112	1,094,800	65,688
Revenue sharing	693,100	810,661	117,561
State taxes and licenses	144,900	157,677	12,777
Investment income	100,000	416,107	316,107
Miscellaneous	472,000	300,122	(171,878)
	<u>4,628,712</u>	<u>4,968,967</u>	<u>340,255</u>
Expenditures:			
General government	1,893,163	1,873,785	19,378
Education	1,151,086	905,980	245,106
Health services	783,297	818,494	(35,197)
Economic development	686,472	666,477	19,995
Transportation and utility	405,495	339,087	66,408
Public safety	312,473	312,374	99
Community affairs	333,998	443,000	(109,002)
	<u>5,565,984</u>	<u>5,359,197</u>	<u>206,787</u>
Deficiency of revenues under expenditures	(937,272)	(390,230)	547,042
Unreserved fund deficit at beginning of year	(1,674,040)	(1,674,040)	-
Other changes in unreserved fund deficit:			
Decrease in reserve for continuing appropriations	-	(14,870)	(14,870)
Increase in reserve for related assets	-	(631,644)	(631,644)
	<u>-</u>	<u>(631,644)</u>	<u>(631,644)</u>
Unreserved fund deficit at end of year	<u>\$ (2,611,312)</u>	<u>\$ (2,710,784)</u>	<u>\$ (99,472)</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, 1997
(With comparative totals for the year ended September 30, 1996)

	Proprietary Fund Type	Totals Primary Government (Memorandum Only)	Component Units		Totals Reporting Entity (Memorandum Only)	
	Internal Service		Kosrae Utilities Authority	Micronesian Petroleum Company	1997	1996
Operating revenues:						
Charges for services	\$ 35,514	\$ 35,514	\$ 1,201,655	\$ 2,194,302	\$ 3,431,471	\$ 1,345,852
Operating expenses:						
Cost of goods sold	-	-	-	1,645,333	1,645,333	-
Taxes	-	-	-	201,941	201,941	-
Personnel services	-	-	421,423	176,179	597,602	338,032
Insurance	-	-	-	167,362	167,362	-
Professional fees	-	-	-	134,863	134,863	-
Travel and entertainment	-	-	-	103,260	103,260	-
Supplies and materials	14,224	14,224	-	28,656	42,880	29,114
Fuel	-	-	697,998	-	697,998	702,047
Depreciation	-	-	365,138	-	365,138	330,062
Other	-	-	281,069	162,960	444,029	158,948
Total operating expenses	14,224	14,224	1,765,628	2,620,554	4,400,406	1,558,203
Operating income (loss)	21,290	21,290	(563,973)	(426,252)	(968,935)	(212,351)
Nonoperating revenues (expenses):						
Operating transfers in (note 11)	-	-	496,125	-	496,125	578,748
Other income	-	-	189,157	11,295	200,452	84,812
Other expenses	-	-	-	(11,160)	(11,160)	-
Total nonoperating revenues	-	-	685,282	135	685,417	663,560
Net income (loss)	21,290	21,290	121,309	(426,117)	(283,518)	451,209
Add depreciation on fixed assets acquired by capital contributions that reduce contributed capital	-	-	314,851	79,607	394,458	294,220
Increase in retained earnings (deficit)	21,290	21,290	436,160	(346,510)	110,940	745,429
Retained earnings (deficit) at beginning of year	(94,669)	(94,669)	1,942,576	-	1,847,907	1,175,462
Retained earnings (deficit) at end of year	(73,379)	(73,379)	2,378,736	(346,510)	1,958,847	1,920,891
Contributed capital at beginning of year	-	-	4,305,400	-	4,305,400	3,424,671
Contributions	-	-	447,607	4,331,630	4,779,237	1,083,209
Less amortization of contributed capital	-	-	(314,851)	(79,607)	(394,458)	(294,220)
Contributed capital at end of year	-	-	4,438,156	4,252,023	8,690,179	4,213,660
Fund equity (deficiency) at end of year	\$ (73,379)	\$ (73,379)	\$ 6,816,892	\$ 3,905,513	\$ 10,649,026	\$ 6,134,551

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, 1997
(With comparative totals for the year ended September 30, 1996)

	Proprietary Fund Type	Totals Primary Government (Memorandum Only)	Component Unit Kosrae Utilities Authority	Totals Reporting Entity (Memorandum Only)	
	Internal Service			1997	1996
Cash flows from operating activities:					
Operating income (loss)	\$ 21,290	\$ 21,290	\$ (563,973)	\$ (542,683)	\$ (212,351)
Adjustment to reconcile operating loss to net cash provided by (used for) operating activities:					
Depreciation	-	-	365,138	365,138	330,062
Interest income	-	-	55,697	55,697	63,921
Other income	-	-	48,888	48,888	20,891
	<u>21,290</u>	<u>21,290</u>	<u>(94,250)</u>	<u>(72,960)</u>	<u>202,523</u>
Changes in assets and liabilities:					
General receivables, net	-	-	144,654	144,654	(66,754)
Inventory	-	-	28,629	28,629	(182,748)
Prepayments	-	-	(5,081)	(5,081)	13,537
Other receivables-OMIP	-	-	(262,301)	(262,301)	-
Other receivables-FSM National Government	-	-	(10,450)	(10,450)	-
Accounts payable	(10,985)	(10,985)	(51,746)	(62,731)	110,708
Accrued payroll and others	-	-	(7,131)	(7,131)	29,767
Due to other funds	(10,305)	(10,305)	-	(10,305)	(16,485)
	<u>(21,290)</u>	<u>(21,290)</u>	<u>(163,426)</u>	<u>(184,716)</u>	<u>(111,975)</u>
Net cash provided by (used for) operating activities	<u>-</u>	<u>-</u>	<u>(257,676)</u>	<u>(257,676)</u>	<u>90,548</u>
Cash flows from noncapital financing activities:					
Operating and other transfers in	-	-	580,680	580,680	578,748
Net cash provided by noncapital financing activities	<u>-</u>	<u>-</u>	<u>580,680</u>	<u>580,680</u>	<u>578,748</u>
Cash flows from capital and related financing activities:					
Additions to fixed assets	-	-	(404,590)	(404,590)	(86,871)
Construction work in progress	-	-	(526,589)	(526,589)	(1,096,799)
Capital contributions	-	-	447,607	447,607	1,083,209
Net cash used for capital and related financing activities	<u>-</u>	<u>-</u>	<u>(483,572)</u>	<u>(483,572)</u>	<u>(100,461)</u>
Net increase (decrease) in cash and equivalents	-	-	(160,568)	(160,568)	568,835
Cash and equivalents at beginning of year	-	-	1,210,003	1,210,003	641,168
Cash and equivalents at end of year	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,049,435</u>	<u>\$ 1,049,435</u>	<u>\$ 1,210,003</u>

See accompanying notes to financial statements.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 1997

(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 two discretely presented component units presented in the accompanying general purpose financial statements.

Discretely Presented Component Units

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. The 1997 financial statements of KUA incorporate certain prior period adjustments, primarily made to recognize previously recorded operating subsidies as contributed capital. Therefore, the 1997 presentation differs from the 1996 comparative totals.

Micronesian Petroleum Corporation (MPC) was established on November 14, 1996 by Kosrae State Law L.B. No. 6-191, L.D. 2. The primary purpose of the Corporation is to operate and manage the State's fuel storage facilities and to engage in the business of buying and selling petroleum products. The Corporation is managed by a five member board consisting of representatives of the State Government and its private sector.

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.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 1997

(1) Summary of Significant Accounting Policies, Continued

B. Fund Accounting, Continued

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.

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.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 1997

(1) Summary of Significant Accounting Policies, Continued

C. Basis of Presentation, Continued

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. Expenditures are recorded when the related fund liability is incurred, except for certain compensated absences and claims and judgments which are recognized when the obligations are expected to be liquidated with expendable available financial resources.

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.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 1997

(1) Summary of Significant Accounting Policies, Continued

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.

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.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 1997

(1) Summary of Significant Accounting Policies, Continued

I. Fixed Assets, Continued

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:

	<u>Estimated Useful Lives</u>	
Production plant	5 - 40 years	\$ 2,488,596
Distribution plant	5 - 30 years	1,808,046
General plant	3 - 20 years	<u>262,981</u>
Electric plant in service		4,559,623
Less accumulated depreciation		(1,317,064)
Construction work in progress		<u>1,623,388</u>
		\$ <u>4,865,947</u>

Fixed assets of the Micronesian Petroleum Company, a component unit - proprietary fund, are depreciated over estimated useful lives of 3 through 40 years and comprise the following:

Bulk plant	\$ 2,506,000
Land	200,000
Equipment	661,464
Less accumulated depreciation	<u>(170,128)</u>
	\$ <u>3,197,336</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.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 1997

(1) Summary of Significant Accounting Policies, Continued

K. Fund Balance Reserves, Continued

Reserves for related assets in the general purpose financial statements at September 30, 1997, are generally as follows:

General Fund:

General receivables and advances	\$ 255,844
Federal assistance fund (deficit)	251,998
Compact special block grant (deficit)	689,327
Kosrae Transportation Fund receivable	162,563
Compact scholarship (deficit)	77,466
O&M assistance fund (deficit)	52,149
Non-U.S. grant (deficit)	104,636
Due from other governments-CFSM fund	1,503,027
Due from other governments-Federal grants fund	1,011,674
Due from other governments-Operation and maintenance	67,463
Due from other governments-TTPI CIP fund	<u>610,998</u>
	\$ <u>4,787,145</u>

Capital Projects Funds:

Equity investments	\$ 1,443,816
Loan receivable	<u>95,000</u>
	\$ <u>1,538,816</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, 1997 is \$734,878. 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.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 1997

(1) Summary of Significant Accounting Policies, Continued

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.

(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.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 1997

(2) Cash and Investments, Continued

- 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.

Funds invested with Hawaiian Trust Co. on behalf of Kosrae State as of September 30, 1997, are summarized below:

<u>Cash and Equivalents</u>	<u>Carrying Amount</u>	<u>Market Value</u>
Certificates of deposit	\$ 122,115	\$ 122,115
<u>Investments</u>		
Pooled investment securities	<u>1,710,664</u>	<u>2,014,635</u>
Total investments	\$ <u>1,832,779</u>	\$ <u>2,136,750</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, 1997, the State had deposits as follows (in each situation, cost approximates market value):

General Fund

Cash on deposit with Hawaiian Trust Co.	\$ 90,911
Cash on deposit with FDIC insured Banks	<u>22,670</u>
	\$ <u>113,581</u>

Special Revenue Funds

Cash on deposit with Hawaiian Trust Co.	\$ <u>8,534</u>
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Capital Projects Funds

Certificates of deposit with FDIC insured bank	\$ <u>890,049</u>
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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, 1997

(2) Cash and Investments, Continued

Investment income for the year ended September 30, 1997, is comprised of the following items:

Gross investment gains	\$ 163,177
Interest and dividends	13,157
Management and other fees	(34,408)
Interest on deposits	<u>274,181</u>
	\$ <u>416,107</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 \$422,429 and \$50,006, respectively. These balances are fully reserved within the related asset component of fund balance in the applicable funds.

The Capital Project Funds has a \$95,000 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 \$338,774, \$400,588, and \$317,335, 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) Equity Investments

During the year ended September 30, 1997, 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, 1997. 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, 1997, Kosrae State Government has \$939,125 in certificates of deposit with the bank.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 1997

(5) Equity 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 (see note 6). 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.

Carrying value at October 1, 1996	\$ 131,548
State's share of PTI's net loss	<u>(131,548)</u>
Carrying value at September 30, 1997	\$ <u>-</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.

Carrying value at October 1, 1996	\$ 480,486
State's share of KSVI's net loss for the year ended September 30, 1997	<u>(118,218)</u>
Carrying value at September 30, 1997	\$ <u>362,268</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.

During the year ended September 30, 1997, Kosrae made an investment of \$350,000 in SEMO Micronesia. 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 1997, cumulative questioned costs of \$274,360 remain unresolved for fiscal years

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 1997

(6) Contingencies, Continued

1985 through 1997. If these questioned costs are ultimately disallowed, the General Fund may bear responsibility for absorbing the amounts so disallowed. 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, 1997, was \$2,127,513.

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, 1997, 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, 1997. If operations of these funds cannot recover prior losses, the State's General Fund may have to absorb these amounts or a portion thereof.

Scholarship Revolving Fund	\$ <u>21,304</u>
Internal Service Fund	\$ <u>73,379</u>
Compact Special Block Grant 221 (b)	\$ <u>689,327</u>
Compact Scholarship Fund	\$ <u>77,466</u>
U.S. Department of the Interior Fund	\$ <u>52,149</u>
Federal Grants Assistance	\$ <u>251,998</u>
Foreign Assistance	\$ <u>104,636</u>
CFSM Capital Projects Fund	\$ <u>49,924</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, 1997

(8) Interfund Receivables and Payables

As of September 30, 1997, interfund receivables and payables resulting from various interfund transactions are as follows:

	Due to other Funds	Due from other Funds
General Fund	\$ 232,878	\$ 1,555,559
Special Revenue Funds:		
Compact-Special Block	735,747	-
Compact-Health and Medical	-	84,377
Compact Post Secondary Education	253,152	-
Compact Energy	-	28,185
Compact Special Development	-	223,070
Fishermen's Revolving Fund	-	1,026
U.S. Department of the Interior Fund	86,533	-
Federal Grants Assistance Fund	1,534,027	-
Foreign Assistance Fund	125,295	-
Capital Project Funds:		
Compact Capital Projects Fund	-	2,622,270
CFSM State Projects	1,726,335	-
TTG - Capital Project Fund	411,411	318,393
Expendable Trust Funds:		
Airport Trust Fund	-	138,166
Production Loan Fund	-	1,495
Scholarship Revolving Fund	11,817	-
Housing Revolving Fund	-	255,178
Aluminum Recycling Fund	-	174
Health Care Fund	-	17,836
Sports Council Fund	-	5,658
Internal Service Fund	<u>134,192</u>	<u>-</u>
	<u>\$ 5,251,387</u>	<u>\$ 5,251,387</u>

(9) Continuing Appropriations

Continuing appropriations as of September 30, 1997, 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	186
Peritoneal Dialysis Program	38,256
Medical Cost Senior Citizens	4,000
Second Constitutional Convention	78
Payment of legal obligations	712
Chiplin Conference	37
Scholarship	<u>18,270</u>
	<u>\$ 65,550</u>

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 1997

(9) Continuing Appropriations, Continued

Special Revenue Funds

Kosraen Chants	\$ 4,478
KUA Establishment	21,941
Power Systems	199,877
KUA OMIP	315,000
Compact Scholarship	<u>900</u>
	<u>\$ 542,196</u>

Capital Project Funds

Compact of Free Association Capital Account -	
Various State approved projects	\$ 1,444,891
Various CFSM approved projects	1,082,732
Various TTPI approved projects	<u>764,260</u>
	<u>\$ 3,291,883</u>

(10) Notes Payable

During fiscal year ended September 30, 1995, Kosrae State Government borrowed \$386,000 from a bank for the purchase of a residential property for its medical referral program in Honolulu. Monthly installments of \$5,101 are to be paid over 10 years. The note is collateralized by a mortgage on the residential property and an assignment of tenant lease rental income and a 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, 1997 is \$294,021.

(11) Operating Transfers Out

Operating transfers out for the year ended September 30, 1997, are as follows:

Transfer from Special Revenue Fund to Kosrae Utility Authority (KUA)	\$ <u>496,125</u>
Transfer from Capital Improvement Project (CIP) Fund to KUA	\$ <u>218,250</u>
Transfer from CIP Fund to Micronesian Petroleum Corporation (MPC) (Compact Capital Funds)	\$ <u>36,674</u>
Transfer from CIP to MPC (CFSM Fund)	\$ <u>325,000</u>

The transfers to MPC were recorded within contributed capital since such were for capital purposes.

Additionally, KUA received \$976,763 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, 1997
(With comparative totals for the year ended September 30, 1996)

	Governmental Fund Types			Fiduciary Fund Type	Totals (Memorandum Only)	
	General	Special Revenue	Capital Projects	Expendable Trust	1997	1996
Expenditures:						
Personnel	\$ 4,312,677	\$ 1,391,002	\$ 496,350	\$ -	\$ 6,200,029	\$ 6,283,891
Travel	122,576	281,596	47,102	-	451,274	512,090
POL	2,256	24,924	10,151	-	37,331	90,742
Capital outlay	34,378	28,606	206,750	-	269,734	342,713
Other	891,885	1,343,723	3,017,075	488,598	5,741,281	8,129,102
Total expenditures	<u>\$ 5,363,772</u>	<u>\$ 3,069,851</u>	<u>\$ 3,777,428</u>	<u>\$ 488,598</u>	<u>\$ 12,699,649</u>	<u>\$ 15,358,538</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

General Fund
September 30, 1997

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**

GENERAL FUND
Combining Balance Sheet
September 30, 1997
(With comparative totals as of September 30, 1996)

	<u>U.S. Grant</u>	<u>State Revenue</u>	<u>Totals</u>	
<u>ASSETS</u>			<u>1997</u>	<u>1996</u>
Cash and equivalents	\$ 113,581	\$ -	\$ 113,581	\$ 287,674
Other term deposits	-	49,076	49,076	542,720
Investments	1,594,927	-	1,594,927	1,379,638
Receivables from other governments	180,636	69,171	249,807	195,358
General receivables, net	(6,350)	49,441	43,091	174,205
Advances	2,861	335,913	338,774	329,399
Due from other funds	1,476,697	78,862	1,555,559	1,798,533
Interest receivable	12,094	-	12,094	17,033
Total assets	<u>\$ 3,374,446</u>	<u>\$ 582,463</u>	<u>\$ 3,956,909</u>	<u>\$ 4,724,560</u>
 <u>LIABILITIES AND FUND BALANCES</u>				
Liabilities:				
Bank overdraft	\$ 364,506	\$ -	\$ 364,506	\$ 830,562
Accounts payable	270,195	17,390	287,585	106,738
Accrued payroll and others	201,758	12,408	214,166	305,797
Due to other funds	183,311	49,567	232,878	273,982
Due to other governments	180,636	-	180,636	180,636
Other payables	315,063	-	315,063	269,965
Total liabilities	<u>1,515,469</u>	<u>79,365</u>	<u>1,594,834</u>	<u>1,967,680</u>
Fund balances:				
Reserved for:				
Related assets	4,362,388	424,757	4,787,145	4,155,501
Encumbrances	145,416	74,748	220,164	224,739
Continuing appropriations	4,197	61,353	65,550	50,680
Unreserved	(2,653,024)	(57,760)	(2,710,784)	(1,674,040)
Total fund balances	<u>1,858,977</u>	<u>503,098</u>	<u>2,362,075</u>	<u>2,756,880</u>
Total liabilities and fund balances	<u>\$ 3,374,446</u>	<u>\$ 582,463</u>	<u>\$ 3,956,909</u>	<u>\$ 4,724,560</u>

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

GENERAL FUND
Combining Statement of Revenues, Expenditures
by Function and Changes in Fund Balances
Year Ended September 30, 1997
(With comparative totals for the year ended September 30, 1996)

	<u>U.S. Grant</u>	<u>State Revenue</u>	<u>Totals</u>	
			<u>1997</u>	<u>1996</u>
Revenues:				
Compact of Free Association:				
Base amount	\$ 2,189,600	\$ -	\$ 2,189,600	\$ 2,791,740
Inflation adjustment	1,094,800	-	1,094,800	1,340,035
Revenue sharing	-	810,661	810,661	832,964
Taxes and licenses	-	157,677	157,677	168,752
Investment income	289,121	126,986	416,107	355,907
Other	154,261	145,861	300,122	451,135
Total revenues	<u>3,727,782</u>	<u>1,241,185</u>	<u>4,968,967</u>	<u>5,940,533</u>
Expenditures:				
General government	222,831	1,632,329	1,855,160	1,841,229
Education	836,081	85,992	922,073	645,925
Health services	826,648	-	826,648	901,470
Economic development	628,496	41,120	669,616	724,623
Public works	338,746	-	338,746	423,286
Public safety	312,424	-	312,424	351,379
Community affairs	116,303	172,361	288,664	317,773
Other	150,441	-	150,441	111,431
Total expenditures	<u>3,431,970</u>	<u>1,931,802</u>	<u>5,363,772</u>	<u>5,317,116</u>
Excess (deficiency) of revenues over (under) expenditures	295,812	(690,617)	(394,805)	623,417
Fund balances at beginning of year	<u>1,563,165</u>	<u>1,193,715</u>	<u>2,756,880</u>	<u>2,133,463</u>
Fund balances at end of year	<u>\$ 1,858,977</u>	<u>\$ 503,098</u>	<u>\$ 2,362,075</u>	<u>\$ 2,756,880</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

**GENERAL FUND
Combining Statement of Revenues, Expenditures
by Account and Changes in Fund Balances
Year Ended September 30, 1997
(With comparative totals for the year ended September 30, 1996)**

	<u>U.S. Grant</u>	<u>State Revenue</u>	<u>Totals</u>	
			<u>1997</u>	<u>1996</u>
Revenues:				
Compact of Free Association:				
Base amount	\$ 2,189,600	\$ -	\$ 2,189,600	\$ 2,791,740
Inflation adjustment	1,094,800	-	1,094,800	1,340,035
Revenue sharing	-	810,661	810,661	832,964
Taxes and licenses	-	157,677	157,677	168,752
Investment income	289,121	126,986	416,107	355,907
Other	154,261	145,861	300,122	451,135
Total revenues	<u>3,727,782</u>	<u>1,241,185</u>	<u>4,968,967</u>	<u>5,940,533</u>
Expenditures:				
Personnel	2,959,234	1,353,443	4,312,677	4,135,304
Travel	39,502	83,074	122,576	212,437
POL	843	1,413	2,256	1,322
Capital outlay	11,790	22,588	34,378	56,891
Other	420,601	471,284	891,885	911,162
Total expenditures	<u>3,431,970</u>	<u>1,931,802</u>	<u>5,363,772</u>	<u>5,317,116</u>
Excess (deficiency) of revenues over (under) expenditures	295,812	(690,617)	(394,805)	623,417
Fund balances at beginning of year	<u>1,563,165</u>	<u>1,193,715</u>	<u>2,756,880</u>	<u>2,133,463</u>
Fund balances at end of year	<u>\$ 1,858,977</u>	<u>\$ 503,098</u>	<u>\$ 2,362,075</u>	<u>\$ 2,756,880</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

**GENERAL FUND
Combining Statement of Revenues, Expenditures and
Changes in Fund Balances; Budgetary Basis
Year Ended September 30, 1997**

	U.S. Grant Fund			State Revenue Fund			Total General Fund		
	Budget	Actual	Variance	Budget	Actual	Variance	Budget	Actual	Variance
Revenues:									
Compact funding:									
Base amount	\$ 2,189,600	\$ 2,189,600	\$ -	\$ -	\$ -	\$ -	\$ 2,189,600	\$ 2,189,600	\$ -
Inflation adjustment	1,029,112	1,094,800	65,688	-	-	-	1,029,112	1,094,800	65,688
Revenue sharing	-	-	-	693,100	810,661	117,561	693,100	810,661	117,561
State taxes and licenses	-	-	-	144,900	157,677	12,777	144,900	157,677	12,777
Investment income	-	289,121	289,121	100,000	126,986	26,986	100,000	416,107	316,107
Miscellaneous	441,200	154,261	(286,939)	30,800	145,861	115,061	472,000	300,122	(171,878)
Total revenues	3,659,912	3,727,782	67,870	968,800	1,241,185	272,385	4,628,712	4,968,967	340,255
Expenditures:									
General government	226,628	225,594	1,034	1,666,535	1,648,191	18,344	1,893,163	1,873,785	19,378
Education	1,046,670	820,218	226,452	104,416	85,762	18,654	1,151,086	905,980	245,106
Health services	783,297	818,494	(35,197)	-	-	-	783,297	818,494	(35,197)
Economic development	646,087	626,207	19,880	40,385	40,270	115	686,472	666,477	19,995
Transportation and utility	405,495	339,087	66,408	-	-	-	405,495	339,087	66,408
Public safety	265,990	312,374	(46,384)	46,483	-	46,483	312,473	312,374	99
Community affairs	159,920	272,480	(112,560)	174,078	170,520	3,558	333,998	443,000	(109,002)
Total expenditures	3,534,087	3,414,454	119,633	2,031,897	1,944,743	87,154	5,565,984	5,359,197	206,787
Excess (deficiency) of revenues over (under) expenditures	125,825	313,328	187,503	(1,063,097)	(703,558)	359,539	(937,272)	(390,230)	547,042
Unreserved fund balances at beginning of year	(2,286,402)	(2,286,402)	-	612,362	612,362	-	(1,674,040)	(1,674,040)	-
Other changes in unreserved fund balances:									
Decrease in reserve for continuing appropriations	-	3,437	3,437	-	(18,307)	(18,307)	-	(14,870)	(14,870)
Increase in reserve for related assets	-	(683,387)	(683,387)	-	51,743	51,743	-	(631,644)	(631,644)
Unreserved fund deficiency at end of year	\$ (2,160,577)	\$ (2,653,024)	\$ (492,447)	\$ (450,735)	\$ (57,760)	\$ 392,975	\$ (2,611,312)	\$ (2,710,784)	\$ (99,472)

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

GENERAL FUND

Combined Statement of Revenues, Expenditures by Function
and Department and Changes in Fund Balance
Year Ended September 30, 1997
(With comparative totals for the year ended September 30, 1996)

	<u>1997</u>	<u>1996</u>
Revenues:		
Compact of Free Association:		
Base amount	\$ 2,189,600	\$ 2,791,740
Inflation adjustment	1,094,800	1,340,035
FSM revenue sharing	810,661	832,964
State taxes and licenses:		
Cigarette tax	\$ 12,588	\$ 9,955
General sales tax	52,148	67,842
Alcohol	62,670	57,612
Motor vehicle sales tax	10,257	9,164
Licenses and fees	15,994	17,181
Court fines	4,020	6,998
	<u>157,677</u>	<u>168,752</u>
Other revenues:		
Medical and dental services	-	91,382
Miscellaneous	300,122	359,753
Investment income	<u>416,107</u>	<u>451,135</u>
	<u>4,968,967</u>	<u>5,940,533</u>
Expenditures:		
General government:		
Governor and staff	227,538	230,965
Department of Administration		
Director of Administration	58,811	40,681
Division of Planning and Statistics	55,197	65,712
Division of Finance and Budget	240,928	196,426
Division of Construction and Engineering	67,639	91,521
Division of Personnel and Employment	63,807	-
Centralize Leasing/Housing	54,961	58,977
	<u>541,343</u>	<u>453,317</u>
Kosrae State Court		
Court Operations	143,153	134,499
Legislative Branch		
Legislative members	282,830	286,029
Standing committees	41,583	48,272
Staff	336,276	341,467
	<u>660,689</u>	<u>675,768</u>
Land commission	154,570	172,692
Municipal operations	-	48,039
Legislative appropriations-election	<u>127,867</u>	<u>125,949</u>
Total general government	<u>1,855,160</u>	<u>1,841,229</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

GENERAL FUND

Combined Statement of Revenues, Expenditures by Function
and Department and Changes in Fund Balance, Continued

Year Ended September 30, 1997

(With comparative totals for the year ended September 30, 1996)

	<u>1997</u>		<u>1996</u>
Expenditures by department, continued:			
Department of Education:			
Director's Office	58,275		81,586
Division of Instructional Services	468,462		216,355
Division of Curriculum Development	166,359		189,114
Facilities Special Services	82,654		92,571
Community Development	61,552		54,979
Scholarship Board	2,811		-
Scholarship Supplement	81,960		-
Legislative appropriations-education	<u>-</u>		<u>11,320</u>
	922,073		645,925
Department of Health Services:			
Director of Health Services	19,945		78,448
Division of Hospital Services	637,467		590,339
Division of Sanitation	54,794		56,309
Division of Dental Services	38,429		58,359
Division of Public Health	76,013		68,382
Legislative appropriations-health services	<u>-</u>		<u>49,633</u>
	826,648		901,470
Economic Development:			
Department of Fisheries and Marines			
Director of Fisheries and Marines	30,198		46,136
Division of Fisheries and Surveillance	23,601		25,765
Division of Marine Resources	<u>30,800</u>	84,599	<u>28,852</u>
			100,753
Department of Agriculture and Land			
Director of Agriculture and Land	77,531		64,655
Division of Crop Production & Research	93,787		125,641
Division of Livestock Prod. & Research	41,817		36,312
Division of Land Management and Pres.	47,658		55,382
Division of Surveying and Mapping	<u>111,258</u>	372,051	<u>107,342</u>
			389,332
Department of Commerce and Industry:			
Director of Commerce and Industry	41,506		44,495
Division of Market and Research	6,723		15,571
Division of Housing C & I	42,578		42,291
Division of Industrial Development	35,373		30,538
Division of Consumer Services	27,953		32,648
Division of Tourism	17,806		36,431
Legislative appropriations-economic dev.	<u>40,121</u>	212,060	<u>32,564</u>
			234,538
Foreign Investment Board	<u>906</u>		<u>-</u>
Total economic development	<u>669,616</u>		<u>724,623</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

GENERAL FUND

Combined Statement of Revenues, Expenditures by Function
and Department and Changes in Fund Balance, Continued
Year Ended September 30, 1997

(With comparative totals for the year ended September 30, 1996)

	<u>1997</u>	<u>1996</u>
Expenditures by department, continued:		
Department of Transportation and Utility:		
Director of Transportation and Utility	50,443	68,598
Division of Road and Public Trans.	202,463	255,598
Division of Water and Wastewater	36,867	47,563
Division of Airport/Dock/Harbot	<u>48,973</u>	<u>51,527</u>
Total transportation/utility	338,746	423,286
Department of Justice		
Director of Justice	40,296	36,917
Police Division	173,639	198,212
Division of Law	97,459	111,238
'92 Police COM Network NE	<u>1,030</u>	<u>5,012</u>
Total justice	312,424	351,379
Community Affairs:		
Sports Operation	33,637	38,350
Lelu Senior Citizens	89	-
Malem Senior Citizens	105	-
KCAP Operations - legislative	36,866	40,099
FY96 agriculture conference	-	1,989
FY96 court settlement	-	20,298
Division of law	-	7,681
FY94 Census Pop/Housing	3,437	4,801
FY-96 Chip-in	1,463	-
FY-96 ConCon overtime	-	11,477
Micro basketball	-	29,868
Parole Board	367	1,094
FY-97 2nd FSM Games	112,866	-
MLSC Operations	36,000	34,500
Broadcast Authority - Legislative	63,834	70,012
MICA/IDC fees	-	19,000
Hiring of grant writer	<u>-</u>	<u>38,604</u>
Total community affairs	288,664	317,773

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

**GENERAL FUND
Combined Statement of Revenues, Expenditures by Function
and Department and Changes in Fund Balance, Continued
Year Ended September 30, 1997
(With comparative totals for the year ended September 30, 1996)**

	<u>1997</u>	<u>1996</u>
Expenditures by department, continued:		
Other	<u>150,441</u>	<u>111,431</u>
Total expenditures	<u>5,363,772</u>	<u>5,317,116</u>
Excess (deficiency) of revenues over (under) expenditures	(394,805)	623,417
Fund balance at beginning of year	<u>2,756,880</u>	<u>2,133,463</u>
Fund balance at end of year	<u>\$ 2,362,075</u>	<u>\$ 2,756,880</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Special Revenue Funds
September 30, 1997

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, 1997, 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 - Health and Medical - Section 216 (a) 2

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

Compact - Post Secondary Education - Section 216 (a) 3

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

Compact - Energy Block Grant - Section 214

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 - Special Development Assistance - Section 212(b)

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

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.

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, 1997
(With comparative totals as of September 30, 1996)**

<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>	
										1997	1996
Cash and equivalents	\$ -	\$ -	\$ -	\$ 206	\$ 8,328	\$ -	\$ -	\$ -	\$ -	\$ 8,534	\$ 6,967
Investments	-	2	-	60,344	33,637	-	-	-	-	93,983	-
Receivables from:											
Federal agencies	-	-	-	-	-	-	67,463	1,011,674	-	1,079,137	1,187,737
Other Governments	-	-	-	-	-	-	-	-	11,550	11,550	11,550
General receivables, net	(19,811)	-	175,686	-	-	-	-	-	-	155,875	181,355
Advances	39,175	27,678	-	4,718	45,925	-	36,796	240,314	5,982	400,588	343,250
Due from other funds	-	84,377	-	28,185	223,070	1,026	-	-	-	336,658	653,366
Total assets	\$ 19,364	\$ 112,057	\$ 175,686	\$ 93,453	\$ 310,960	\$ 1,026	\$ 104,259	\$ 1,251,988	\$ 17,532	\$ 2,086,325	\$ 2,384,225
<u>LIABILITIES AND FUND BALANCES (DEFICIT)</u>											
Liabilities:											
Accounts payable	\$ (40,911)	\$ 3,706	\$ -	\$ 54,488	\$ 19,846	\$ -	\$ 41,283	\$ (36,833)	\$ (3,252)	\$ 38,327	\$ 295,758
Accrued payroll and others	13,855	-	-	-	-	-	497	6,792	125	21,269	15,223
Due to other funds	735,747	-	253,152	-	-	-	86,533	1,534,027	125,295	2,734,754	2,730,004
Deferred revenues	-	-	-	-	-	-	28,095	-	-	28,095	28,095
Total liabilities	708,691	3,706	253,152	54,488	19,846	-	156,408	1,503,986	122,168	2,822,445	3,069,080
Fund balances (deficit):											
Reserved for:											
Encumbrances	29,228	38,559	-	7,986	51,417	-	26,284	284,985	22,461	460,920	462,706
Continuing appropriations	-	-	900	-	-	-	541,296	-	-	542,196	226,296
Unreserved	(718,555)	69,792	(78,366)	30,979	239,697	1,026	(619,729)	(536,983)	(127,097)	(1,739,236)	(1,373,857)
Total fund balances (deficit)	(689,327)	108,351	(77,466)	38,965	291,114	1,026	(52,149)	(251,998)	(104,636)	(736,120)	(684,855)
Total liabilities and fund balances (deficit)	\$ 19,364	\$ 112,057	\$ 175,686	\$ 93,453	\$ 310,960	\$ 1,026	\$ 104,259	\$ 1,251,988	\$ 17,532	\$ 2,086,325	\$ 2,384,225

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, 1997
(With comparative totals for the year ended September 30, 1996)

	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	
										1997	1996
Revenues:											
Compact grants:											
Base amount	\$ 875,000	\$ 112,122	\$ 133,422	\$ 450,000	\$ 250,000	\$ -	\$ -	\$ -	\$ -	\$ 1,820,544	\$ 1,839,392
Inflation adjustment	-	-	-	225,000	125,000	-	-	-	-	350,000	336,000
Federal contributions	-	-	-	-	-	-	131,421	1,154,784	-	1,286,205	1,972,995
Other	-	-	-	-	-	-	-	-	57,962	57,962	80,733
Total revenues	<u>875,000</u>	<u>112,122</u>	<u>133,422</u>	<u>675,000</u>	<u>375,000</u>	<u>-</u>	<u>131,421</u>	<u>1,154,784</u>	<u>57,962</u>	<u>3,514,711</u>	<u>4,229,120</u>
Expenditures:											
General government	-	-	-	-	120,604	-	131,421	1,154,784	-	1,406,809	1,986,175
Education	892,499	-	127,761	-	14,120	-	-	-	-	1,034,380	1,282,972
Health services	86,526	104,700	-	-	-	-	-	-	-	191,226	201,802
Economic development	-	-	-	-	-	-	-	-	-	-	561,125
Community affairs	-	-	-	-	-	-	-	-	55,666	55,666	57,103
Other	-	-	-	131,770	250,000	-	-	-	-	381,770	263,049
Total expenditures	<u>979,025</u>	<u>104,700</u>	<u>127,761</u>	<u>131,770</u>	<u>384,724</u>	<u>-</u>	<u>131,421</u>	<u>1,154,784</u>	<u>55,666</u>	<u>3,069,851</u>	<u>4,352,226</u>
Excess (deficiency) of revenues over (under) expenditures	(104,025)	7,422	5,661	543,230	(9,724)	-	-	-	2,296	444,860	(123,106)
Other financing uses:											
Operating transfers out	-	-	-	(496,125)	-	-	-	-	-	(496,125)	(485,019)
Excess (deficiency) of revenues over (under) expenditures and other financing uses	(104,025)	7,422	5,661	47,105	(9,724)	-	-	-	2,296	(51,265)	(608,125)
Fund balances (deficit) at beginning 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>
Fund balances (deficit) at end of year	<u>\$ (689,327)</u>	<u>\$ 108,351</u>	<u>\$ (77,466)</u>	<u>\$ 38,965</u>	<u>\$ 291,114</u>	<u>\$ 1,026</u>	<u>\$ (52,149)</u>	<u>\$ (251,998)</u>	<u>\$ (104,636)</u>	<u>\$ (736,120)</u>	<u>\$ (684,855)</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, 1997
(With comparative totals for the year ended September 30, 1996)

	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	
										1997	1996
Revenues:											
Compact grants:											
Base amount	\$ 875,000	\$ 112,122	\$ 133,422	\$ 450,000	\$ 250,000	\$ -	\$ -	\$ -	\$ -	\$ 1,820,544	\$ 1,839,392
Inflation adjustment	-	-	-	225,000	125,000	-	-	-	-	350,000	336,000
Federal contributions	-	-	-	-	-	-	131,421	1,154,784	-	1,286,205	1,972,995
Other	-	-	-	-	-	-	-	-	57,962	57,962	80,733
Total revenues	<u>875,000</u>	<u>112,122</u>	<u>133,422</u>	<u>675,000</u>	<u>375,000</u>	<u>-</u>	<u>131,421</u>	<u>1,154,784</u>	<u>57,962</u>	<u>3,514,711</u>	<u>4,229,120</u>
Expenditures:											
Personnel	892,499	-	-	-	13,000	-	20,257	444,331	20,915	1,391,002	1,644,910
Travel	-	52,038	-	-	77,889	-	325	150,164	1,180	281,596	190,952
POL	-	-	-	-	24,198	-	-	726	-	24,924	64,027
Capital outlay	-	-	-	-	-	-	-	28,606	-	28,606	124,300
Other	<u>86,526</u>	<u>52,662</u>	<u>127,761</u>	<u>131,770</u>	<u>269,637</u>	<u>-</u>	<u>110,839</u>	<u>530,957</u>	<u>33,571</u>	<u>1,343,723</u>	<u>2,328,037</u>
Total expenditures	<u>979,025</u>	<u>104,700</u>	<u>127,761</u>	<u>131,770</u>	<u>384,724</u>	<u>-</u>	<u>131,421</u>	<u>1,154,784</u>	<u>55,666</u>	<u>3,069,851</u>	<u>4,352,226</u>
Excess (deficiency) of revenues over (under) expenditures	(104,025)	7,422	5,661	543,230	(9,724)	-	-	-	2,296	444,860	(123,106)
Other financing uses:											
Operating transfers out	<u>-</u>	<u>-</u>	<u>-</u>	<u>(496,125)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(496,125)</u>	<u>(485,019)</u>
Excess (deficiency) of revenues over (under) expenditures and other financing uses	(104,025)	7,422	5,661	47,105	(9,724)	-	-	-	2,296	(51,265)	(608,125)
Fund balances (deficit) at beginning 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>
Fund balances (deficit) at end of year	<u>\$ (689,327)</u>	<u>\$ 108,351</u>	<u>\$ (77,466)</u>	<u>\$ 38,965</u>	<u>\$ 291,114</u>	<u>\$ 1,026</u>	<u>\$ (52,149)</u>	<u>\$ (251,998)</u>	<u>\$ (104,636)</u>	<u>\$ (736,120)</u>	<u>\$ (684,855)</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Capital Projects Funds
September 30, 1997

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, 1997, follows:

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.

CFSM Capital Projects

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

TTG - Capital Projects

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

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

**CAPITAL PROJECTS FUNDS
Combining Balance Sheet
September 30, 1997
(With comparative totals as of September 30, 1996)**

	Compact Capital Projects	CFSM Capital Projects	TTG Capital Projects	Totals	
				1997	1996
<u>ASSETS</u>					
Cash and equivalents	\$ -	\$ -	\$ -	\$ -	\$ 544,572
Other term deposits	890,049	-	-	890,049	761,187
Investments	21,754	-	-	21,754	21,753
Equity investments	1,312,268	-	-	1,312,268	1,212,033
Receivables from U.S.					
Department of the Interior	-	-	610,998	610,998	504,755
Receivables from FSM Gov't	-	1,625,462	158,545	1,784,007	1,408,171
General receivables, net	(13,002)	-	-	(13,002)	-
Advances	210,307	92,763	14,265	317,335	288,507
Loans receivable, net	95,000	-	-	95,000	125,000
Due from other funds	2,622,270	-	318,393	2,940,663	2,194,788
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total assets	\$ 5,138,646	\$ 1,718,225	\$ 1,102,201	\$ 7,959,072	\$ 7,060,766
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
<u>LIABILITIES AND FUND BALANCES (DEFICIT)</u>					
Liabilities:					
Accounts payable	\$ 168,464	\$ 38,667	\$ 362,103	\$ 569,234	\$ 278,582
Accrued payroll and others	(4,282)	3,147	5,552	4,417	3,060
Due to other funds	-	1,726,335	411,411	2,137,746	1,917,203
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total liabilities	164,182	1,768,149	779,066	2,711,397	2,198,845
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Fund balances (deficit):					
Reserved for:					
Related assets	1,538,816	-	-	1,538,816	1,337,033
Encumbrances	1,545,889	170,546	227,569	1,944,004	1,565,376
Continuing appropriations	1,444,891	1,082,732	764,260	3,291,883	3,196,647
Unreserved	444,868	(1,303,202)	(668,694)	(1,527,028)	(1,237,135)
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total fund balances (deficit)	4,974,464	(49,924)	323,135	5,247,675	4,861,921
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total liabilities and fund balances (deficit)	\$ 5,138,646	\$ 1,718,225	\$ 1,102,201	\$ 7,959,072	\$ 7,060,766
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>

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, 1997
(With comparative totals for the year ended September 30, 1996)

	Compact Capital Projects	CFSM Capital Projects	TTG Capital Projects	Totals	
				1997	1996
Revenues:					
Compact of Free Association:					
Base amount	\$ 1,918,400	\$ -	\$ -	\$ 1,918,400	\$ 2,445,960
Inflation adjustment	959,200	-	-	959,200	1,174,061
U.S. Department of the					
Interior grants	-	-	538,872	538,872	243,432
FSM Nat'l Gov't Contribution	-	1,576,400	-	1,576,400	1,185,748
Total revenues	2,877,600	1,576,400	538,872	4,992,872	5,049,201
Expenditures:					
Capital projects	1,987,156	1,251,400	538,872	3,777,428	5,082,857
Total expenditures	1,987,156	1,251,400	538,872	3,777,428	5,082,857
Excess (deficiency) of revenues over (under) expenditures	890,444	325,000	-	1,215,444	(33,656)
Other financing sources (uses):					
Bond principal repayments	-	-	-	-	(1,000,000)
Bond interest expense	-	-	-	-	(41,850)
Equity loss on investment	(249,766)	-	-	(249,766)	(326,346)
Operating transfers out	(254,924)	(325,000)	-	(579,924)	-
Total other financing sources (uses), net	(504,690)	(325,000)	-	(829,690)	(1,368,196)
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	385,754	-	-	385,754	(1,401,852)
Fund balances (deficit) at beginning of year	4,588,710	(49,924)	323,135	4,861,921	6,263,773
Fund balances (deficit) at end of year	\$ 4,974,464	\$ (49,924)	\$ 323,135	\$ 5,247,675	\$ 4,861,921

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, 1997

(With comparative totals for the year ended September 30, 1996)

	Compact Capital Projects	CFSM Capital Projects	TTG Capital Projects	Totals	
				1997	1996
Revenues:					
Compact of Free Association:					
Base amount	\$ 1,918,400	\$ -	\$ -	\$ 1,918,400	\$ 2,445,960
Inflation adjustment	959,200	-	-	959,200	1,174,061
U.S. Department of the					
Interior grants	-	-	538,872	538,872	243,432
FSM National Gov't contribution	-	1,576,400	-	1,576,400	1,185,748
Total revenues	2,877,600	1,576,400	538,872	4,992,872	5,049,201
Expenditures:					
Personnel	144,356	351,994	-	496,350	503,677
Travel	40,258	6,844	-	47,102	108,701
POL	3,267	6,884	-	10,151	25,393
Capital outlay	81,605	125,145	-	206,750	161,522
Other	1,717,670	760,533	538,872	3,017,075	4,283,564
Total expenditures	1,987,156	1,251,400	538,872	3,777,428	5,082,857
Excess (deficiency) of revenues over (under) expenditures	890,444	325,000	-	1,215,444	(33,656)
Other financing sources (uses):					
Bond principal repayments	-	-	-	-	(1,000,000)
Bond interest expense	-	-	-	-	(41,850)
Equity loss on investment	(249,766)	-	-	(249,766)	(326,346)
Operating transfer out	(254,924)	(325,000)	-	(579,924)	-
Total other financing sources (uses), net	(504,690)	(325,000)	-	(829,690)	(1,368,196)
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	385,754	-	-	385,754	(1,401,852)
Fund balances (deficit) at beginning of year	4,588,710	(49,924)	323,135	4,861,921	6,263,773
Fund balances (deficit) at end of year	\$ 4,974,464	\$ (49,924)	\$ 323,135	\$ 5,247,675	\$ 4,861,921

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Expendable Trust Funds
September 30, 1997

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:

Airport Trust Fund

This fund accounts for the airport departure fee.

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.

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.

Health Care Fund

This fund accounts for health and medical fees collected by the State to be used for purchase of medical supplies.

Sports Council Fund

This fund accounts for fees collected at the State gymnasium to be used for the purchase of sports equipment.

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

**EXPENDABLE TRUST FUNDS
Combining Balance Sheet
September 30, 1997
(With comparative totals as of September 30, 1996)**

	Airport Trust	Agriculture Revolving	Production Loan	Scholarship Revolving Loan	Housing Revolving	Aluminum Recycling	Health Care Fund	Sports Council Fund	Tourism Revolving	Totals	
										1997	1996
<u>ASSETS</u>											
General receivables, net	\$ 5,006	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 45,000	\$ -	\$ -	\$ 50,006	\$ 7,911
Advances	7,182	-	-	-	(8,824)	-	-	-	-	(1,642)	-
Loans receivable, net	-	-	-	(9,823)	432,252	-	-	-	-	422,429	455,944
Due from other funds	138,166	-	1,495	-	255,178	174	17,836	5,658	-	418,507	418,999
Total assets	\$ 150,354	\$ -	\$ 1,495	\$ (9,823)	\$ 678,606	\$ 174	\$ 62,836	\$ 5,658	\$ -	\$ 889,300	\$ 882,854
<u>LIABILITIES AND FUND BALANCES</u>											
Liabilities:											
Accounts payable	\$ 2,735	\$ -	\$ -	\$ (336)	\$ (1,010)	\$ -	\$ 119	\$ 664	\$ -	\$ 2,172	\$ 42,581
Due to other funds	-	-	-	11,817	-	-	-	-	-	11,817	-
Total liabilities	2,735	-	-	11,481	(1,010)	-	119	664	-	13,989	42,581
Fund balances:											
Reserved for:											
Related assets	-	-	-	-	455,944	-	-	-	-	455,944	455,944
Encumbrances	13,380	-	-	-	160,874	9,054	12,849	-	-	196,157	149,892
Unreserved	134,239	-	1,495	(21,304)	62,798	(8,880)	49,868	4,994	-	223,210	234,437
Total fund balances	147,619	-	1,495	(21,304)	679,616	174	62,717	4,994	-	875,311	840,273
Total liabilities and fund balances	\$ 150,354	\$ -	\$ 1,495	\$ (9,823)	\$ 678,606	\$ 174	\$ 62,836	\$ 5,658	\$ -	\$ 889,300	\$ 882,854

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, 1997
(With comparative totals for the year ended September 30, 1996)

	Airport Trust	Agriculture Revolving	Production Loan	Scholarship Revolving Loan	Housing Revolving	Aluminum Recycling	Health Care Fund	Sports Council Fund	Tourism Revolving	Totals	
										1997	1996
Revenues:											
Sales	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 77,122	\$ 125,620	\$ 6,416	\$ -	\$ 209,158	\$ 75,453
Others	72,383	-	-	8,195	233,900	-	-	-	-	314,478	294,801
Total revenues	72,383	-	-	8,195	233,900	77,122	125,620	6,416	-	523,636	370,254
Expenditures:											
Cost of sales	-	-	-	-	-	86,002	-	-	-	86,002	55,267
Others	32,907	-	-	57,866	247,498	-	62,903	1,422	-	402,596	551,072
Total expenditures	32,907	-	-	57,866	247,498	86,002	62,903	1,422	-	488,598	606,339
Excess (deficiency) of revenues over (under) expenditures	39,476	-	-	(49,671)	(13,598)	(8,880)	62,717	4,994	-	35,038	(236,085)
Fund balances (deficit) at beginning of year	108,143	-	1,495	28,367	693,214	9,054	-	-	-	840,273	1,076,358
Fund balances at end of year	\$ 147,619	\$ -	\$ 1,495	\$ (21,304)	\$ 679,616	\$ 174	\$ 62,717	\$ 4,994	\$ -	\$ 875,311	\$ 840,273

See Accompanying Independent Auditors' Report.



**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON INTERNAL
CONTROL OVER FINANCIAL REPORTING BASED UPON THE AUDIT
PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

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, 1997, and have issued our report thereon dated February 19, 1998, which report was modified due to our inability to substantiate the General Fixed Assets Account Group and travel advance receivables of all Governmental Fund Types; the omission of the Component Unit - Governmental Fund and the Agriculture Revolving Fund, Production Loan Fund and Tourism Revolving Fund from the Fiduciary Fund Type - Expendable Trust Funds; our inability to verify fixed asset additions of the Micronesian Petroleum Company, a Proprietary Fund Type - Component Unit and the lack of a statement of cash flows from that entity and the absence of audited support for certain State investments. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

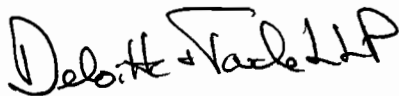
As part of obtaining reasonable assurance about whether State of Kosrae's general purpose financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and accordingly, we do not express such an opinion. The results of our tests disclosed one instance of noncompliance that is required to be reported under *Government Auditing Standards* which is described in the accompanying Schedule of Findings and Questioned Costs (pages 64 through 75) as item 97-1. We noted certain immaterial instances of noncompliance that we have reported to the management of Kosrae State in the accompanying Schedule of Findings and Questioned Costs as items 97-2, 97L-1 and 97L-2.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the State of Kosrae's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the general purpose financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operations of the internal control over financial reporting that, in our judgement, 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 financial statements. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items 97-3 through 97-9.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the 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 over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe none of the reportable conditions described above is a material weaknesses.

This report is intended for the information of the management of the State of Kosrae, federal awarding agencies, pass-through entities 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 "Delbert H. Taylor, II". The signature is written in a cursive, flowing style.

February 19, 1998



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

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

Compliance

We have audited the compliance of the State of Kosrae with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended September 30, 1997. The State of Kosrae's major federal programs are identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs (pages 64 through 75). Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the State of Kosrae's management. Our responsibility is to express an opinion on the State of Kosrae's compliance based on our audit.

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

As described in items 97-1 and 97-2 in the accompanying Schedule of Findings and Questioned Costs, the State of Kosrae did not comply with requirements regarding cash management (84.265) and federal equipment standards (all programs). Compliance with such requirements is necessary, in our opinion, for the State of Kosrae to comply with requirements applicable to those programs.

In our opinion, except for the noncompliance described in the preceding paragraph, the State of Kosrae complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended September 30, 1997.

Internal Control Over Compliance

The management of the State of Kosrae is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the State of Kosrae's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

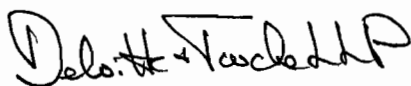
We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect Kosrae State's ability to administer a major federal program in accordance with applicable requirements of laws, regulations, contracts, and grants. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items 97-1 and 97-2.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program 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 over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe none of the reportable conditions described above to be a material weakness.

Schedule of Expenditures of Federal Awards

We have audited the general purpose financial statements of the State of Kosrae, as of and for the year ended September 30, 1997, and have issued our report thereon dated February 19, 1998, which report was modified due to our inability to substantiate the General Fixed Assets Account Group and travel advance receivables of all Governmental Fund Types; the omission of the Component Unit - Governmental Fund and the Agriculture Revolving Fund, Production Loan Fund and Tourism Revolving Fund from the Fiduciary Fund Type - Expendable Trust Funds; our inability to verify fixed asset additions of the Micronesian Petroleum Company, a Proprietary Fund Type - Component Unit and the lack of a statement of cash flows from that entity and the absence of audited support for certain State investments. Our audit was performed for the purpose of forming an opinion on the general purpose financial statements taken as a whole. The accompanying schedule of expenditures of federal awards (pages 47 through 60) is presented for the purpose of additional analysis as required by OMB Circular A-133 and is not a required part of the general purpose financial statements. This schedule is the responsibility of the management of the State of Kosrae. Such information has been subjected to the auditing procedures applied in our audit of the general purpose financial statements and, in our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had the propriety of travel advance receivables of all Governmental Fund Types been determinable, 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, federal awarding agencies, pass-through entities and the cognizant audit and other federal agencies. However, this report is a matter of public record and its distribution is not limited.



February 19, 1998

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards
U.S. Federal and Other Assistance Fund
Year Ended September 30, 1997

Grantor Program Title	CFDA I.D. #	Kosrae Org. #	1997 Fiscal Year Expenditures
<u>U.S. Dept. of Education:</u>			
FY95 Special Education	84.027	7729	\$ 7,321
Total CFDA 84.027			7,321
FY97 TFAS Educational Grant	84.256	5847	256,370
FY95 TFAS Educational Grant	84.256	5426	8,303
FY96 TFAS Educational Grant	84.256	5846	416,184
Total CFDA 84.256			680,857
96 Goal 2000 Program	84.276	3012	22,485
Total CFDA 84.276			22,485
FY96 Vocational Education PREL	84.994	3932	171
Voc. Education Improvement Prog.	84.994	3938	55,988
FY95 Vision and Dreams	84.994	3544	5,777
Total CFDA 84.994			61,936
Total U.S. Department of Education			772,599
<u>U.S. Dept. of Labor:</u>			
FY96 JTPA Administration	17.250	3155	17,172
FY96 JTPA Adult Program	17.250	3156	23,454
FY96 JTPA Youth	17.250	3157	17,071
JTPA Participation/Support	17.250	3158	5,000
FY96 JTPA Elderly	17.250	3166	11,898
FY95 JTPA Administration	17.250	3203	6,372
FY95 JTPA Youth Program	17.250	3205	3,858
FY95 JTPA Elderly	17.250	3214	1,117
Total U.S. Department of Labor (CFDA #17.250)			85,942
<u>U.S. Dept. of Agriculture:</u>			
FY95 Fire Prevention	10.664	3408	4,741
FY93 Forestry	10.664	7708	1,334
FY94 Forestry	10.664	7714	800
Total U.S. Department of Agriculture (CFDA #10.664)			6,875
<u>U.S. Dept. of Health and Human Services:</u>			
FY96 Tuberculosis/AIDS	93.116	3665	2,476
FY97 Tuberculosis & AIDS	93.116	3718	4,008
FY95 TB/AIDS Control	93.116	7448	231
Total CFDA 93.116			6,715
FY95 Mental Health Information	93.119	7372	1,954
Total CFDA 93.119			1,954
Balance forward			865,416

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
U.S. Federal and Other Assistance Fund, Continued
Year Ended September 30, 1997

Balance forwarded			\$ 865,416
<u>U.S. Dept. of Health and Human Services, Continued</u>			
FY97 Family Planning	93.217	3675	22,128
3745 Family Planning	93.217	3676	2,456
FY96 Family Planning	93.217	7438	(4,061)
Total CFDA 93.217			20,523
FY96 Immunization	93.268	3669	722
FY97 Immunization	93.268	3711	15,798
Total CFDA 93.268			16,520
FY96 Aids Prevention	93.940	3682	400
FY97 Aids Prevention	93.940	3725	172
Total CFDA 93.940			572
FY96 Substance Abuse	93.959	3700	38,529
FY95 Substance Abuse	93.959	3655	2,746
Total CFDA 93.959			41,275
FY96 Diabetes Program	93.988	3696	565
Total CFDA 93.988			565
FY96 PH & PH	93.991	3707	1,317
Total CFDA 93.991			1,317
FY96 MCH Program	93.994	3689	54,437
FY95 MCH Program	93.994	7445	189
Total CFDA 93.994			54,626
Total U.S. Department of Health and Human Services			144,067
<u>U.S. Environmental Protection Agency:</u>			
Waste Water Construction	66.418	3585	112,049
Total U.S. Environmental Protection Agency (CFDA #66.418)			112,049
<u>U.S. Dept. of the Interior:</u>			
FY95 Historic Preservation	15.904	3451	21,127
FY96 Historic Preservation	15.904	3456	10,228
Total U.S. Department of Interior (CFDA #15.904)			31,355
<u>Pacific Basin Development Council:</u>			
Emergency Management Network	N/A	3838	1,897
Total Pacific Basin Development Council			1,897
Total federal and other assistance expenditures			\$ 1,154,784

Note: The above grants are received in a subgrantee capacity through the FSM National Government except for the TFAS grants (84.256) and the PREL programs (CFDA #84.994) which were received directly from the grantor.

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
Foreign Assistance Fund
Year Ended September 30, 1997

Account Title	CFDA #	Kosrae Org. #	1997 Fiscal Year Expenditures
World Health Organization: FY96 Clinical Protocol	N/A	7399	\$ 560
South Pacific Commission Grants: Kosrae Anti Substance Abuse	N/A	7315	26,199
UNICEF Grants: Family Food Nutrition Program	N/A	3959	2,552
Other Grants: Utwe Sport Equipment	N/A	3936	430
FY96 Walung Water Project	N/A	3937	11,781
FY97 Mooring Buoy Project	N/A	3941	14,144
			26,355
Total Foreign Assistance Fund			\$ 55,666

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

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
TTPI Capital Projects Fund
Year Ended September 30, 1997

<u>Grantor Account Title</u>	<u>CFDA I.D. #</u>	<u>Kosrae Org. #</u>	<u>1997 Fiscal Year Expenditures</u>
Kosrae Okat Dock	15.875	6350	\$ 522,878
Tofol Water Treatment	15.875	6808	<u>15,994</u>
Total TTPI CIP			<u>\$ 538,872</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 expenditures of federal awards.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
CFSM Capital Projects Fund
Year Ended September 30, 1997

Account Title	Kosrae Org. #	1997 Fiscal Year Expenditures
Olympic Swimming Pool	1178	\$ 192,820
Olympic Grand Stand	1190	96,504
FY97 Gym Extension	1191	52,782
Kosrae State Court	4612	58,056
Joint Law Enforcement	4632	65,054
FY94 Broiler Project	6900	3,687
FY95 Health Programs	9585	27,145
FY96 Fisheries Fuel	9586	4,466
FY95 CFSM Education	9588	15,544
Procure/Medical Supplies	9590	1,380
FY96 Road Development	9592	365,894
Kosrae POL Bulk Plant	9599	325,000
FY97 School Improvement	9600	170,302
FY97 Chip Seal	9610	43,310
FY97 Tourism Development	9611	9,449
Medical Supplies	9612	14,159
Senior Citizens	9613	2,947
Agriculture Research	9614	16,721
Completion Sports	9615	110,504
FY97 Poultry Nat. Project	9752	676
Total CFSM CIP		<u>\$ 1,576,400</u>

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 expenditures of federal awards.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
Operations and Maintenance Grants Fund
Year Ended September 30, 1997

Grantor Account Title	CFDA I.D. #	Kosrae Org. #	1997 Fiscal Year Expenditures
<u>Office of Territorial and International Affairs</u>			
FY97 Local Closeup	15.875	3546	\$ 325
Solid Waste Management Program	15.875	3624	47,050
Road Maintenance Management Improvement	15.875	3625	82,483
FY95 School Maintenance	15.875	7320	755
FY95 Reorg. DPW 2nd Year	15.875	7330	163
FY95 Jail OMIP Maintenance	15.875	7331	645
			<hr/>
Total operations and maintenance grants fund			\$ 131,421
			<hr/>

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

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
Compact of Free Association Capital Projects Fund -
Section 211(a) Capital Account
Year Ended September 30, 1997

Grantor Account Title	CFDA I.D. #	Kosrae Org. #	1997 Fiscal Year Expenditures
<u>Office of Territorial and International Affairs</u>			
Airport Improvement	15.875	6201	\$ 2,189
Citrus Fumigation	15.875	6227	205
Poultry & Swine Production	15.875	6460	2,108
Marine Park Establishment	15.875	6461	2,235
FY92 Land Acquisition	15.875	6464	7,480
FY92 Land Acquisition	15.875	6466	2,254
FY92 Medical Equipment	15.875	6468	12,291
Broadcast Facility	15.875	9782	150
Tofol Gymnasium	15.875	6792	25,861
Fisheries Development	15.875	6807	23,541
Housing Renovation Loan Fund	15.875	6811	50,000
Elementary Classroom	15.875	6813	4,852
FY93 Housing Renovation Loans	15.875	6822	651
FY93 Municipal Water Systems	15.875	6826	12,363
FY93 OMIP Matching	15.875	6829	1,291
FY93 Kosrae High School	15.875	6830	684
FY94 Land Acquisition	15.875	6834	9,651
FY94 Project Administration	15.875	6835	2,006
FY94 Road Pavement	15.875	6837	6,768
FY94 Lelu Power Upgrade	15.875	6838	2
FY94 Maintenance Program	15.875	6839	20,759
FY94 Education OMIP Matching	15.875	6841	59,881
FY94 Public Safety Matching	15.875	6842	171
FY94 Sansrik Elementary Con.	15.875	6843	4,608
FY95 Utwe Sewer System	15.875	6849	13,764
FY95 Land Acquisition	15.875	6850	11,059
FY95 OMIP Matching	15.875	6851	7,319
FY95 Trochus Development	15.875	6853	133
FY95 OMIP Matching/Education	15.875	6855	63,439
FY95 Utwe Office Renovation	15.875	6862	2,680
FY95 Walung Youw Bridge	15.875	6864	5,400
FY95 Malem School Bridge	15.875	6865	3,383
FY96 New Classroom	15.875	6868	51,900
FY96 Manpower	15.875	6869	4,595
FY96 Road Development	15.875	6870	170,881
FY96 POL Bulk Plant	15.875	6871	150,900
FY96 Slipway	15.875	6872	368,250
FY96 Sports Facilities	15.875	6874	77,701
FY96 Building Maintenance	15.875	6875	94,682
FY96 Project Administration	15.875	6876	16
FY96 Land Acquisition	15.875	6877	42,726
Subtotal			<u>1,320,829</u>

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
Compact of Free Association Capital Projects Fund -
Section 211(a) Capital Account, Continued
Year Ended September 30, 1997

Grantor Account Title	CFDA I.D. #	Kosrae Org. #	1997 Fiscal Year Expenditures
Balance forwarded			\$ 1,320,829
FY84 Water Resources Development	15.875	6879	59,643
FY96 KSL Renovation/H.R. Dev.	15.875	6880	12,815
FY96 T/A Water Master Plan	15.875	6881	26,995
FY96 Agriculture Lab Facilities	15.875	6882	36,987
FY96 KBD Advisory Centers	15.875	6883	338
FY96 Farmers Exchange	15.875	6884	10,025
Trochus G/Snail	15.875	6885	720
Power Plant Improvement	15.875	6887	218,250
FY97 Manpower Development Training	15.875	6889	33,293
FY97 Pacific Tuna Industries	15.875	6890	250,000
FY97 Agriculture Equipment	15.875	6891	54,403
FY97 Sports Facilities	15.875	6892	217,778
Building Maintenance	15.875	6893	72,065
FY97 Road Development	15.875	6895	211,623
FY97 Land Acquisition	15.875	6896	63,350
FY97 Project Administration	15.875	6897	16,292
FY97 MPC	15.875	6898	36,674
Loss on equity investment	15.875	N/A	249,766
Total Compact of Free Association Capital Projects Fund - Section 211(a) Capital Accounts			\$ 2,891,846
Balance per the general-purpose financial statements			\$ 2,491,846
Investment in SEMO-FY96 slipway		6872	350,000
Escrow-Housing Renovation Loan Fund		6811	50,000
			\$ 2,891,846

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

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
Compact of Free Association - Section 216(a)(2)
Health and Medical Programs
Year Ended September 30, 1997

Grantor Account Title	CFDA I.D. #	Kosrae Org. #	1997 Fiscal Year Expenditures
<u>Office of Territorial and International Affairs</u>			
Medical Referral	15.875	2499	\$ <u>104,700</u>
Total Compact of Free Association - Section 216(a)(2)			\$ <u><u>104,700</u></u>

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

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
Compact of Free Association - Section 212(b)
Special Development Program
Year Ended September 30, 1997

Account Title	CFDA I.D. #	Kosrae Org. #	1997 Fiscal Year Expenditures
FY95 Centralized Pol.	15.875	2819	\$ 29,738
FY97 Centralized Travel	15.875	2826	77,889
FY97 Consultancy	15.875	2828	12,977
FY97 Kosrae SDA School Contribution	15.875	2829	14,120
Civic Action Team	15.875	N/A	<u>250,000</u>
Total Compact of Free Association - Section 212(b)			<u>\$ 384,724</u>

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

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Schedule of Expenditures of Federal Awards, Continued
Compact of Free Association Section 216(a)(3)
Scholarship Program
Year Ended September 30, 1997

<u>Account Title</u>	<u>CFDA I.D. #</u>	<u>Kosrae Org. #</u>	<u>1997 Fiscal Year Expenditures</u>
FY97 Scholarship Grant	15.875	2653	\$ <u>127,761</u>
Total Compact of Free Association - Section 216(a)(3)			\$ <u><u>127,761</u></u>

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

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
Compact of Free Association Section 221(b)
Special Block Grant Fund
Year Ended September 30, 1997

Grantor Account Title	CFDA I.D. #	Kosrae Org. #	1997 Fiscal Year Expenditures
<u>Office of Territorial and International Affairs</u>			
Health Special Block Program	15.875	2075	\$ 86,526
Education Special Block Program	15.875	2128	<u>892,499</u>
 Total Compact of Free Association - Section 221(b)			 <u>\$ 979,025</u>

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

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
Compact of Free Association - Section 214(b)
Energy Grant Program
Year Ended September 30, 1997

Account Title	CFDA I.D. #	Kosrae Org. #	1997 Fiscal Year Expenditures
Power Generation	15.875	2803	\$ 496,125
FY96 Government Power Bill	15.875	2806	1,006
Governor Utility Billing	15.875	2807	9,920
Agriculture Utility Billing	15.875	2808	6,166
Commerce and Industry Utility Billing	15.875	2809	3,795
Fisheries Utility Billing	15.875	2810	1,775
Education Utility Billing	15.875	2811	34,052
Health Utility Billing	15.875	2812	28,568
T & U Utility Billing	15.875	2813	24,712
DOJ Utility Billing	15.875	2814	2,067
DOA Utility Billinh	15.875	2815	14,800
Broadcast Utility Billing	15.875	2816	2,762
DRC Utility Billing	15.875	2817	75
Land Commission Utility Billing	15.875	2830	450
Sports Utility Billing	15.875	2831	1,622
Total Compact of Free Association Section 214(b)			\$ 627,895
Balance per the fund financial statements			\$ 627,895
Transfer to Kosrae Utilities Authority	2803	2803	(496,125)
			\$ 131,770

Note: These funds are made available by Title Two, Article I, Section 214(b) of the Compact of Free Association, and are disbursed through the Office of Territorial and International (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 expenditures of federal awards.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
Compact of Free Association Section 211(a)
Current Account Fund
Year Ended September 30, 1997

<u>Account Title</u>	<u>Kosrae Org. #</u>	<u>CFDA I.D. #</u>	<u>1997 Fiscal Year Expenditures</u>
General Fund: Current Account	Various	15.875	\$ <u>3,284,400</u>

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

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

**Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 1997**

(1) Scope of Review

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

A. Programs Subject to Single Audit

- U.S. Department of Agriculture
- U.S. Department of Education
- U.S. Department of Health and Human Services
- U.S. Department of the Interior
- U.S. Department of Labor
- U.S. Environmental Protection 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-133. The Kosrae Utilities Authority's Schedule of Expenditures of Federal Awards is as follows:

<u>Grantor Agency/Program</u>	<u>CFDA#</u>	<u>Fiscal Year 1997 Expenditures</u>
U.S. Department of the Interior:		
Compact of Free Association:		
Energy (214B)	15.875	\$ 496,124
Capital Account funds	15.875	218,250

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 1997

(3) Component Units, Continued

Operations and Maintenance:		
OMIP-KOS-95-1, 2nd Year	15.875	57,334
OMIP-KOS-96-1, 3rd Year	15.875	<u>205,055</u>
Total expenditures		\$ <u>976,763</u>

The Compact of Free Association programs are received from the State of Kosrae in a subrecipient capacity. The Operations and Maintenance funds are provided to Kosrae Utilities Authority in a direct recipient 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 Schedule of Expenditures of Federal Awards 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-133
Year Ended September 30, 1997

<u>Grantor Program Title</u>	<u>CFDA No.</u>	<u>1997 Fiscal Year Expenditures</u>
<u>Major Programs</u>		
<u>U.S. Dept. of the Interior</u>		
Compact of Free Association:	15.875	
211(A) Capital Account		\$ 2,891,846
221(B) Special Block Grant		979,025
Health and Medical		104,700
Post Secondary Education		127,761
Energy Programs		627,895
Special Development		<u>384,724</u>
Total Major Programs under CFDA # 15.875 excluding Compact of Free Association Section 211 (A) Current Account expenditures		5,115,951
<u>U.S. Department of Interior</u>		
Kosrae Okat Dock	15.875	522,878
<u>U.S. Department of Education</u>		
TFAS Educational Grant	84.256	<u>680,857</u>
Total U.S. Federal program expenditures selected excluding Compact Section 211 (A) Current Account expenditures		\$ <u>6,319,686</u>
Total U.S. Federal program expenditures excluding Compact Section 211 (A) Current Account expenditures		\$ <u>6,941,028</u>
% of total U.S. Federal Program expenditures covered by Major Programs excluding Compact Section 211 (A) Current Account expenditures		<u>91%</u>

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs
Year Ended September 30, 1997

Part I - Summary of Auditors' Results

1. The Independent Auditors' Report on the financial statements expressed a qualified opinion.
2. Reportable conditions in internal control over financial reporting were identified, none of which are considered to be material weaknesses.
3. One instance of noncompliance considered material to the financial statements was disclosed by the audit.
4. Reportable conditions in internal control over compliance with requirements applicable to major federal award programs were identified, none of which are considered to be material weaknesses.
5. The independent auditors' report on compliance with requirements applicable to major federal award programs expressed a qualified opinion.
6. The audit disclosed findings required to be reported by OMB Circular A-133.
7. The State's major programs were:

<u>Name of Federal Program or Cluster</u>	<u>CFDA Number</u>
U.S. Department of the Interior - Compact of Free Association	15.875
U.S. Department of the Interior - Kosrae Okat Dock	15.875
U.S. Department of Education - TFAS Educational Grant	84.256

8. A threshold of \$300,000 was used to distinguish between Type A and Type B programs as those terms are defined in OMB Circular A-133.
9. The State did not qualify as a low-risk auditee as that term is defined in OMB Circular A-133.

Part II - Financial Statement Findings Section

<u>Reference Number</u>	<u>Findings</u>	<u>Questioned Costs</u>
97-3	Bank reconciliations	\$ -
97-4	Stale-dated checks	-
97-5	Outstanding checks	-
97-6	Travel advances	-
97-7	Accounts payable	-
97-8	Over-expenditures of special block grant	-
97-9	Prior year findings	-

Part III - Federal Award Findings and Questioned Cost Section

<u>Reference Number</u>	<u>Findings</u>	<u>Questioned Costs</u>
97-1	Cash management requirements	\$ -
97-2	Property standards	-

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 1997

Federal Awards Findings and Questioned Costs

<u>Program</u>	<u>Reason For Questioned Cost</u>	<u>Questioned Costs</u>
97-1. TFAS Educational Grant -CFDA # 84.256	<p><u>Criteria:</u> Kosrae State must follow procedures to minimize the time lapsing between the transfer of funds from the U.S. Treasury and disbursement.</p> <p><u>Condition:</u> The required advance/reimbursement reports were not available for inspection.</p> <p><u>Cause:</u> The cause of this condition is unknown.</p> <p><u>Effect:</u> Possible noncompliance with cash management requirements could result from this finding.</p> <p><u>Recommendation:</u> We recommend that Kosrae State ensure that it complies with cash management requirements.</p>	

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 1997

Federal Awards Findings and Questioned Costs, Continued

Unresolved Prior Years' Federal Findings

97-2. Criteria: Findings from prior audit reports should be resolved in a timely manner.

Condition: The following finding from previous years' Single Audit Reports remains unresolved.

<u>Fiscal Year</u>	<u>Page No.</u>	<u>Finding No.</u>	<u>Description</u>
1988	26	5	Federal property standards

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.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 1997

Financial Statement Findings

Bank Reconciliations

Finding No. 97-3

Criteria: The General Ledger cash in bank balance should be reconciled to the actual bank balance on a monthly basis.

Condition: We found that the Treasury Fund was out of balance by \$74,976 as of September 30, 1997.

Cause: Kosrae State has been performing one-sided bank reconciliations.

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

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

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 1997

Financial Statement Findings, Continued

Stale Dated Checks

Finding No. 97-4

Criteria: A functioning system of internal control requires periodic review of the outstanding checklist so proper adjustments can be made to restore cash and accounts payable.

Condition: We found that \$156,825 of checks outstanding as of September 30, 1997 have been outstanding for over one year.

Cause: Kosrae State does not review the outstanding checklist on a periodic basis.

Effect: There is no effect of this condition on the financial statements as reclassifications were proposed in the audit process to correct for this matter.

Recommendation: We recommend that Kosrae State make periodic review of the outstanding checklist for stale dated checks.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 1997

Financial Statement Findings, Continued

Outstanding Checks

Finding No. 97-5

Criteria: Canceled checks should be excluded from the list of outstanding checks..

Condition: Three checks totaling \$289,383 returned with the October 1996 bank statements were still listed as outstanding as of September 30, 1997.

Cause: Kosrae State does not review the outstanding checklist for propriety.

Effect: There is no effect on the financial statements as a result of this condition as adjustments were proposed to correct this condition in the audit process.

Recommendation: We recommend that Kosrae State ensure that canceled checks are properly excluded from the list of outstanding checks.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 1997

Financial Statement Findings, Continued

Travel Advances

Finding No. 97-6

Criteria: Kosrae State should maintain a travel advance subsidiary ledger to support the general ledger travel account balances.

Condition: We found that Kosrae State did not keep detail subsidiary travel advance ledgers.

Cause: The cause of this condition is unknown.

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

Recommendation: We recommend that Kosrae State ensure that all travel advance subsidiary ledgers are maintained and reconciled to the general ledger.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 1997

Financial Statement Findings, Continued

Accounts Payable

Finding No. 97-7

Criteria: Detailed listings of accounts payable must be made available to support the general ledger control accounts.

Condition: Kosrae State did not provide the detail of accounts payable to support the 1997 fiscal year-end general ledger accounts payable balances.

Cause: The cause of this condition is unknown.

Effect: Alternative procedures were performed in the audit process to mitigate the effect of this condition on the financial statements.

Recommendation: We recommend that Kosrae State ensure that the accounts payable subsidiary ledger is backed-up at the end of each fiscal year or a hard copy is printed.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 1997

Financial Statement Findings, Continued

Special Block Grant - Over Expenditures

Finding No. 97-8

Criteria: Expenditures should be monitored in order to prevent overspending.

Condition: Kosrae State continues to overspend balances of the Compact Special Block Grant Fund.

Cause: Personnel expenditures for the Education department teachers are also funded by the Special Block Grant.

Effect: The Compact Special Block Grant Fund has a cumulative fund deficit of \$689,327 as of September 30, 1997.

Recommendation: We recommend that Kosrae State ensure that over expenditures of special funds be charged directly to the General Fund unless alternative sources of future funds will be available.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 1997

Financial Statement Findings, Continued

Prior Year Internal Control Findings

Finding No. 97-9

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>
From September 30, 1988 report:		
15	11	Insurance coverage
18	14	External reporting requirements
From September 30, 1990 report:		
89	2	Fixed assets subledger
From September 30, 1991 report:		
91	5	Resolution of disputed liabilities
From September 30, 1994 report:		
105	6	Cash and equivalents
110	11	Purchases and disbursement cycle

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.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 1997

Local Findings

Compact Energy Funds

97L-1. Criteria: Kosrae State should ensure that it complies with the intent of the Compact treaty.

Condition: During fiscal year 1997, Kosrae State expended Compact Energy funds aggregating \$131,603 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.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 1997

Local Findings, Continued

Unresolved Prior Years' Local Findings

97L-2. Criteria: Findings from prior audit reports should be resolved in a timely manner.

Condition: The following finding from previous years' Single Audit Reports remains unresolved.

<u>Fiscal Year</u>	<u>Page No.</u>	<u>Finding No.</u>	<u>Description</u>
1990	82	6	Common stock purchase - Bank of the FSM

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.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

**Unresolved Prior Years' Findings and Questioned Costs
Year Ended September 30, 1997**

The following is a summary of unresolved questioned costs of the State of Kosrae as of September 30, 1997:

	Questioned Costs Set Forth in Prior Audit Report <u>1996</u>	Questioned Costs Resolved in Fiscal Year <u>1997</u>	Questioned Costs at <u>September 30, 1997</u>
Unresolved Questioned Costs FY 85	\$ 12,838	\$ 12,838 (1)	\$ -
Unresolved Questioned Costs FY 88	215,383	215,383 (1)	-
Unresolved Questioned Costs FY 94	8,246	8,246 (1) (2)	-
Unresolved Questioned Costs FY 95	2,983	2,983 (1) (2)	-
Unresolved Questioned Costs FY 96	274,360	-	274,360
Unresolved Questioned Costs FY 97	<u>-</u>	<u>-</u>	<u>-</u>
	\$ <u>513,810</u>	\$ <u>239,450</u>	\$ <u>274,360</u>

- (1) Findings have been reported to federal agencies for in excess of the two year threshold or the questioned costs were forgiven under the laws of the Compact of Free Association and its subsidiary agreements.
- (2) The amount of the original questioned costs were less than the \$10,000 threshold established by OMB Circular A-133.



**KOSRAE STATE GOVERNMENT
DEPARTMENT OF ADMINISTRATION
OFFICE OF THE DIRECTOR
P. O. BOX 878
TOFOL, KOSRAE STATE, FM 96944**

October 28, 1998

Director Office: (691) 370-3400 / 3163/3170* Facsimile: (691) 370-2004
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Division of Finance & Budget: (691) 370-3004/3170
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Division of Construction & Engineering: (691) 370-3169

Mr. Simao Iehsi
Deloitte & Touche
P.O. Box 753
Kolonia, Pohnpei

Dear Mr. Iehsi:

Below are the Auditee Responses and Corrective Action Plans for fiscal year 1997. You should have gotten the representation letter from the Kosrae State Attorney General and the Stock Fund Inventory report for fiscal year 1997 today along with this report.

Federal Findings: 97-01 TFAS grant

Auditee response: Original PMS forms were mailed to the granting agency since this is a direct grant.

Corrective Action Plan: Extra copies will be made available for Auditors and chief accountant commencing fiscal year 1999. We will also look into appropriating this grant separately to reflect its budget cycle by fiscal year 2001 to comply with its cash management requirements.

Finding no. 97-02... Unresolved prior years' Federal findings:

Prior audit findings should be resolved:

Auditee response: Kosrae State will eliminate all prior findings.

Corrective Action Plan: Kosrae State Government will need to create a Public Auditor Agency by year 2001.

Finding 97-03... Bank Reconciliation:

Auditee Response: This one-sided bank reconciliation needs to be corrected.

Corrective Action Plans: Reassignment of duties within the Finance Unit will need to be activated by year 2001.

Finding No. 97-04: Periodic review of outstanding checklist:

Auditee response: Job descriptions of personnel involved will need to be realigned specifically to system operators and the Treasury Unit.

Corrective Action Plans: (DOA) With the installation of the new system by mid-1999 improvements will be realized. Realignment of personnel will be effective upon installation of new system and will resolve this finding by year 2001.

Finding No. 97-05... Outstanding checks.

"Positive Growth for Everyone"

Auditee response: We've gone thru this with our system operators and identify this to be a technical problem. Kosrae State agrees with this criteria.

Corrective Action Plans: We recommend deleting this finding as there's no effect on the financial statement and since this is a technical problem, the installation of the new hardware system will correct this by year 2000.

Finding No.97-06....Travel Advances/ subsidiary ledger.

Auditee Response: We feel that this is not necessary since the Travel advance (bread-down) which is not an expenditure is made available on the TA by the computing agency. Training of the State's Payroll Officer in September 1998 conducted by the FSM National Government (Administration & Finance) also contributed to this need.

Corrective Action Plans: Effective at the beginning of fiscal year 1999, the manual ledgers for travel advances will be made available (Payroll Officer). Recommend deletion of this finding.

Finding No. 97-07 Accounts Payable detail listing.

Auditee response: System operators should provide all reports requested by auditors. If this detail listing is system-generated then this should not be a problem.

Corrective Action Plans: Accounts payable subsidiary ledger will be printed at the end of each fiscal year by the chief accountant. Kosrae State will make hard copies available at the end of each fiscal year commencing in fiscal year 1998. Recommend deletion of this finding.

Finding No.97-08 SBG over-spending.

Auditee response: Kosrae State Government (DOE) had been tapping its SBG funds prior to tapping its current account funds. Overspent balance should have been Jved to the current account.

Corrective Action Plans: Adjustments will have to be made to reduce this overspending balance by tapping the current account funds. Finance Chief Accountant will be responsible for ensuring that such request is made from DOE. We will resolve this by year 2001.

Finding No.97-09... Prior year Internal control

Auditee response: Prior findings on Insurance coverage, external reporting requirements, fixed assets sub-ledger, resolution of disputed liabilities, cash and equivalents, and Purchase and disbursement cycle are not issues that are overlooked. Questions should have been asked upon visits made by the Public Auditor, but rather a never ending finding hangs whereby policies and directives were established each year for improvements.

Corrective Action Plans: Upon establishing the Kosrae State Public Auditor's office and the installation of the new hardware system, improvements on these issues can be realized. Kosrae State will resolve these findings by year 2001.

Finding No. 97-10..... use of compact Energy Funds 214:

Auditee Response: Kosrae State Attorney General's office did provide an opinion to the National Government's A.G on this issue and to date, there is no opinion made available to the State.

Corrective Action Plan: Kosrae State Attorney General will work closely with the National Government to resolve this issue by year 2001.


Finding No. 97-010.....Local Finding on Common Stock purchase:

Auditee Response: An opinion was provided on this issue, but no response from the auditors as to fulfilling such need. Kosrae is so sure that such term as obligation is satisfied thru documentation of a request to allot funds against such authorized amount.

Corrective action Plan: Until such response is received on the opinion that was provided, Kosrae State will take an extra step to amend the expiration date on the existing law.

Please advise upon receipt of the Representation Letter and the stock Inventory Report

Kulo



Chris F. Nedlic

Director of Administration