

**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, 1999

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

YEAR ENDED SEPTEMBER 30, 1999

INDEX

	<u>Page No.</u>
INDEPENDENT AUDITORS' REPORT, GENERAL PURPOSE FINANCIAL STATEMENTS AND ADDITIONAL INFORMATION	1 - 49
INDEPENDENT AUDITORS' REPORTS ON COMPLIANCE AND INTERNAL CONTROLS	50 - 85

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Table of Contents
Year Ended September 30, 1999

	<u>Page No.</u>
I. Independent Auditors' Report	1
II. General Purpose Financial Statements:	
Combined Balance Sheet - All Fund Types, Account Groups and Discretely Presented Component Units	3
Combined Statement of Revenues, Expenditures and Changes in Fund Balances - All Governmental Fund Types and Expendable Trust Funds	5
Combined Statement of Revenues, Expenditures and Changes in Deficit - Budgetary Basis - General Fund	6
Combined Statement of Revenues, Expenses and Changes in Fund Equity (Deficiency) - All Proprietary Fund Types and Discretely Presented Component Units	7
Combined Statement of Cash Flows - All Proprietary Fund Types and Discretely Presented Component Units	8
Notes to Financial Statements	9
III. Additional Information:	
Combining Schedule of Expenditures by Account - All Governmental Fund Types and Expendable Trust Funds	25
General Fund:	
Introduction to General Fund	26
Combining Balance Sheet	27
Combining Statement of Revenues, Expenditures by Function and Changes in Fund Balances	28
Combining Statement of Revenues, Expenditures by Account and Changes in Fund Balances	29
Combining Statement of Revenues, Expenditures and Changes in Fund Balances (Deficit); Budgetary Basis	30
Combined Statement of Revenues, Expenditures by Function and Department and Changes in Fund Balance	31

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Table of Contents, Continued
Year Ended September 30, 1999

	<u>Page No.</u>
III. Additional Information, Continued:	
Special Revenue Funds:	
Introduction to Special Revenue Funds	35
Combining Balance Sheet	36
Combining Statement of Revenues, Expenditures by Function and Changes in Fund Balances (Deficit)	37
Combining Statement of Revenues, Expenditures by Account and Changes in Fund Balances (Deficit)	38
Capital Projects Funds:	
Introduction to Capital Projects Funds	39
Combining Balance Sheet	40
Combining Statement of Revenues, Expenditures by Function and Changes in Fund Balances (Deficit)	41
Combining Statement of Revenues, Expenditures by Account and Changes in Fund Balances (Deficit)	42
Component Units - Proprietary Funds:	
Introduction to Component Units – Proprietary Funds	43
Combining Balance Sheet	44
Combining Statement of Revenues, Expenses and Changes in Fund Equity	45
Combining Statement of Cash Flows	46
Expendable Trust Funds:	
Introduction to Expendable Trust Funds	47
Combining Balance Sheet	48
Combining Statement of Revenues, Expenditures and Changes in Fund Balances (Deficit)	49
IV. Independent Auditors' Reports on Compliance and Internal Control:	
Independent Auditors' Report on Compliance and on Internal Control Over Financial Reporting Based Upon the Audit Performed in Accordance with <i>Government Auditing Standards</i>	50
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	52

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Table of Contents, Continued
Year Ended September 30, 1999

Page No.

IV. Independent Auditors' Reports on Compliance and Internal Control, Continued

Schedule of Expenditures of Federal Awards:

• U.S. Federal and Other Assistance Fund	55
• U.S. Direct Grants	58
• Foreign Assistance Fund	59
• CFSM Capital Projects Fund	60
• Operations and Maintenance Grants Fund	61
• Compact of Free Association Capital Projects Fund - Section 211(a) (CFDA No. 15.875)	62
• Compact of Free Association Health & Medical Programs - Section 216(a)(2) (CFDA No. 15.875)	63
• Compact of Free Association Special Development Program - Section 212(b) (CFDA No. 15.875)	64
• Compact of Free Association Scholarship Program - Section 216(a)(3) (CFDA No. 15.875)	65
• Compact of Free Association Special Block Grant Fund - Section 221(b) (CFDA No. 15.875)	66
• Compact of Free Association Energy Grant Program - Section 214(b) (CFDA No. 15.875)	67
• Compact of Free Association Current Account Fund - Section 211(a) (CFDA No. 15.875)	68
Notes to Schedule of Expenditures of Federal Awards	69
Schedule of Programs Selected for Audit in Accordance with OMB Circular A-133	71
Schedule of Findings and Questioned Costs	72
Unresolved Prior Years' Findings and Questioned Costs	85

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

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

YEAR ENDED SEPTEMBER 30, 1999



INDEPENDENT AUDITORS' REPORT

Honorable Rensley A. Sigrah
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, 1999, 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.

We were not able to apply sufficient alternative procedures to assure ourselves as to the propriety of advances receivable for all Governmental Fund Types; inventories of the Proprietary Fund Types; loans receivable of the Fiduciary Fund Type, and accounts payable for all fund types as of September 30, 1999.

The State of Kosrae has not adequately updated its General Fixed Assets Account Group during the year ended September 30, 1999, 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.

We were not able to obtain audited financial statements supporting the financial activities of Kosrae Community Action Program (KCAP) and Micronesia Petroleum Corporation (MPC), nor were we able to satisfy ourselves as to those financial activities by other auditing procedures. Additionally, we were unable to obtain information necessary for a presentation of KCAP cash flows. Those financial statements are presented as component units with KCAP representing 100% of the assets and revenues of the Component Units – Governmental Funds and MPC represents 37% and 87% of the assets and revenues, respectively, of the Component Units – Proprietary Funds.

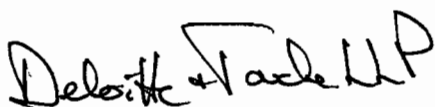
We were not able to obtain financial statements of the Agriculture Revolving Fund (ARF), Production Loan Fund (PLF) or Tourism Revolving Fund (TRF), Fiduciary Fund Type - Expendable Trust Funds. In our opinion, presentation of these funds should be included to conform with generally accepted accounting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

We were provided unaudited financial statements to support Kosrae State's investment in SEMO Micronesia (SEMO). In addition, we were not able to obtain financial statements for Pacific Tuna Industries (PTI) and Kosrae Sea Ventures, Inc. (KSV) to support Kosrae State's equity investments. Accordingly, we were not able to verify the carrying value of Kosrae State's investment in these entities (SEMO, KSV and PTI) recorded as equity investments in the Governmental Fund Type - Capital Projects Fund 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 advances receivable of all Governmental Fund Types; inventories of the Proprietary Fund Types; loans receivable of the Fiduciary Fund Type; accounts payable for all fund types; and fixed assets of the General Fixed Assets Account Group; 2) obtain audited financial statements for KCAP and MPC; 3) obtain financial statements for ARF, PLF and TRF; and 4) examine evidence regarding the investments in Kosrae Sea Ventures, Inc., SEMO Micronesia, and Pacific Tuna Industries as discussed in the third through seventh paragraphs above, such general purpose financial statements, as set forth in Section II of the table of contents, with the exception of the General Fixed Assets Account Group upon which we were unable to express an opinion because of the matters expressed in the fourth paragraph, present fairly, in all material respects, the financial position of the State of Kosrae as of September 30, 1999, 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 IV 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 items described in the third and fifth through seventh paragraphs 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 May 19, 2000 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. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

A handwritten signature in black ink, appearing to read "Deloitte & Touche LLP", is written over a horizontal line.

May 19, 2000

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Combined Balance Sheet - All Fund Types, Account Groups and Discretely Presented Component Units
September 30, 1999
(With comparative totals as of September 30, 1998)

	Governmental Fund Types			Proprietary Fund Type	Fiduciary Fund Type	Account Groups		Totals Primary Government (Memorandum Only)	Component Units	Totals Reporting Entity (Memorandum Only)	
	General	Special Revenue	Capital Projects	Internal Service	Expendable Trust	General Fixed Assets	General Long-Term Debt			1999	1998
ASSETS											
Cash and equivalents (note 2)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 1,835,719	\$ 1,835,719	\$ 1,878,361
Cash - restricted (note 2)	-	115,340	957,144	-	1,348,629	-	-	2,421,113	-	2,421,113	876,993
Investments (note 2)	2,287,682	350,295	1,196,800	-	-	-	-	3,834,777	-	3,834,777	2,968,526
Equity investments (note 5)	-	-	2,658,316	-	-	-	-	2,658,316	-	2,658,316	2,525,247
Receivables from federal agencies (note 3)	-	1,614,474	502,440	-	-	-	-	2,116,914	60,283	2,177,197	1,798,497
Receivables from other governments (note 3)	578,303	14,599	465,997	-	-	-	-	1,058,899	2,284	1,061,183	2,076,121
General receivables, net (note 4)	170,286	55,379	-	1,257	28,643	-	-	255,565	1,383,327	1,638,892	761,858
Advances (note 4)	399,033	414,889	298,752	-	(1,642)	-	-	1,111,032	-	1,111,032	1,099,082
Loans receivable, net (note 4)	-	-	375,000	-	432,251	-	-	807,251	-	807,251	550,944
Due from other funds (note 8)	1,889,699	429,093	1,064,791	-	762,497	-	-	4,146,080	-	4,146,080	4,767,300
Inventories, at cost	-	-	-	59,556	-	-	-	59,556	679,542	739,098	326,782
Interest receivable	12,094	-	-	-	-	-	-	12,094	-	12,094	12,094
Prepayments	-	-	-	-	-	-	-	-	43,640	43,640	2,383
Fixed assets, net	-	-	-	-	-	1,264,375	-	1,264,375	8,355,002	9,619,377	5,867,343
Amount to be provided for retirement of long-term debt	-	-	-	-	-	-	2,408,259	2,408,259	-	2,408,259	1,572,574
Amount available in designated expendable trust fund	-	-	-	-	-	-	404,663	404,663	-	404,663	191,860
Total assets	\$ 5,337,097	\$ 2,994,069	\$ 7,519,240	\$ 60,813	\$ 2,570,378	\$ 1,264,375	\$ 2,812,922	\$ 22,558,894	\$ 12,359,797	\$ 34,918,691	\$ 27,275,965

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, 1999
(With comparative totals as of September 30, 1998)

	Governmental Fund Types			Proprietary Fund Type	Fiduciary Fund Type	Account Groups		Totals Primary		Totals Reporting Entity	
	General	Special Revenue	Capital Projects	Internal Service	Expendable Trust	General Fixed Assets	General Long-Term Debt	Government (Memorandum Only)	Component Units	(Memorandum Only)	
										1999	1998
LIABILITIES AND FUND EQUITY (DEFICIENCY)											
Liabilities:											
Bank overdraft	\$ 633,115	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 633,115	\$ -	\$ 633,115	\$ 958,372
Accounts payable	94,745	137,232	165,804	-	18,232	-	-	416,013	1,391,933	1,807,946	774,137
Accrued payroll and others	401,252	7,148	15,758	-	-	-	-	424,158	77,040	501,198	391,593
Due to other funds (note 8)	512,333	2,436,265	1,010,279	133,291	53,912	-	-	4,146,080	-	4,146,080	4,767,300
Deferred revenues	-	278,592	-	-	-	-	-	278,592	-	278,592	28,095
Due to other governments	180,636	-	-	-	-	-	-	180,636	-	180,636	180,636
Long-term notes payable (note 10)	-	-	-	-	-	-	2,207,267	2,207,267	1,300,850	3,508,117	1,094,102
Vacation leave accrual	-	-	-	-	-	-	605,655	605,655	-	605,655	689,145
Other payables	306,449	-	-	-	-	-	-	306,449	62,278	368,727	318,469
Total liabilities	2,128,530	2,859,237	1,191,841	133,291	72,144	-	2,812,922	9,197,965	2,832,101	12,030,066	9,201,849
Minority interest in subsidiary	-	-	-	-	-	-	-	-	26,037	26,037	-
Fund equity (deficiency):											
Investment in general fixed assets	-	-	-	-	-	1,264,375	-	1,264,375	-	1,264,375	1,264,375
Retained earnings (deficit)	-	-	-	(72,478)	-	-	-	(72,478)	1,079,633	1,007,155	2,812,811
Contributed capital	-	-	-	-	-	-	-	-	8,422,026	8,422,026	4,155,568
Fund balances (deficit):											
Reserved for:											
Related assets	3,322,779	115,340	3,990,460	-	1,780,880	-	-	9,209,459	-	9,209,459	8,210,434
Encumbrances	260,870	552,886	1,031,003	-	285,183	-	-	2,129,942	-	2,129,942	3,767,313
Continuing appropriations (note 9)	65,550	542,196	1,282,810	-	-	-	-	1,890,556	-	1,890,556	3,075,233
Unreserved	(440,632)	(1,075,590)	23,126	-	432,171	-	-	(1,060,925)	-	(1,060,925)	(5,211,618)
Total fund equity (deficiency)	3,208,567	134,832	6,327,399	(72,478)	2,498,234	1,264,375	-	13,360,929	9,501,659	22,862,588	18,074,116
Contingencies (note 6)											
Total liabilities and fund equity (deficiency)	\$ 5,337,097	\$ 2,994,069	\$ 7,519,240	\$ 60,813	\$ 2,570,378	\$ 1,264,375	\$ 2,812,922	\$ 22,558,894	\$ 12,359,797	\$ 34,918,691	\$ 27,275,965
See accompanying notes to financial statements.											

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Combined Statement of Revenues, Expenditures and Changes in Fund Balances -
All Governmental Fund Types and Expendable Trust Funds
Year Ended September 30, 1999
(With comparative totals for the year ended September 30, 1998)

	Governmental Fund Types			Fiduciary Fund Type	Totals Reporting Entity (Memorandum Only)	
	General	Special Revenue	Capital Projects	Expendable Trust	1999	1998
Revenues:						
Compact of Free Association:						
Base amount	\$ 2,189,600	\$ 1,815,288	\$ 1,918,400	\$ -	\$ 5,923,288	\$ 5,795,122
Inflation adjustment	1,160,488	371,000	1,016,752	-	2,548,240	2,548,240
U.S. Department of the Interior grants	-	-	-	-	-	227,854
Revenue sharing	1,258,634	-	-	-	1,258,634	868,395
Federal contributions	-	1,584,753	-	-	1,584,753	1,433,817
FSM National governmentl contributions	-	-	499,545	-	499,545	405,976
Taxes and licenses	165,814	-	-	-	165,814	149,033
Investment income (note 2)	645,121	-	14,611	-	659,732	307,506
Other	124,258	53,178	-	405,434	582,870	1,753,065
Total revenues	5,543,915	3,824,219	3,449,308	405,434	13,222,876	13,489,008
Expenditures:						
General government	1,578,181	2,196,552	-	-	3,774,733	3,742,480
Education	607,790	888,383	-	-	1,496,173	1,463,843
Health services	728,932	234,912	-	-	963,844	826,195
Economic development	559,748	-	-	-	559,748	562,946
Public works	245,902	-	-	-	245,902	236,199
Public safety	292,668	-	-	-	292,668	264,995
Boards and commissions	120,846	24,201	-	-	145,047	224,834
Capital projects	-	-	3,334,202	-	3,334,202	2,514,662
Other	297,473	-	-	598,852	896,325	1,324,136
Total expenditures	4,431,540	3,344,048	3,334,202	598,852	11,708,642	11,160,290
Excess (deficiency) of revenues over (under) expenditures	1,112,375	480,171	115,106	(193,418)	1,514,234	2,328,718
Other financing sources (uses):						
Proceeds from (repayments of) issuance of debt (notes 10 and 11)	-	145,000	-	1,200,000	1,345,000	(40,771)
Equity loss on investment (note 5)	-	-	(48,931)	-	(48,931)	-
Interest income	-	-	-	23,617	23,617	-
Operating transfers in (out) (note 12)	(200,000)	(506,250)	-	200,000	(506,250)	(499,500)
Total other financing sources (uses), net	(200,000)	(361,250)	(48,931)	1,423,617	813,436	(540,271)
Excess of revenues and other financing sources over expenditures and other financing uses before the cumulative effect of a change in accounting principle	912,375	118,921	66,175	1,230,199	2,327,670	1,788,447
Add: cumulative effect of a change in accounting principle	-	-	-	-	-	303,974
Excess of revenues and other financing sources over expenditures and other financing uses	912,375	118,921	66,175	1,230,199	2,327,670	2,092,421
Fund balances at beginning of year	2,296,192	15,911	6,261,224	1,268,035	9,841,362	7,748,941
Fund balances at end of year	\$ 3,208,567	\$ 134,832	\$ 6,327,399	\$ 2,498,234	\$ 12,169,032	\$ 9,841,362

See accompanying notes to financial statements.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Combined Statement of Revenues, Expenditures and Changes in Deficit -
 Budgetary Basis - General Fund
 Year Ended September 30, 1999

	<u>Budget</u>	<u>Actual</u>	<u>Variance</u>
Revenues:			
Compact funding:			
Base amount	\$ 2,189,600	\$ 2,189,600	\$ -
Inflation adjustment	1,094,800	1,160,488	65,688
Revenue sharing	779,400	1,258,634	479,234
State taxes and licenses	168,000	165,814	(2,186)
Investment income	50,000	645,121	595,121
Miscellaneous	372,280	124,258	(248,022)
Total revenues	<u>4,654,080</u>	<u>5,543,915</u>	<u>889,835</u>
Expenditures:			
General government	1,436,327	1,314,809	121,518
Education	626,984	607,541	19,443
Health services	674,087	722,857	(48,770)
Economic development	570,201	556,874	13,327
Transportation and utility	242,468	238,034	4,434
Public safety	289,645	294,053	(4,408)
Boards and commissions	304,308	328,024	(23,716)
Other legislative appropriations	240,200	362,080	(121,880)
Total expenditures	<u>4,384,220</u>	<u>4,424,272</u>	<u>(40,052)</u>
Excess of revenues over expenditures	269,860	1,119,643	849,783
Other financing uses:			
Operating transfer out (note 12)	<u>(200,000)</u>	<u>(200,000)</u>	<u>-</u>
Excess of revenues over expenditures and other financing uses	69,860	919,643	(849,783)
Unreserved deficit at beginning of year	(2,379,879)	(2,379,879)	-
Other changes in unreserved fund deficit:			
Decrease in reserve for related assets	<u>-</u>	<u>1,019,604</u>	<u>(1,019,604)</u>
Unreserved deficit at end of year	<u>\$ (2,310,019)</u>	<u>\$ (440,632)</u>	<u>\$ (1,869,387)</u>

See accompanying notes to financial statements.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Combined Statement of Revenues, Expenses and Changes in Fund Equity (Deficiency)
All Proprietary Fund Types and Discretely Presented Component Units
Year Ended September 30, 1999
(With comparative totals for the year ended September 30, 1998)

	Proprietary Fund Type	Totals Primary Government (Memorandum Only)	Component Units	Totals Reporting Entity (Memorandum Only)	
	Internal Service			1999	1998
Operating revenues:					
Charges for services	\$ 19,656	\$ 19,656	\$ 9,831,857	\$ 9,851,513	\$ 1,246,192
Operating expenses:					
Cost of goods sold	13,448	13,448	7,945,012	7,958,460	23,289
Personnel services	-	-	744,482	744,482	378,716
Taxes	-	-	269,930	269,930	-
Travel	-	-	167,901	167,901	-
Supplies and materials	-	-	26,890	26,890	-
Fuel	-	-	663,037	663,037	661,503
Contractual services	-	-	152,389	152,389	-
Utilities	-	-	9,533	9,533	-
Communications	-	-	97,197	97,197	-
Depreciation	-	-	639,060	639,060	439,298
Administration and general	-	-	402,442	402,442	191,380
Repair and maintenance	-	-	132,033	132,033	68,505
Rent	-	-	15,000	15,000	-
Others	-	-	77,780	77,780	-
Total operating expenses	13,448	13,448	11,342,686	11,356,134	1,762,691
Operating income (loss)	6,208	6,208	(1,510,829)	(1,504,621)	(516,499)
Nonoperating revenues (expenses):					
Operating transfers in (note 12)	-	-	506,250	506,250	499,500
Interest income	-	-	73,914	73,914	55,473
Other income	-	-	150,310	150,310	88,468
Loss from investment in subsidiary	-	-	(372,131)	(372,131)	-
Other expense	-	-	(131,916)	(131,916)	-
Total nonoperating revenues (expenses), net	-	-	226,427	226,427	643,441
Net income (loss)	6,208	6,208	(1,284,402)	(1,278,194)	126,942
Add depreciation on fixed assets acquired by capital contributions that reduce contributed capital	-	-	498,004	498,004	380,512
Increase (decrease) in retained earnings (deficit)	6,208	6,208	(786,398)	(780,190)	507,454
Retained earnings (deficit) at beginning of year	(78,686)	(78,686)	1,825,835	1,747,149	2,305,357
Minority interest in subsidiary loss	-	-	40,196	40,196	-
Retained earnings (deficit) at end of year	(72,478)	(72,478)	1,079,633	1,007,155	2,812,811
Contributed capital at beginning of year	-	-	8,421,719	8,421,719	4,438,156
Contributions	-	-	564,544	564,544	97,924
Less depreciation on fixed assets acquired by capital contributions that reduce contributed capital	-	-	(498,004)	(498,004)	(380,512)
Minority interest in contributed capital	-	-	(66,233)	(66,233)	-
Contributed capital at end of year	-	-	8,422,026	8,422,026	4,155,568
Fund equity (deficiency) at end of year	\$ (72,478)	\$ (72,478)	\$ 9,501,659	\$ 9,429,181	\$ 6,968,379

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, 1999
(With comparative totals for the year ended September 30, 1998)

	Proprietary Fund Type	Totals Primary Government (Memorandum Only)	Component Units Proprietary Funds	Totals Reporting Entity (Memorandum Only)	
	Internal Service			1999	1998
Cash flows from operating activities:					
Operating income (loss)	\$ 6,208	\$ 6,208	\$ (1,460,113)	\$ (1,453,905)	\$ (511,192)
Adjustment to reconcile operating income (loss) to net cash provided by (used for) operating activities:					
Depreciation	-	-	752,892	752,892	439,298
Other income	-	-	3,363	3,363	1,554
	<u>6,208</u>	<u>6,208</u>	<u>(703,858)</u>	<u>(697,650)</u>	<u>(70,340)</u>
Changes in assets and liabilities:					
General receivables, net	(484)	(484)	(590,597)	(591,081)	(33,703)
Inventory	-	-	(170,627)	(170,627)	(14,306)
Prepayments	-	-	(10,257)	(10,257)	2,698
Other receivables-OMIP	-	-	-	-	292,979
Other receivables-FSM National Government	-	-	-	-	(97,924)
Accounts payable	-	-	1,043,448	1,043,448	(843)
Accrued payroll and others	-	-	(2,539)	(2,539)	(4,503)
Due to other funds	(5,724)	(5,724)	-	(5,724)	4,823
	<u>(6,208)</u>	<u>(6,208)</u>	<u>269,428</u>	<u>263,220</u>	<u>149,221</u>
Net cash (used for) provided by operating activities	<u>-</u>	<u>-</u>	<u>(434,430)</u>	<u>(434,430)</u>	<u>78,881</u>
Cash flows from investing activities:					
Investment in subsidiary	-	-	20,470	20,470	-
Interest income	-	-	73,914	73,914	55,473
Net cash provided by investing activities	<u>-</u>	<u>-</u>	<u>94,384</u>	<u>94,384</u>	<u>55,473</u>
Cash flows from noncapital financing activities:					
Operating and other transfers in (note 12)	<u>-</u>	<u>-</u>	<u>570,991</u>	<u>570,991</u>	<u>581,307</u>
Net cash provided by noncapital financing activities	<u>-</u>	<u>-</u>	<u>570,991</u>	<u>570,991</u>	<u>581,307</u>
Cash flows from capital and related financing activities:					
Additions to fixed assets	-	-	(1,110,189)	(1,110,189)	(171,212)
Proceeds from borrowing	-	-	271,450	271,450	-
Capital contributions	-	-	692,158	692,158	97,924
Net cash used for capital and related financing activities	<u>-</u>	<u>-</u>	<u>(146,581)</u>	<u>(146,581)</u>	<u>(73,288)</u>
Net increase in cash and equivalents	-	-	84,364	84,364	642,373
Cash and equivalents at beginning of year	<u>-</u>	<u>-</u>	<u>1,750,341</u>	<u>1,750,341</u>	<u>1,049,435</u>
Cash and equivalents at end of year	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,834,705</u>	<u>\$ 1,834,705</u>	<u>\$ 1,691,808</u>

See accompanying notes to financial statements.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 1999

(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

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. Government Accounting Standards Board (GASB) Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting", requires that proprietary activities apply all applicable GASB pronouncements as well as Statements and Interpretations issued by the Financial Accounting Standards Board (FASB), Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989. The State of Kosrae has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

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 three discretely presented component units which are 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.

Micronesia 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. MPC is presented as a component unit - proprietary fund. However, financial statements for 1998 were not presented and therefore, such is not included in the 1998 memorandum only totals.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 1999

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

Discretely Presented Component Units, Continued

Kosrae Community Action Program (KCAP) is a non-profit organization incorporated in 1984 under laws of FSM. The primary purpose of the organization is to administer community action programs, related antipoverty programs and other programs for which it is appointed as grantee. KCAP is presented as a component unit – governmental fund.

B. Fund Accounting

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

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

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

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

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.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 1999

(1) Summary of Significant Accounting Policies, Continued

B. Fund Accounting, Continued

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

C. Basis of Presentation

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

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

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

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 1999

(1) Summary of Significant Accounting Policies, Continued

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 1999, supplemental appropriations were made for both operating and capital purposes, to reflect revised financial priorities of Kosrae State Government.

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

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

E. Receivables

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

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.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 1999

(1) Summary of Significant Accounting Policies, Continued

F. Interfund Transactions, Continued

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

Kosrae State reports investments under the standards of GASB 31. GASB 31 provides that governmental activities shall, with certain exceptions, report investments at fair value on the balance sheet. Fair value is the amount which an investment could be exchanged in a current transaction between willing parties. Investments in the equity of companies are carried at cost if less than twenty percent of the companies' total equity, on the equity method if greater than twenty percent and less than fifty percent, and on a consolidated basis if greater than fifty percent. (See Note 2).

I. Fixed Assets

Governmental general fixed assets are carried in the General Fixed Assets Account Group. No depreciation is provided for on these assets. Assets are stated at cost or estimated cost. Fixed assets of Kosrae State Government also include capital infrastructure.

The State has not recorded additions or deletions to this Account Group in recent years and therefore, no statement of changes in general fixed assets is included in the accompanying general purpose financial statements.

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

	<u>Estimated Useful Lives</u>	
Production plant	5 - 40 years	\$ 4,103,456
Distribution plant	5 - 30 years	2,043,156
General plant	3 - 20 years	<u>392,961</u>
Electric plant in service		6,539,573
Less accumulated depreciation		<u>(2,218,685)</u>
		4,320,888
Construction in progress		<u>795,710</u>
		\$ <u>5,116,598</u>

Fixed assets of the Micronesia Petroleum Corporation, a component unit - proprietary fund, are comprised of various bulk plant assets which are depreciated by the straight-line method over the estimated useful lives of equipment, vehicles, furniture and fixtures and bulk plant assets which range from 3 to 40 years.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 1999

(1) Summary of Significant Accounting Policies, Continued

I. Fixed Assets, Continued

Bulk plant	\$ 2,506,000
Vehicles and tank trucks	289,045
Office equipment	116,971
Furniture and fixtures	62,324
Machines and equipment	313,107
Buildings and improvements	134,243
Land	200,000
Construction in progress	101,282
Fixed assets - MPC Yap	<u>219,286</u>
	3,942,258
Less accumulated depreciation	<u>(703,854)</u>
	<u>\$ 3,238,404</u>

J. Actual Expenditures Contrasted With Budgetary Expenditures

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

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

K. Fund Balance Reserves

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

Reserves for related assets in the general purpose financial statements at September 30, 1999, are generally as follows:

General Fund:

General receivables and advances	\$ 496,202
Federal assistance fund (deficit)	251,998
Kosrae Transportation Fund receivable	162,563
Compact scholarship (deficit)	48,839
O&M assistance fund (deficit)	52,149
Non-U.S. grant (deficit)	117,599

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 1999

(1) Summary of Significant Accounting Policies, Continued

K. Fund Balance Reserves, Continued

General Fund, Continued:

Due from other governments-Federal grants fund	1,497,116
Due from other governments-TTPI CIP fund	343,895
Revenue share-restricted for Education and Health	<u>352,418</u>
	\$ <u>3,322,779</u>

Special Revenue Funds:

Federal Grants restricted cash	\$ <u>115,340</u>
--------------------------------	-------------------

Capital Projects Funds:

Equity investments	\$ 2,658,316
Loans receivable	375,000
Term deposits	<u>957,144</u>
	\$ <u>3,990,460</u>

Expendable Trust Funds:

Loans receivable	\$ 432,251
Cash restricted for debt service	<u>1,348,629</u>
	\$ <u>1,780,880</u>

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, 1999 is \$605,655. No expenditure is reported for these amounts.

N. Totals - Memorandum Only

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

O. Management Estimates

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

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 1999

(2) Cash and Investments

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

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

- A. Investment managers may invest in stocks, bonds and cash equivalents. Minimum standards of quality for investments at the time of purchase shall be:
 - 1. Stocks - A "B" rating by a national rating service. Non-rated stocks such as banks or insurance companies must be equal in quality or higher.
 - 2. Bonds - Confined to issues rated "A" or higher by a national rating service, except in the case of U.S. Treasury or Agency securities which are not rated.
 - 3. Cash and equivalents - The manager may engage in all normally accepted short-term investment practices including, but not limited to: U.S. Treasury and Agency securities, bankers acceptances, certificates of deposit, commercial paper and repurchase agreements using any of the foregoing as collateral. The following restrictions apply:
 - a. Commercial paper must be rated A-1/P-1 or higher by Standard & Poors Corporation and Moodys Investor Services.
 - b. Certificates of deposit must be from FDIC insured banks of which must have assets in excess of two billion dollars. Deposits in smaller institutions are acceptable, but must not exceed the amount of the insurance unless collateralized by U. S. Treasury Securities at 102%.
- B. The equity portfolio shall be diversified among issues and industry classifications. No more than 25% of the equity portfolio may be invested in any single classification, as described by the Standard and Poors 500 Index, unless prior approval is received from the Secretary of Finance.
- C. No investment may be made in a single corporate entity which exceeds 5% of the total assets of the fund at the time of purchase without prior approval of the Secretary of Finance.

At September 30, 1999, the market value of the State's investment was \$3,834,777. These investments have been reported at fair value in accordance with GASB 31.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 1999

(2) Cash and Investments, Continued

Demand deposits	\$ 185,477
Investment in equity securities	<u>3,649,300</u>
	\$ <u>3,834,777</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 and \$100,000 for Micronesia Petroleum Corporation. The remaining balances of cash and equivalents are uncollateralized. At September 30, 1999, the State had deposits as follows (in each situation, cost approximates market value), which are restricted for the following programs; Medium Term Notes, Housing Escrow Fund, Waste Water System, and Early Retirement Program.

Capital Projects Funds

Certificates of deposit and savings accounts with FDIC insured bank	\$ 957,144
---	------------

Special Revenue Funds

Savings account with FDIC insured bank	115,340
--	---------

Expendable Trust Fund

Certificates of deposit and savings accounts with FDIC insured bank	<u>1,348,629</u>
	\$ <u>2,421,113</u>

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

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

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

Investment income for the year ended September 30, 1999, is comprised of the following items:

Compact Related Investments

Gross investment gains	\$ 379,316
Interest and dividends	233,362
Management and other fees	<u>(44,716)</u>
	567,962

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 1999

(2) Cash and Investments, Continued

Unrealized gains/losses	<u>58,229</u>
	626,191
<u>Noncompact Investments</u>	
Interest on certificates of deposit and savings accounts	<u>18,930</u>
	\$ <u>645,121</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 \$432,251 and \$28,643, respectively. The loan balances are fully reserved within the related asset component of fund balance in the applicable funds.

The Capital Project Funds has \$375,000 in loans outstanding at September 30, 1999, from the following borrowers (1) \$95,000 from Pacific Tuna Industries, a related party (See Note 5) at 3 percent to be repaid in eight installments beginning September, 1995 and (2) \$280,000 from Micronesia Petroleum Corporation, a component unit-proprietary fund type, interest at 1%, maturing in February 2009.

The General Fund, Special Revenue Funds and Capital Project Funds, have \$399,033, \$414,889, and \$298,752, 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.

(5) Equity Investments

As of September 30, 1999, the State has 50,000 shares in the Bank of the Federated States of Micronesia at a total cost of \$500,000. The Government's 50,000 shares represent approximately 5% of the Bank's total shares at September 30, 1999. 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, 1999, Kosrae State Government has \$1,161,806 in certificates of deposit and savings accounts with the bank.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 1999

(5) Equity Investments, Continued

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. The carrying value of this investment has been reduced to \$0.

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. The investment's carrying value was \$362,268 at September 30, 1999. No financial information has been received to allow adjustment for 1999 results.

At September 30, 1999, Kosrae State has a total investment of \$200,000 in Pacific Islands Development Bank which 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, 1999, Kosrae made an additional investment of \$182,000 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.

Carrying value at October 1, 1998	\$ 1,462,979
FY99 additional investments	182,000
State's share of SEMO Micronesia's net loss for the year ended September 30, 1999	<u>(48,931)</u>
Carrying value at September 30, 1999	\$ <u>1,596,048</u>

(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 1999, cumulative questioned costs of \$58,080 remain unresolved for fiscal years 1996 through 1999. 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.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 1999

(6) Contingencies, Continued

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, 1999, was \$1,964,417.

Litigation

The State of Kosrae is party to certain legal proceedings 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, 1999, is not predictable but will have no material impact on the accompanying general purpose financial statements. Therefore, no liability for such matters has been accrued for in the accompanying financial statements.

Loan Collateralization

At September 30, 1999, a time certificate of deposit in the amount of \$626,388 for Kosrae State Government was held by a local bank as collateral for a loan to Micronesia Petroleum Corporation, a component unit-proprietary fund (see note 10).

Risk Management

The State of Kosrae does not purchase commercial insurance covering its potential risks. The State is self insured for all risks. The State is of the opinion that no material losses have been sustained as a result of this practice.

Risk Management - KUA

KUA carries insurance to cover its potential risks from fire on its building and the contents and full coverage on property damage. KUA is substantially self-insured for all other risks. Management is of the opinion that no material losses have been sustained as a result of this practice.

Risk Management - MPC

MPC purchases commercial insurance to cover its potential risks from fire on its building and the contents and full coverage on property damage. MPC is substantially self-insured for all other risks. Management is of the opinion that no material losses have been sustained as a result of this practice.

(7) Material Fund Deficits

The following funds reflect material fund deficits as of September 30, 1999. If operations of these funds cannot recover prior losses, the State's General Fund may have to absorb these amounts or a portion thereof.

Internal Service Fund	\$ <u>72,478</u>
Compact Scholarship Fund	\$ <u>48,839</u>
U.S. Department of the Interior Fund	\$ <u>52,149</u>
Federal Grants Assistance	\$ <u>251,998</u>

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 1999

(7) Material Fund Deficits, Continued

Foreign Assistance	\$ <u>117,599</u>
CFSM Capital Projects Fund	\$ <u>49,924</u>
Scholarship Revolving Fund	\$ <u>25,092</u>
Aluminum Recycling Fund	\$ <u>38,307</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.

(8) Interfund Receivables and Payables

As of September 30, 1999, interfund receivables and payables resulting from various interfund transactions are as follows:

	Due to other Funds	Due from other Funds
General Fund	\$ 512,333	\$ 1,889,699
Special Revenue Funds:		
Compact-Special Block	85,882	-
Compact-Health and Medical	-	69,042
Compact-Scholarship Fund	57,839	-
Compact Energy	-	26,886
Compact Special Development	-	189,572
Fishermen's Revolving Fund	-	1,026
U.S. Department of the Interior Fund	135,744	-
Federal Grants Assistance Fund	2,017,059	-
U.S. Direct Grant	-	142,567
Foreign Assistance Fund	139,741	-
Capital Project Funds:		
Compact Capital Projects Fund	-	728,088
CFSM State Projects	598,867	-
TTG - Capital Project Fund	411,412	336,703
Expendable Trust Funds:		
Airport Trust Fund	-	152,119
Production Loan Fund	-	1,495
Scholarship Revolving Fund	15,605	-
Housing Revolving Fund	-	401,828
Aluminum Recycling Fund	38,307	-
Health Care Fund	-	11,378
Sports Council Fund	-	769
Early Retirement Program	-	194,908
Internal Service Fund	<u>133,291</u>	<u>-</u>
	\$ <u>4,146,080</u>	\$ <u>4,146,080</u>

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 1999

(9) Continuing Appropriations

Continuing appropriations as of September 30, 1999, 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	18,270
	<u>\$ 65,550</u>

Special Revenue Funds

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

Capital Project Funds

Compact of Free Association Capital Account –	
Various State approved projects	\$ 260,214
Various CFSM approved projects	258,336
Various TTPI approved projects	764,260
	<u>\$ 1,282,810</u>

(10) Notes Payable

During fiscal year 1995, Kosrae State Government borrowed \$386,000 from a bank to purchase residential property for use by the 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 balance as of September 30, 1999 is \$254,127. \$ 254,127

During fiscal year 1998, Kosrae State Government implemented an early retirement program for employees within the public service system. The program is funded through a \$2,200,000 loan from the Asian Development Bank through the FSM National Government. The first installment of \$1,000,000 was received from the Asian Development Bank during fiscal year 1998. During fiscal year 1999, the final installment amount of \$1,200,000 was received. As of September 30, 1999, Kosrae State has an outstanding loan balance of \$1,808,140 under this program. Loan repayments amounting to \$391,860 have been deposited into a separate bank account. (See note 11). 1,808,140

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 1999

(10) Notes Payable, Continued

During fiscal year 1999, Kosrae received \$145,000 of loan proceeds from Rural Utilities Services through the U.S. Department of Agriculture for the Malem Wastewater System Project. The note has a 4.5% rate and is due in 40 annual payments of \$8,199, commencing on September 28, 2001. 145,000

Total long-term debt \$ 2,207,267

Future maturities of the above payables are as follows:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>
2000	\$ 1,122,577	\$ 27,612
2001	765,015	25,901
2002	46,268	21,506
2003	51,271	16,624
2004	62,828	11,248
Thereafter	<u>159,308</u>	<u>161,154</u>
	\$ <u>2,207,267</u>	\$ <u>264,045</u>

Notes payable of Micronesia Petroleum Corporation consist of the following at September 30, 1999:

Loan payable to Kosrae State Government, primary government, in the amount of \$300,000 due in monthly installments of \$2,628, interest at 1%, maturing in February 1, 2009. \$ 285,481

Loan payable to FSM Development Bank in the amount of \$500,000 due in monthly installments of \$5,100, with a balloon payment of approximately \$264,000 due at maturity. Interest is at 9%, maturity in September 2008, secured by the property and inventory of the company. 485,468

A \$600,000 short-term credit facility with the Bank of the FSM to finance purchase of inventory. The \$600,000 line of credit is collateralized by a first mortgage on inventory and a time certificate of deposit held by Kosrae State Government, primary recipient. The Attorney General of Kosrae State is of the opinion that the use of a Kosrae State Government TCD as collateral was not properly authorized (see note 6). 526,901

Total debt \$ 1,297,850

Details of a \$3,000 loan payable of the Kosrae Community Action Program are not available.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 1999

(10) Notes Payable, Continued

Future maturities of the above payable are as follows:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>
2000	\$ 570,076	\$ 41,989
2001	47,484	43,651
2002	49,124	41,499
2003	50,918	39,169
2004	54,869	36,645
Thereafter	<u>525,379</u>	<u>122,087</u>
	\$ <u>1,297,850</u>	\$ <u>325,040</u>

(11) Early Retirement Program

During the year ended September 30, 1998, the State implemented an Early Retirement Scheme (ERS) in which employees holding certain nonessential positions as identified by the State were retired early with a payout of the equivalent of two-years wages. The ERS program is funded by a \$2,200,000 loan from the Asian Development Bank through the FSM National Government. During the year ended September 30, 1999, \$1,200,000 of the loan was released to the FSM National Government, which was then transferred to the State of Kosrae. The activities of the ERS Program are recorded in an expendable trust fund. Program expenditures as of September 30, 1999 consisted of employees' retirement payouts.

The ADB loan has a grace period of ten years with the first payment due in February 2008 and the last payment in August 2038. However, pursuant to the terms of the Financing Agreement between the State of Kosrae and the FSM National Government, the State is required to deposit into the ERS Trust account held in the name of Kosrae State within the FSM National Government investment portfolio, 100% of the outstanding principal balance by September 30, 2001. The estimated principal balances to be repaid in future years approximate \$1,320,000 in fiscal year 2000 and \$880,000 in fiscal year 2001.

Funds for the repayment of the ADB loan are expected to derive from annual appropriations for salaries and wages earmarked for the positions abolished under the Early Retirement Scheme. The Financing Agreement requires the State to continue to appropriate salaries for the abolished positions and deposit the appropriate funds into the ERS Trust Account. State management has restricted cash in the expendable trust fund in the amount of \$404,663 designated for the repayment of this debt.

(12) Operating Transfers Out

Operating transfers out for the year ended September 30, 1999, are as follows:

Transfer from Special Revenue Fund to Kosrae Utility Authority (KUA)	\$ <u>506,250</u>
Transfer from General Fund to Expendable Trust Fund	\$ <u>200,000</u>

**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, 1999
(With comparative totals for the year ended September 30, 1998)

	<u>Governmental Fund Types</u>			<u>Fiduciary Fund Type</u>	<u>Totals</u>	
	<u>General</u>	<u>Special Revenue</u>	<u>Capital Projects</u>	<u>Expendable Trust</u>	<u>(Memorandum Only)</u>	
					<u>1999</u>	<u>1998</u>
Expenditures:						
Personnel	\$ 3,429,001	\$ 1,198,982	\$ 241,343	\$ -	\$ 4,869,326	\$ 4,988,376
Travel	256,445	191,859	61,168	-	509,472	643,058
Supplies and materials	343,676	711,441	496,277	-	1,551,394	164,446
POL	140,206	39,009	3,548	-	182,763	64,245
Capital outlay	56,916	225,585	129,546	-	412,047	473,801
Contractual services	202,974	977,172	2,402,320	-	3,582,466	1,543,698
Other	<u>2,322</u>	<u>-</u>	<u>-</u>	<u>598,852</u>	<u>601,174</u>	<u>3,282,666</u>
Total expenditures	<u>\$ 4,431,540</u>	<u>\$ 3,344,048</u>	<u>\$ 3,334,202</u>	<u>\$ 598,852</u>	<u>\$ 11,708,642</u>	<u>\$ 11,160,290</u>

See Accompanying Independent Auditors' Report.

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

General Fund
September 30, 1999

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, 1999
(With comparative totals as of September 30, 1998)

	<u>U.S. Grant</u>	<u>State Revenue</u>	<u>Totals</u>	
<u>ASSETS</u>			<u>1999</u>	<u>1998</u>
Cash-restricted	\$ -	\$ -	\$ -	\$ 49,076
Investments	2,287,682	-	2,287,682	1,893,033
Receivables from other governments	180,636	397,667	578,303	278,152
General receivables, net	26,906	143,380	170,286	136,459
Advances	-	399,033	399,033	381,957
Due from other funds	1,889,699	-	1,889,699	1,723,869
Interest receivable	<u>12,094</u>	<u>-</u>	<u>12,094</u>	<u>12,094</u>
Total assets	<u>\$ 4,397,017</u>	<u>\$ 940,080</u>	<u>\$ 5,337,097</u>	<u>\$ 4,474,640</u>
 <u>LIABILITIES AND FUND BALANCES</u>				
Liabilities:				
Bank overdraft	\$ 633,115	\$ -	\$ 633,115	\$ 958,372
Accounts payable	25,781	68,964	94,745	98,205
Accrued payroll and others	399,798	1,454	401,252	263,154
Due to other funds	222,955	289,378	512,333	359,612
Due to other governments	180,636	-	180,636	180,636
Other payables	<u>306,449</u>	<u>-</u>	<u>306,449</u>	<u>318,469</u>
Total liabilities	<u>1,768,734</u>	<u>359,796</u>	<u>2,128,530</u>	<u>2,178,448</u>
Fund balances:				
Reserved for:				
Related assets	2,338,502	984,277	3,322,779	4,342,383
Encumbrances	167,893	92,977	260,870	268,138
Continuing appropriations	4,197	61,353	65,550	65,550
Unreserved	<u>117,691</u>	<u>(558,323)</u>	<u>(440,632)</u>	<u>(2,379,879)</u>
Total fund balances	<u>2,628,283</u>	<u>580,284</u>	<u>3,208,567</u>	<u>2,296,192</u>
Total liabilities and fund balances	<u>\$ 4,397,017</u>	<u>\$ 940,080</u>	<u>\$ 5,337,097</u>	<u>\$ 4,474,640</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, 1999

(With comparative totals for the year ended September 30, 1998)

	<u>U.S. Grant</u>	<u>State Revenue</u>	<u>Totals</u>	
			<u>1999</u>	<u>1998</u>
Revenues:				
Compact of Free Association:				
Base amount	\$ 2,189,600	\$ -	\$ 2,189,600	\$ 2,189,600
Inflation adjustment	1,160,488	-	1,160,488	1,160,488
Revenue sharing	-	1,258,634	1,258,634	868,395
Taxes and licenses	-	165,814	165,814	149,033
Investment income	626,191	18,930	645,121	307,506
Other	-	124,258	124,258	222,604
	<u>3,976,279</u>	<u>1,567,636</u>	<u>5,543,915</u>	<u>4,897,626</u>
Total revenues				
Expenditures:				
General government	698,690	879,491	1,578,181	1,764,189
Education	607,790	-	607,790	1,376,904
Health services	728,932	-	728,932	665,631
Economic development	559,748	-	559,748	562,946
Public works	245,902	-	245,902	236,199
Public safety	292,668	-	292,668	264,995
Boards and commissions	-	120,846	120,846	187,720
Other legislative appropriations	42,182	255,291	297,473	17,039
	<u>3,175,912</u>	<u>1,255,628</u>	<u>4,431,540</u>	<u>5,075,623</u>
Total expenditures				
Excess (deficiency) of revenues over (under) expenditures	800,367	312,008	1,112,375	(177,997)
Other financing sources (uses):				
Operating transfer out	<u>(50,000)</u>	<u>(150,000)</u>	<u>(200,000)</u>	<u>(191,860)</u>
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses before the cumulative effect of a change in accounting principle	750,367	162,008	912,375	(369,857)
Add: cumulative effect of a change in accounting principle	<u>-</u>	<u>-</u>	<u>-</u>	<u>303,974</u>
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	750,367	162,008	912,375	(65,883)
Fund balances at beginning of year	<u>1,877,916</u>	<u>418,276</u>	<u>2,296,192</u>	<u>2,362,075</u>
Fund balances at end of year	<u>\$ 2,628,283</u>	<u>\$ 580,284</u>	<u>\$ 3,208,567</u>	<u>\$ 2,296,192</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, 1999

(With comparative totals for the year ended September 30, 1998)

	<u>U.S. Grant</u>	<u>State Revenue</u>	<u>Totals</u>	
			<u>1999</u>	<u>1998</u>
Revenues:				
Compact of Free Association:				
Base amount	\$ 2,189,600	\$ -	\$ 2,189,600	\$ 2,189,600
Inflation adjustment	1,160,488	-	1,160,488	1,160,488
Revenue sharing	-	1,258,634	1,258,634	868,395
Taxes and licenses	-	165,814	165,814	149,033
Investment income	626,191	18,930	645,121	307,506
Other	-	124,258	124,258	222,604
	<u>3,976,279</u>	<u>1,567,636</u>	<u>5,543,915</u>	<u>4,897,626</u>
Total revenues				
Expenditures:				
Personnel	2,605,195	823,806	3,429,001	3,968,189
Travel	121,324	135,121	256,445	148,727
Supplies and materials	295,099	48,577	343,676	164,446
POL	9	140,197	140,206	1,896
Capital outlay	54,942	1,974	56,916	171,478
Contractual services	99,205	103,769	202,974	47,594
Other	138	2,184	2,322	573,293
	<u>3,175,912</u>	<u>1,255,628</u>	<u>4,431,540</u>	<u>5,075,623</u>
Total expenditures				
Excess (deficiency) of revenues over (under) expenditures	800,367	312,008	1,112,375	(177,997)
Other financing sources (uses):				
Operating transfer out	<u>(50,000)</u>	<u>(150,000)</u>	<u>(200,000)</u>	<u>(191,860)</u>
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses before the cumulative effect of a change in accounting principle	750,367	162,008	912,375	(369,857)
Add: cumulative effect of a change in accounting principle	<u>-</u>	<u>-</u>	<u>-</u>	<u>303,974</u>
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	750,367	162,008	912,375	(65,883)
Fund balances at beginning of year	<u>1,877,916</u>	<u>418,276</u>	<u>2,296,192</u>	<u>2,362,075</u>
Fund balances at end of year	<u>\$ 2,628,283</u>	<u>\$ 580,284</u>	<u>\$ 3,208,567</u>	<u>\$ 2,296,192</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 (Deficit); Budgetary Basis
Year Ended September 30, 1999

	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	1,094,800	1,160,488	65,688	-	-	-	1,094,800	1,160,488	65,688
Revenue sharing	-	-	-	779,400	1,258,634	479,234	779,400	1,258,634	479,234
State taxes and licenses	-	-	-	168,000	165,814	(2,186)	168,000	165,814	(2,186)
Investment income	50,000	626,191	576,191	-	18,930	18,930	50,000	645,121	595,121
Miscellaneous	-	-	-	372,280	124,258	(248,022)	372,280	124,258	(248,022)
Total revenues	3,334,400	3,976,279	641,879	1,319,680	1,567,636	247,956	4,654,080	5,543,915	889,835
Expenditures:									
General government	700,705	602,716	97,989	735,622	712,093	23,529	1,436,327	1,314,809	121,518
Education	626,984	607,541	19,443	-	-	-	626,984	607,541	19,443
Health services	674,087	722,857	(48,770)	-	-	-	674,087	722,857	(48,770)
Economic development	570,201	556,874	13,327	-	-	-	570,201	556,874	13,327
Transportation and utility	242,468	238,034	4,434	-	-	-	242,468	238,034	4,434
Public safety	289,645	294,053	(4,408)	-	-	-	289,645	294,053	(4,408)
Boards and commissions	-	-	-	304,308	328,024	(23,716)	304,308	328,024	(23,716)
Other legislative appropriations	61,000	174,937	(113,937)	179,200	187,143	(7,943)	240,200	362,080	(121,880)
Total expenditures	3,165,090	3,197,012	(31,922)	1,219,130	1,227,260	(8,130)	4,384,220	4,424,272	(40,052)
Excess (deficiency) of revenues over (under) expenditures	169,310	779,267	609,957	100,550	340,376	239,826	269,860	1,119,643	849,783
Other financing sources (uses):									
Operating transfer out	(50,000)	(50,000)	-	(150,000)	(150,000)	-	(200,000)	(200,000)	-
Excess (deficiency) of revenues over (under) expenditures and other financing uses	119,310	729,267	609,957	(49,450)	190,376	239,826	69,860	919,643	849,783
Unreserved deficit at beginning of year	(2,045,841)	(2,045,841)	-	(334,038)	(334,038)	-	(2,379,879)	(2,379,879)	-
Other changes in unreserved fund balances:									
Decrease (increase) in reserve for related assets	-	1,434,265	1,434,265	-	414,661	(414,661)	-	1,848,926	1,019,604
Unreserved fund balance (deficit) at end of year	\$ (1,926,531)	\$ 117,691	\$ 2,044,222	\$ (383,488)	\$ 270,999	\$ (174,835)	\$ (2,310,019)	\$ 388,690	\$ 1,869,387

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, 1999
(With comparative totals for the year ended September 30, 1998)

	1999		1998
Revenues:			
Compact of Free Association:			
Base amount	\$ 2,189,600		\$ 2,189,600
Inflation adjustment	1,160,488		1,160,488
FSM revenue sharing	1,258,634		868,395
State taxes and licenses:			
Cigarette tax	\$ 15,153		\$ 13,194
General sales tax	61,353		59,528
Alcohol	55,620		46,532
Motor vehicle sales tax	14,417		9,597
Licenses and fees	15,721		13,995
Court fines	3,550	165,814	6,187
			149,033
Other revenues:			
Medical and dental services	3,897		1,208
Miscellaneous	120,361	124,258	221,396
Investment income		645,121	307,506
Total revenues		5,543,915	4,897,626
Expenditures:			
General government:			
Governor and staff		167,053	341,923
Department of Administration:			
Director of Administration	52,349		33,329
Division of Planning and Statistics	65,122		53,550
Division of Finance and Budget	201,910		198,852
Division of Construction and Engineering	61,255		50,187
Division of Personnel and Employment	45,905		52,950
Centralize Leasing/Housing	-	426,541	62,450
			451,318
Kosrae State Court:			
Court Operations		153,068	124,725
Legislative Branch:			
KSL Operations	90,866		-
Legislative members	252,628		251,934
Standing committees	49,354		48,668
Staff	280,360	673,208	277,586
			578,188
Land commission		147,616	129,818
Legislative appropriations-election		10,695	138,217
Total general government		1,578,181	1,764,189

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, 1999
(With comparative totals for the year ended September 30, 1998)

	<u>1999</u>		<u>1998</u>
Expenditures by department, continued:			
Department of Education:			
Director's Office	50,969		48,593
Division of Instructional Services	319,647		1,022,017
Division of Curriculum Development	116,263		121,506
Facilities Special Services	83,440		53,182
Community Development	37,471		30,544
Scholarship Supplement	-		99,130
	<u>607,790</u>		<u>1,374,972</u>
Department of Health Services:			
Director of Health Services	58,098		97,630
Division of Hospital Services	575,301		483,577
Division of Sanitation	20,439		20,950
Division of Dental Services	43,895		22,507
Division of Public Health	27,216		40,967
Health services	3,983		-
	<u>728,932</u>		<u>665,631</u>
Economic Development:			
Department of Fisheries and Marines			
Director of Fisheries and Marines	23,050		24,237
Division of Fisheries and Surveillance	19,876		22,453
Division of Marine Resources	37,653	80,579	31,064
			77,754
Department of Agriculture and Land			
Director of Agriculture and Land	79,329		58,646
Division of Crop Production & Research	89,273		63,125
Division of Livestock Prod. & Research	30,188		53,356
Division of Land Management and Pres.	40,794		39,051
Division of Surveying and Mapping	65,358	304,942	64,791
			278,969
Department of Commerce and Industry:			
Director of Commerce and Industry	40,158		39,468
Division of Market and Research	6,953		6,291
Division of Housing C & I	48,508		52,460
Division of Industrial Development	30,166		32,899
Division of Consumer Services	27,024		25,174
Division of Tourism	21,418		16,649
Legislative appropriations-economic dev.	-	174,227	787
			173,728
Total economic development	<u>559,748</u>		<u>530,451</u>
Department of Public Works:			
Director of Transportation and Utility	34,765		37,502
Division of Road and Public Trans.	143,551		136,477
Division of Water and Wastewater	18,921		22,348
Division of Airport/Dock/Harbot	48,665		39,872
Total public works	<u>245,902</u>		<u>236,199</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, 1999
(With comparative totals for the year ended September 30, 1998)

	<u>1999</u>	<u>1998</u>
Expenditures by department, continued:		
Department of Justice:		
Director of Justice	14,207	22,991
Police Division	124,535	182,552
Division of Law	<u>153,926</u>	<u>59,452</u>
Total justice	<u>292,668</u>	<u>264,995</u>
Boards and Commissions		
Development Review Commission	60,361	32,495
Broadcast Authority	58,782	49,634
Scholarship Board	1,703	1,932
Parole Board	<u>-</u>	<u>240</u>
Total boards and commissions	<u>120,846</u>	<u>84,301</u>
Other Legislative Appropriations:		
FY97 Retirement	55,564	-
FY97 Workmen Compensation	20,075	-
FY98 Tafunsak Municipal Election	990	-
FY98 Malem Municipal Election	1,000	-
FY98 Utwe Municipal Election	1,000	-
Lelu Municipal Charter Ref.	1,000	-
FY99 COM Kosrae	25,000	-
FY98 Legal Fees	22,787	-
Civic Action Team	-	30,000
FY99 Leadership Conference	8,860	-
APNCL (Health Services)	5,028	-
Inauguration 1999	15,005	-
98-99 Transition Act	4,972	-
99 Liberation Day	12,500	-
MLSC Operations	36,000	36,000
Annual PIBA Conference	5,012	-
Sports Operation	51,690	36,546
FY98 Malem ConCon	2,490	-
KCAP Operations - legislative	23,811	20,952
General local revenue	255	-
FY98 Tafunsak ConCon	660	4,340
FY-97 2nd FSM Games	1,528	1,500
Lelu Senior Citizens	519	1,190
Malem Senior Citizens	977	422
Tafunsak Senior Citizens	-	1,709
Utwe Senior Citizens	750	-
FY98 Utwe ConCon	-	2,490
FY95 Legislative Opp.	<u>-</u>	<u>2,697</u>
Total other legislative appropriations	<u>297,473</u>	<u>137,846</u>
Other	<u>-</u>	<u>17,039</u>
Total expenditures	<u>4,431,540</u>	<u>5,075,623</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, 1999
(With comparative totals for the year ended September 30, 1998)

	<u>1999</u>	<u>1998</u>
Excess (deficiency) of revenues over (under) expenditures	1,112,375	(177,997)
Other financing sources (uses):		
Operating transfer out	<u>(200,000)</u>	<u>(191,860)</u>
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses before the cumulative effect of a change in accounting principle	912,375	(369,857)
Add: cumulative effect of a change in accounting principle	<u>-</u>	<u>303,974</u>
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	912,375	(65,883)
Fund balance at beginning of year	<u>2,296,192</u>	<u>2,362,075</u>
Fund balance at end of year	<u>\$ 3,208,567</u>	<u>\$ 2,296,192</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Special Revenue Funds
September 30, 1999

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, 1999, 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 - Scholarship - 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 - 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 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.

U.S. Direct Grants

This fund accounts for financial transactions related to direct federal assistance from United States government.

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, 1999

(With comparative totals as of September 30, 1998)

ASSETS	Compact Special Block Grant	Compact Health and Medical	Compact Scholarship	Compact Energy Block Grant	Compact Special Development	Fishermen's Revolving	U.S. Department of the Interior	Federal Grants Assistance	U.S. Direct Grants	Foreign Assistance	Totals	
	221(b)	216(a)(2)	216(a)(3)	214	212(b)						1999	1998
Cash-restricted	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 115,340	\$ -	\$ -	\$ 115,340	\$ -
Investments	43,750	56,063	-	128,350	122,132	-	-	-	-	-	350,295	284,920
Receivables from:												
Federal agencies	-	-	-	-	-	-	117,358	1,497,116	-	-	1,614,474	1,214,250
Other Governments	-	-	-	-	-	-	-	-	-	14,599	14,599	14,599
General receivables, net	19,238	-	9,000	-	-	-	-	23,473	-	3,668	55,379	191,123
Advances	39,175	32,039	-	4,718	53,042	-	36,716	242,961	2,440	3,798	414,889	410,661
Due from other funds	-	69,042	-	26,886	189,572	1,026	-	-	142,567	-	429,093	258,588
Total assets	\$ 102,163	\$ 157,144	\$ 9,000	\$ 159,954	\$ 364,746	\$ 1,026	\$ 154,074	\$ 1,878,890	\$ 145,007	\$ 22,065	\$ 2,994,069	\$ 2,374,411
LIABILITIES AND FUND BALANCES (DEFICIT)												
Liabilities:												
Accounts payable	\$ -	\$ 6,418	\$ -	\$ 53,147	\$ 31,003	\$ -	\$ 41,887	\$ -	\$ 4,777	\$ -	\$ 137,232	\$ 193,808
Accrued payroll and others	3,166	-	-	-	-	-	497	3,562	-	(77)	7,148	92,846
Due to other funds	85,882	-	57,839	-	-	-	135,744	2,017,059	-	139,741	2,436,265	2,043,751
Deferred revenues	-	-	-	-	-	-	28,095	110,267	140,230	-	278,592	28,095
Total liabilities	89,048	6,418	57,839	53,147	31,003	-	206,223	2,130,888	145,007	139,664	2,859,237	2,358,500
Fund balances (deficit):												
Reserved for:												
Related assets	-	-	-	-	-	-	-	115,340	-	-	115,340	-
Encumbrances	13,653	11,684	-	3,328	16,269	-	34,308	400,996	60,265	12,383	552,886	733,180
Continuing appropriations	-	-	900	-	-	-	541,296	-	-	-	542,196	542,196
Unreserved	(538)	139,042	(49,739)	103,479	317,474	1,026	(627,753)	(768,334)	(60,265)	(129,982)	(1,075,590)	(1,259,465)
Total fund balances (deficit)	13,115	150,726	(48,839)	106,807	333,743	1,026	(52,149)	(251,998)	-	(117,599)	134,832	15,911
Total liabilities and fund balances (deficit)	\$ 102,163	\$ 157,144	\$ 9,000	\$ 159,954	\$ 364,746	\$ 1,026	\$ 154,074	\$ 1,878,890	\$ 145,007	\$ 22,065	\$ 2,994,069	\$ 2,374,411

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, 1999
(With comparative totals for the year ended September 30, 1998)

	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	U.S. Direct Grants	Foreign Assistance	Totals	
											1999	1998
Revenues:												
Compact grants:												
Base amount	\$ 875,000	\$ 112,122	\$ 128,166	\$ 450,000	\$ 250,000	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 1,815,288	\$ 1,687,122
Inflation adjustment	-	-	-	238,500	132,500	-	-	-	-	-	371,000	371,000
Federal contributions	-	-	-	-	-	-	177,978	904,726	502,049	-	1,584,753	1,433,817
Other	-	-	32,988	-	-	-	-	-	-	20,190	53,178	28,162
Total revenues	<u>875,000</u>	<u>112,122</u>	<u>161,154</u>	<u>688,500</u>	<u>382,500</u>	<u>-</u>	<u>177,978</u>	<u>904,726</u>	<u>502,049</u>	<u>20,190</u>	<u>3,824,219</u>	<u>3,520,101</u>
Expenditures:												
General government	-	-	-	158,012	308,787	-	177,978	1,049,726	502,049	-	2,196,552	1,978,291
Education	760,218	-	128,165	-	-	-	-	-	-	-	888,383	86,939
Health services	116,749	118,163	-	-	-	-	-	-	-	-	234,912	160,564
Community affairs	-	-	-	-	-	-	-	-	-	24,201	24,201	37,114
Other	-	-	-	-	-	-	-	-	-	-	-	5,662
Total expenditures	<u>876,967</u>	<u>118,163</u>	<u>128,165</u>	<u>158,012</u>	<u>308,787</u>	<u>-</u>	<u>177,978</u>	<u>1,049,726</u>	<u>502,049</u>	<u>24,201</u>	<u>3,344,048</u>	<u>2,268,570</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(1,967)</u>	<u>(6,041)</u>	<u>32,989</u>	<u>530,488</u>	<u>73,713</u>	<u>-</u>	<u>-</u>	<u>(145,000)</u>	<u>-</u>	<u>(4,011)</u>	<u>480,171</u>	<u>1,251,531</u>
Other financing sources (uses):												
Proceeds from issuance of debt	-	-	-	-	-	-	-	145,000	-	-	145,000	-
Operating transfers out	-	-	-	(506,250)	-	-	-	-	-	-	(506,250)	(499,500)
Total other financing sources (uses)	<u>-</u>	<u>-</u>	<u>-</u>	<u>(506,250)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>145,000</u>	<u>-</u>	<u>-</u>	<u>(361,250)</u>	<u>(499,500)</u>
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing sources (uses)	<u>(1,967)</u>	<u>(6,041)</u>	<u>32,989</u>	<u>24,238</u>	<u>73,713</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(4,011)</u>	<u>118,921</u>	<u>752,031</u>
Fund balances (deficit) at beginning of year	<u>15,082</u>	<u>156,767</u>	<u>(81,828)</u>	<u>82,569</u>	<u>260,030</u>	<u>1,026</u>	<u>(52,149)</u>	<u>(251,998)</u>	<u>-</u>	<u>(113,588)</u>	<u>15,911</u>	<u>(736,120)</u>
Fund balances (deficit) at end of year	<u>\$ 13,115</u>	<u>\$ 150,726</u>	<u>\$ (48,839)</u>	<u>\$ 106,807</u>	<u>\$ 333,743</u>	<u>\$ 1,026</u>	<u>\$ (52,149)</u>	<u>\$ (251,998)</u>	<u>\$ -</u>	<u>\$ (117,599)</u>	<u>\$ 134,832</u>	<u>\$ 15,911</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, 1999
(With comparative totals for the year ended September 30, 1998)

	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	U.S. Direct Grants	Foreign Assistance	Totals	
											1999	1998
Revenues:												
Compact grants:												
Base amount	\$ 875,000	\$ 112,122	\$ 128,166	\$ 450,000	\$ 250,000	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 1,815,288	\$ 1,687,122
Inflation adjustment	-	-	-	238,500	132,500	-	-	-	-	-	371,000	371,000
Federal contributions	-	-	-	-	-	-	177,978	904,726	502,049	-	1,584,753	1,433,817
Other	-	-	32,988	-	-	-	-	-	-	20,190	53,178	28,162
Total revenues	875,000	112,122	161,154	688,500	382,500	-	177,978	904,726	502,049	20,190	3,824,219	3,520,101
Expenditures:												
Personnel	760,218	-	-	-	-	-	-	370,613	68,151	-	1,198,982	601,723
Travel	-	34,646	-	-	19,268	-	7,837	127,077	3,031	-	191,859	380,886
Supplies and material	103,570	10,122	-	158,012	2,420	-	16,097	159,115	260,624	1,481	711,441	-
POL	-	-	-	-	37,099	-	-	1,910	-	-	39,009	44,542
Capital outlay	1,886	-	-	-	-	-	6,538	92,971	111,190	13,000	225,585	162,252
Contractual services	11,293	73,395	128,165	-	250,000	-	147,506	298,040	59,053	9,720	977,172	411,574
Other	-	-	-	-	-	-	-	-	-	-	-	667,593
Total expenditures	876,967	118,163	128,165	158,012	308,787	-	177,978	1,049,726	502,049	24,201	3,344,048	2,268,570
Excess (deficiency) of revenues over (under) expenditures	(1,967)	(6,041)	32,989	530,488	73,713	-	-	(145,000)	-	(4,011)	480,171	1,251,531
Other financing sources (uses):												
Proceeds from issuance of debt	-	-	-	-	-	-	-	145,000	-	-	145,000	-
Operating transfers out	-	-	-	(506,250)	-	-	-	-	-	-	(506,250)	(499,500)
Total other financing sources (uses)	-	-	-	(506,250)	-	-	-	145,000	-	-	(361,250)	(499,500)
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing sources (uses)	(1,967)	(6,041)	32,989	24,238	73,713	-	-	-	-	(4,011)	118,921	752,031
Fund balances (deficit) at beginning of year	15,082	156,767	(81,828)	82,569	260,030	1,026	(52,149)	(251,998)	-	(113,588)	15,911	(736,120)
Fund balances (deficit) at end of year	\$ 13,115	\$ 150,726	\$ (48,839)	\$ 106,807	\$ 333,743	\$ 1,026	\$ (52,149)	\$ (251,998)	\$ -	\$ (117,599)	\$ 134,832	\$ 15,911

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Capital Projects Funds
September 30, 1999

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, 1999, 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, 1999
(With comparative totals as of September 30, 1998)**

	Compact Capital Projects	CFSM Capital Projects	TTG Capital Projects	Totals	
				1999	1998
<u>ASSETS</u>					
Cash-restricted	\$ 957,144	\$ -	\$ -	\$ 957,144	\$ 827,917
Investments	1,196,800	-	-	1,196,800	790,573
Equity investments	2,658,316	-	-	2,658,316	2,525,247
Receivables from U.S.					
Department of the Interior	-	-	502,440	502,440	502,440
Receivables from FSM National Government	-	465,997	-	465,997	1,674,996
Advances	199,971	84,517	14,264	298,752	297,804
Loans receivable, net	375,000	-	-	375,000	95,000
Due from other funds	728,088	-	336,703	1,064,791	2,142,670
Total assets	\$ 6,115,319	\$ 550,514	\$ 853,407	\$ 7,519,240	\$ 8,856,647
<u>LIABILITIES AND FUND BALANCES (DEFICIT)</u>					
Liabilities:					
Accounts payable	\$ 50,924	\$ 1,571	\$ 113,309	\$ 165,804	\$ 358,433
Accrued payroll and others	10,207	-	5,551	15,758	20,788
Due to other funds	-	598,867	411,412	1,010,279	2,216,202
Total liabilities	61,131	600,438	530,272	1,191,841	2,595,423
Fund balances (deficit):					
Reserved for:					
Related assets	3,990,460	-	-	3,990,460	3,220,247
Encumbrances	817,949	212,593	461	1,031,003	2,552,796
Continuing appropriations	260,214	258,336	764,260	1,282,810	2,467,487
Unreserved	985,565	(520,853)	(441,586)	23,126	(1,979,306)
Total fund balances (deficit)	6,054,188	(49,924)	323,135	6,327,399	6,261,224
Total liabilities and fund balances (deficit)	\$ 6,115,319	\$ 550,514	\$ 853,407	\$ 7,519,240	\$ 8,856,647

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, 1999
(With comparative totals for the year ended September 30, 1998)

	Compact Capital Projects	CFSM Capital Projects	TTG Capital Projects	Totals	
				1999	1998
Revenues:					
Compact of Free Association:					
Base amount	\$ 1,918,400	\$ -	\$ -	\$ 1,918,400	\$ 1,918,400
Inflation adjustment	1,016,752	-	-	1,016,752	1,016,752
U.S. Department of the					
Interior grants	-	-	-	-	227,854
FSM National Government contribution	-	499,545	-	499,545	405,976
Interest and investment income	14,611	-	-	14,611	-
Total revenues	2,949,763	499,545	-	3,449,308	3,568,982
Expenditures:					
Capital projects	2,834,657	499,545	-	3,334,202	2,514,662
Total expenditures	2,834,657	499,545	-	3,334,202	2,514,662
Excess of revenues over expenditures	115,106	-	-	115,106	1,054,320
Other financing sources (uses):					
Equity loss on investment	(48,931)	-	-	(48,931)	(40,771)
Total other financing sources (uses), net	(48,931)	-	-	(48,931)	(40,771)
Excess of revenues and other financing sources over expenditures and other financing uses	66,175	-	-	66,175	1,013,549
Fund balances (deficit) at beginning of year	5,988,013	(49,924)	323,135	6,261,224	5,247,675
Fund balances (deficit) at end of year	\$ 6,054,188	\$ (49,924)	\$ 323,135	\$ 6,327,399	\$ 6,261,224

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, 1999

(With comparative totals for the year ended September 30, 1998)

	Compact Capital Projects	CFSM Capital Projects	TTG Capital Projects	Totals	
				1999	1998
Revenues:					
Compact of Free Association:					
Base amount	\$ 1,918,400	\$ -	\$ -	\$ 1,918,400	\$ 1,918,400
Inflation adjustment	1,016,752	-	-	1,016,752	1,016,752
U.S. Department of the					
Interior grants	-	-	-	-	227,854
FSM National Government contribution	-	499,545	-	499,545	405,976
Interest and investment income	14,611	-	-	14,611	-
Total revenues	2,949,763	499,545	-	3,449,308	3,568,982
Expenditures:					
Personnel	159,687	81,656	-	241,343	418,464
Travel	41,454	19,714	-	61,168	113,445
Supplies and material	330,892	165,385	-	496,277	-
POL	3,548	-	-	3,548	17,807
Capital outlay	8,341	121,205	-	129,546	140,071
Contractual services	2,290,735	111,585	-	2,402,320	1,084,530
Other	-	-	-	-	740,345
Total expenditures	2,834,657	499,545	-	3,334,202	2,514,662
Excess of revenues over expenditures	115,106	-	-	115,106	1,054,320
Other financing sources (uses):					
Equity loss on investment	(48,931)	-	-	(48,931)	(40,771)
Total other financing sources (uses), net	(48,931)	-	-	(48,931)	(40,771)
Excess of revenues and other financing sources over expenditures and other financing uses	66,175	-	-	66,175	1,013,549
Fund balances (deficit) at beginning of year	5,988,013	(49,924)	323,135	6,261,224	5,247,675
Fund balances (deficit) at end of year	\$ 6,054,188	\$ (49,924)	\$ 323,135	\$ 6,327,399	\$ 6,261,224

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Component Units - Proprietary Funds
September 30, 1999

The Component Units - proprietary funds are legally separate organizations for which the elected officials of Kosrae State are financially accountable. Proprietary funds are used to account for a government's ongoing organizations and activities that are similar to those often found in the private sector. All assets, liabilities, equities, revenues, expenses and transfers relating to the government's business and quasi - business activities - where net income and capital maintenance are measured - are accounted for through proprietary funds. The generally accepted accounting principles here are generally those applicable to similar businesses in the private sector; the measurement focus is on determination of net income, financial position and cash flows. The State government's component units - proprietary funds are described below.

Kosrae Utilities Authority (KUA) was established by State Public Law 5-38. The primary purpose of the Corporation is to provide electrical services to the public through the operation and maintenance of the State's electric power system.

Micronesia 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.

Kosrae Community Action Program (KCAP) was incorporated in 1984 under FSM laws. The primary purpose of the Organization is to administer community based projects such as aluminum recycling project, etc.

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

COMPONENT UNITS
Combining Balance Sheet
Year Ended September 30, 1999

ASSETS	Proprietary Fund Types			Governmental Fund Type	Totals
	Kosrae Utilities Authority	Micronesia Petroleum Corporation	Total Proprietary Fund Types	Kosrae Community Action Program	
Cash and equivalents	\$ 1,684,288	\$ 150,417	\$ 1,834,705	\$ 1,014	\$ 1,835,719
Receivable - OMIP grant	60,283	-	60,283	-	60,283
Receivable - FSM National Government grant	2,284	-	2,284	-	2,284
Accounts receivable	489,579	841,046	1,330,625	52,702	1,383,327
Inventories	290,144	374,398	664,542	15,000	679,542
Prepayments	5,642	37,998	43,640	-	43,640
Fixed assets, net	5,116,598	3,238,404	8,355,002	-	8,355,002
Total assets	<u>\$ 7,648,818</u>	<u>\$ 4,642,263</u>	<u>\$ 12,291,081</u>	<u>\$ 68,716</u>	<u>\$ 12,359,797</u>
 LIABILITIES AND FUND EQUITY					
Liabilities:					
Accounts payable	\$ 25,897	\$ 1,366,036	\$ 1,391,933	\$ -	\$ 1,391,933
Accrued liabilities	39,570	37,470	77,040	-	77,040
Payable to Kosrae State Government	-	62,278	62,278	-	62,278
Notes payable	-	1,297,850	1,297,850	3,000	1,300,850
Total liabilities	<u>65,467</u>	<u>2,763,634</u>	<u>2,829,101</u>	<u>3,000</u>	<u>2,832,101</u>
Minority interest in subsidiary	<u>-</u>	<u>26,037</u>	<u>26,037</u>	<u>-</u>	<u>26,037</u>
Fund equity:					
Contributed capital	4,335,940	4,071,086	8,407,026	15,000	8,422,026
Retained earnings (deficit)	<u>3,247,411</u>	<u>(2,218,494)</u>	<u>1,028,917</u>	<u>50,716</u>	<u>1,079,633</u>
Total fund equity	<u>7,583,351</u>	<u>1,852,592</u>	<u>9,435,943</u>	<u>65,716</u>	<u>9,501,659</u>
Total liabilities and fund equity	<u>\$ 7,648,818</u>	<u>\$ 4,642,263</u>	<u>\$ 12,291,081</u>	<u>\$ 68,716</u>	<u>\$ 12,359,797</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

**COMPONENT UNITS
Combining Statement of Revenues, Expenses and Changes in Fund Equity
Year Ended September 30, 1999**

	Proprietary Fund Types			Governmental Fund Type Kosrae Community Action Program	Totals
	Kosrae Utilities Authority	Micronesia Petroleum Corporation	Total Proprietary Fund Types		
Operating revenues:					
Charges for services	\$ 1,190,818	\$ 8,548,879	\$ 9,739,697	\$ 92,160	\$ 9,831,857
Operating expenses:					
Cost of goods sold	-	7,945,012	7,945,012	-	7,945,012
Personnel services	416,055	328,427	744,482	-	744,482
Taxes	-	269,930	269,930	-	269,930
Travel	-	167,901	167,901	-	167,901
Supplies and materials	-	26,890	26,890	-	26,890
Fuel	663,037	-	663,037	-	663,037
Contractual services	-	152,389	152,389	-	152,389
Utilities	-	9,533	9,533	-	9,533
Communications	-	97,197	97,197	-	97,197
Depreciation	467,500	171,560	639,060	-	639,060
Administration and general	259,566	-	259,566	142,876	402,442
Repair and maintenance	61,186	70,847	132,033	-	132,033
Rent	-	15,000	15,000	-	15,000
Others	-	77,780	77,780	-	77,780
Total operating expenses	1,867,344	9,332,466	11,199,810	142,876	11,342,686
Operating loss	(676,526)	(783,587)	(1,460,113)	(50,716)	(1,510,829)
Nonoperating revenues (expenses):					
Operating transfers in	506,250	-	506,250	-	506,250
Interest income	73,914	-	73,914	-	73,914
Other income	68,104	82,206	150,310	-	150,310
Loss from subsidiary	-	(372,131)	(372,131)	-	(372,131)
Other expense	-	(131,916)	(131,916)	-	(131,916)
Total nonoperating revenues (expenses), net	648,268	(421,841)	226,427	-	226,427
Net loss	(28,258)	(1,205,428)	(1,233,686)	(50,716)	(1,284,402)
Add depreciation on fixed assets acquired by capital contributions that reduce contributed capital	384,172	113,832	498,004	-	498,004
Increase (decrease) in retained earnings (deficit)	355,914	(1,091,596)	(735,682)	(50,716)	(786,398)
Retained earnings (deficit) at beginning of year	2,891,497	(1,167,094)	1,724,403	101,432	1,825,835
Minority interest in subsidiary loss	-	40,196	40,196	-	40,196
Retained earnings (deficit) at end of year	3,247,411	(2,218,494)	1,028,917	50,716	1,079,633
Contributed capital at beginning of year	4,155,568	4,251,151	8,406,719	15,000	8,421,719
Contributions	564,544	-	564,544	-	564,544
Less depreciation on fixed assets acquired by capital contributions that reduce contributed capital	(384,172)	(113,832)	(498,004)	-	(498,004)
Minority interest in contributed capital	-	(66,233)	(66,233)	-	(66,233)
Contributed capital at end of year	4,335,940	4,071,086	8,407,026	15,000	8,422,026
Fund equity (deficiency) at end of year	\$ 7,583,351	\$ 1,852,592	\$ 9,435,943	\$ 65,716	\$ 9,501,659

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

**COMPONENT UNITS
Combining Statement of Cash Flows -
Year Ended September 30, 1999**

	<u>Proprietary Fund Types</u>		
	<u>Kosrae Utilities Authority</u>	<u>Micronesia Petroleum Corporation</u>	<u>Total Proprietary Fund Types</u>
Cash flows from operating activities:			
Operating loss	\$ (676,526)	\$ (783,587)	\$ (1,460,113)
Adjustment to reconcile operating loss to net cash used for operating activities:			
Depreciation	467,500	285,392	752,892
Other income	3,363	-	3,363
	<u>(205,663)</u>	<u>(498,195)</u>	<u>(703,858)</u>
Changes in assets and liabilities:			
General receivables, net	(102,410)	(488,187)	(590,597)
Inventory	(22,918)	(147,709)	(170,627)
Prepayments	(3,259)	(6,998)	(10,257)
Accounts payable	(29,848)	1,073,296	1,043,448
Accrued payroll and others	5,952	(8,491)	(2,539)
	<u>(152,483)</u>	<u>421,911</u>	<u>269,428</u>
Net cash used for operating activities	<u>(358,146)</u>	<u>(76,284)</u>	<u>(434,430)</u>
Cash flows from investing activities:			
Investment in subsidiary	-	20,470	20,470
Interest income	73,914	-	73,914
Net cash provided by investing activities	<u>73,914</u>	<u>20,470</u>	<u>94,384</u>
Cash flows from noncapital financing activities:			
Operating and other transfers in	570,991	-	570,991
Net cash provided by noncapital financing activities	<u>570,991</u>	<u>-</u>	<u>570,991</u>
Cash flows from capital and related financing activities:			
Additions to fixed assets	(981,130)	(129,059)	(1,110,189)
Proceeds from borrowing	-	271,450	271,450
Capital contributions	692,158	-	692,158
Net cash (used for) provided by capital and related financing activities	<u>(288,972)</u>	<u>142,391</u>	<u>(146,581)</u>
Net increase (decrease) in cash and equivalents	(2,213)	86,577	84,364
Cash and equivalents at beginning of year	<u>1,686,501</u>	<u>63,840</u>	<u>1,750,341</u>
Cash and equivalents at end of year	<u>\$ 1,684,288</u>	<u>\$ 150,417</u>	<u>\$ 1,834,705</u>

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Expendable Trust Funds
September 30, 1999

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. No financial statements for fiscal year 1999 were available from the Agriculture Revolving Fund.

Production Loan Fund

This fund accounts for low interest loans made to individuals.

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. No financial statements for fiscal year 1999 were available from the Tourism Revolving Fund.

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.

Early Retirement Fund

This fund accounts for the Asian Development Bank loan proceeds, retirement pay-out, and the loan repayments relating to the Early Retirement Program .

See Accompanying Independent Auditors' Report.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

**EXPENDABLE TRUST FUNDS
Combining Balance Sheet
September 30, 1999
(With comparative totals as of September 30, 1998)**

	Airport Trust	Production Loan	Scholarship Revolving Loan	Housing Revolving	Aluminum Recycling	Health Care Fund	Sports Council Fund	Early Retirement Program	Totals	
									1999	1998
<u>ASSETS</u>										
Cash and equivalents	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 191,860
Cash-restricted	-	-	-	-	-	-	-	1,348,629	1,348,629	-
General receivables, net	2,654	-	-	-	-	25,989	-	-	28,643	46,334
Advances	7,182	-	-	(8,824)	-	-	-	-	(1,642)	8,660
Loans receivable, net	-	-	-	432,251	-	-	-	-	432,251	455,944
Due from other funds	152,119	1,495	-	401,828	-	11,378	769	194,908	762,497	641,903
Total assets	\$ 161,955	\$ 1,495	\$ -	\$ 825,255	\$ -	\$ 37,367	\$ 769	\$ 1,543,537	\$ 2,570,378	\$ 1,344,701
<u>LIABILITIES AND FUND BALANCES</u>										
Liabilities:										
Accounts payable	\$ 5,632	\$ -	\$ 9,487	\$ 2,477	\$ -	\$ 636	\$ -	\$ -	\$ 18,232	\$ 67,946
Due to other funds	-	-	15,605	-	38,307	-	-	-	53,912	8,720
Total liabilities	5,632	-	25,092	2,477	38,307	636	-	-	72,144	76,666
Fund balances:										
Reserved for:										
Related assets	-	-	-	432,251	-	-	-	1,348,629	1,780,880	647,804
Encumbrances	9,295	-	-	235,344	-	40,292	-	252	285,183	213,199
Unreserved	147,028	1,495	(25,092)	155,183	(38,307)	(3,561)	769	194,656	432,171	407,032
Total fund balances	156,323	1,495	(25,092)	822,778	(38,307)	36,731	769	1,543,537	2,498,234	1,268,035
Total liabilities and fund balances	\$ 161,955	\$ 1,495	\$ -	\$ 825,255	\$ -	\$ 37,367	\$ 769	\$ 1,543,537	\$ 2,570,378	\$ 1,344,701

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, 1999
(With comparative totals for the year ended September 30, 1998)

	Airport Trust	Production Loan	Scholarship Revolving Loan	Housing Revolving	Aluminum Recycling	Health Care Fund	Sports Council Fund	Early Retirement Program	Totals	
									1999	1998
Revenues:										
Sales	\$ -	\$ -	\$ -	\$ -	\$ 58,478	\$ 43,253	\$ 350	\$ -	\$ 102,081	\$ 177,034
Other	77,430	-	3,111	222,812	-	-	-	-	303,353	1,325,265
Total revenues	77,430	-	3,111	222,812	58,478	43,253	350	-	405,434	1,502,299
Expenditures:										
Cost of sales	-	-	-	-	127,703	-	-	-	127,703	36,627
Others	75,250	-	9,996	153,701	-	84,555	98	147,549	471,149	1,264,808
Total expenditures	75,250	-	9,996	153,701	127,703	84,555	98	147,549	598,852	1,301,435
Excess (deficiency) of revenues over (under) expenditures	2,180	-	(6,885)	69,111	(69,225)	(41,302)	252	(147,549)	(193,418)	200,864
Other financing sources:										
Loan proceeds	-	-	-	-	-	-	-	1,200,000	1,200,000	-
Interest income	-	-	-	-	-	-	-	23,617	23,617	-
Operating transfer in	-	-	-	-	-	-	-	200,000	200,000	191,860
Total financing sources	-	-	-	-	-	-	-	1,423,617	1,423,617	191,860
Excess (deficiency) of revenues and other financing sources over (under) expenditures	2,180	-	(6,885)	69,111	(69,225)	(41,302)	252	1,276,068	1,230,199	392,724
Fund balances (deficit) at beginning of year	154,143	1,495	(18,207)	753,667	30,918	78,033	517	267,469	1,268,035	875,311
Fund balances (deficit) at end of year	\$ 156,323	\$ 1,495	\$ (25,092)	\$ 822,778	\$ (38,307)	\$ 36,731	\$ 769	\$ 1,543,537	\$ 2,498,234	\$ 1,268,035

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 Rensley A. Sigrah
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, 1999, and have issued our report thereon dated May 19, 2000, which report was qualified due to our inability to 1) assure ourselves as to the propriety of advances receivable of all Governmental Fund Types; inventories of the Proprietary Fund Types; loans receivable of the Fiduciary Fund Type; accounts payable for all fund types; and fixed assets of the General Fixed Assets Account Group; 2) obtain audited financial statements for the Kosrae Community Action Program, a Component Unit – Governmental Fund, the Micronesia Petroleum Corporation, a Component Unit – Proprietary Fund, and the Agriculture Revolving Fund, the Production Loan Fund and Tourism Revolving Fund, Fiduciary Fund Type – Expendable Trust Funds; and 3) examine evidence regarding the Governmental Fund Type – Capital Projects Fund investments in Kosrae Sea Ventures, Inc., SEMO Micronesia, and Pacific Tuna Industries. Except as discussed in the preceding sentence, 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

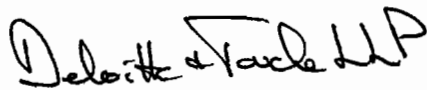
As part of obtaining reasonable assurance about whether State of Kosrae's general purpose financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material 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 instances of noncompliance that are required to be reported under *Government Auditing Standards*, which are described in the accompanying Schedule of Findings and Questioned Costs (pages 72 through 84) as finding numbers 99-2 and 99-5.

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 judgment, could adversely affect the State of Kosrae's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items 99-1 and 99-3 through 99-11.

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, of the reportable conditions described above, we consider items 99-3 through 99-11 to be material weaknesses.

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

A handwritten signature in black ink, appearing to read "Deloitte & Touche LLP", with a stylized flourish at the end.

May 19, 2000



**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 Rensley A. Sigrah
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, 1999. 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 72 through 84). 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 item 99-2 in the accompanying Schedule of Findings and Questioned Costs, the State of Kosrae did not comply with requirements regarding cash management for U.S. Department of Education TFAS Educational Grant (CFDA 84.256). Compliance with such requirements is necessary, in our opinion, for the State of Kosrae to comply with requirements applicable to that program.

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, 1999.

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.

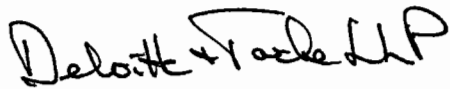
We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance 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 99-1, 99-2 and 99-5.

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, of the reportable conditions described above, we believe Finding 99-5 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, 1999, and have issued our report thereon dated May 19, 2000, which report was qualified due to our inability to 1) assure ourselves as to the propriety advances receivable of all Governmental Fund Types; inventories of the Proprietary Fund Types; loans receivable of the Fiduciary Fund Type; accounts payable for all fund types; and fixed assets of the General Fixed Assets Account Group; 2) obtain audited financial statements for the Kosrae Community Action Program, a Component Unit – Governmental Fund, the Micronesia Petroleum Corporation, a Component Unit – Proprietary Fund, and the Agriculture Revolving Fund, the Production Loan Fund and Tourism Revolving Fund, Fiduciary Fund Type – Expendable Trust Funds; and 3) examine evidence regarding the Governmental Fund Type – Capital Projects Fund investments in Kosrae Sea Ventures, Inc., SEMO Micronesia, and Pacific Tuna Industries. 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 54 through 68) 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 and accounts payable 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 and use of the management of the State of Kosrae, federal awarding agencies, pass-through entities, and the cognizant audit and other federal agencies, and is not intended to be, and should not be, used by anyone other than those specified parties.

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

May 19, 2000

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards
U.S. Federal and Other Assistance Fund
Year Ended September 30, 1999

Grantor Program Title	CFDA I.D. #	Kosrae Org. #	1999 Fiscal Year Expenditures
<u>U.S. Dept. of Education:</u>			
FY97 Special Education	84.027	3023	\$ 31,718
FY99 Special Education	84.027	3037	396,207
Total CFDA 84.027			427,925
FY98 Goal 2000 Program	84.276	3033	20,150
FY97 Goal 2000 Program	84.276	3029	12,400
Total CFDA 84.276			32,550
Total U.S. Department of Education			460,475
<u>U.S. Dept. of Labor:</u>			
FY95 School to Work	17.249	3164	29,197
FY95 School to Work	17.249	3181	12,720
Total CFDA #17.249			41,917
FY97 JTPA Administration	17.250	3172	285
FY97 JTPA Adult Program	17.250	3173	273
FY97 JTPA Youth Program	17.250	3174	2,375
FY97 JTPA Participant Support	17.250	3175	8,461
FY98 JTPA Elderly Program	17.250	3185	15,000
FY98 JTPA Administration	17.250	3188	13,376
FY98 JTPA Adult Program	17.250	3189	18,347
FY98 JTPA Youth Program	17.250	3190	7,708
FY98 JTPA Participant Support	17.250	3191	4,569
FY95 JTPA Adult Program	17.250	3204	274
Total CFDA #17.250			70,668
Total U.S. Department of Labor			112,585
<u>U.S. Dept. of Agriculture:</u>			
FY97 Forestry/Seedling	10.664	3311	30
FY97 Forestry/Urban Development	10.664	3312	745
FY98 Forestry/Urban Development	10.664	3314	199
FY98 Forestry	10.664	3136	13,904
FY98 Fire Prevention	10.664	3315	8,005
Total CFDA #10.664			22,883
Malem Wasterwater System	10.418		188,491
Total CFDA #10.418			188,491
Total U.S. Department of Agriculture			211,374

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, 1999

Grantor Program Title	CFDA I.D. #	Kosrae Org. #	1999 Fiscal Year Expenditures
<u>U.S. Dept. of Health and Human Services:</u>			
FY99 Tuberculosis & AIDS	93.116	3571	6,303
FY98 Tuberculosis & AIDS	93.116	3773	119
Total CFDA 93.116			6,422
FY99 Family Planning	93.217	3798	16,819
Total CFDA 93.217			16,819
FY99 Immunization	93.268	3570	13,538
FY98 Immunization	93.268	3769	2,154
Total CFDA 93.268			15,692
Expanding Internet	93.879	3567	750
Total CFDA 93.879			750
FY99 Aids Prevention	93.940	7530	6,493
FY98 Aids Prevention	93.940	3789	2,984
Total CFDA 93.940			9,477
FY98 Substance Abuse	93.959	3566	54,255
FY97 Substance Abuse	93.959	3756	4,206
Total CFDA 93.959			58,461
FY98 Diabetes Program	93.988	3564	5,892
Total CFDA 93.988			5,892
FY98 Preventive Health	93.991	3791	2,672
Total CFDA 93.991			2,672
FY98 MCH Program	93.994	3779	32,356
FY98 MCH Program/Dental	93.994	3780	1,048
FY97 MCH Program	93.994	3738	2,242
FY98 MCH Program	93.994	3781	5,274
Total CFDA 93.994			40,920
Total U.S. Department of Health and Human Services			157,105

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, 1999

Grantor Program Title	CFDA I.D. #	Kosrae Org. #	1999 Fiscal Year Expenditures
<u>U.S. Dept. of the Interior:</u>			
FY97 Historic Preservation	15.904	3460	6,319
FY97 Historic Special Project	15.904	3462	1,931
Historic Special Project	15.904	7523	10,176
Historic Administration	15.904	7524	33,870
Historic Special Project	15.904	7526	2,834
Historic Preservation Operation	15.904	7527	9,378
Total U.S. Department of Interior (CFDA #15.904)			64,508
<u>Federal Emergency Management Agency</u>			
FY98 HMGP FEMA Administration	83.519	3860	1,033
Total Federal Emergency Management Agency (CFDA #83.519)			1,033
Total federal and other assistance expenditures			\$ 1,007,080
Balance per the fund financial statements			\$ 1,049,726
TFAS grants transferred to Direct U.S. Grants fund	84.256	various	(41,680)
Vocational Education Improvement Prog. (PREL) grants transferred to Direct U.S. Grants fund	84.994	various	(14,870)
Forestry grant transferred from U.S. directl grants fund	10.664	3136	13,904
			\$ 1,007,080

Note: The above grants are received in a subgrantee capacity through the FSM 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
U.S. Direct Grants Fund
Year Ended September 30, 1999

Grantor Program Title	CFDA I.D. #	Kosrae Org. #	1999 Fiscal Year Expenditures
<u>U.S. Dept. of Education:</u>			
FY97 TFAS Educational Grant	84.256	5847	\$ 25,079
FY98-99 TFAS Educational Grant	84.256	5846	14,692
FY98-99 TFAS Educational Grant	84.256	5849	217,922
FY99-2000 TFAS Educational Grant	84.256	5848	1,909
FY99-2000 TFAS Educational Grant	84.256	5850	<u>129,267</u>
Total CFDA 84.256			<u>388,869</u>
FY96 Voc. Education Improvement Prog. (PREL)	84.994	3932	1,161
FY97 Voc. Education Improvement Prog. (PREL)	84.994	3938	185
FY98 Voc. Education Improvement Prog. (PREL)	84.994	3948	13,524
Voc. Education Improvement Prog. (PREL)	84.994	3958	<u>139,956</u>
Total CFDA 84.994			<u>154,826</u>
Total U.S. Department of Education			<u>\$ 543,695</u>
Balance per the fund financial statements			\$ 502,049
TFAS grants transferred from Federal grants assistance fund	84.256	various	41,680
Vocational Education Improvement Prog. (PREL) grants transferred from Federal grants assistance fund	84.994	various	14,870
FY99 Local Close-up grant transferred to CFSM CIP fund		3551	(1,000)
Forestry grant transferred to Federal grants assistance fund	10.664	3136	<u>(13,904)</u>
			<u>\$ 543,695</u>

Note: The above grants are received in a direct capacity from the U.S. Department of Education (TFAS grants (CFDA # 84.994)) and the the Pacific Regional Education Laboratory (PREL).

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, 1999

<u>Account Title</u>	<u>CFDA #</u>	<u>Kosrae Org. #</u>	<u>1999 Fiscal Year Expenditures</u>
South Pacific Commission Grants:			
Kosrae Anti Substance Abuse	N/A	7315	\$ <u>653</u>
UNICEF Grants:			
Family Food Nutrition Program	N/A	3959	<u>320</u>
Other Grants:			
FY96 Walung Water Project	N/A	3937	9,720
FY97 Mooring Buoy Project	N/A	3941	508
FY99 Police Equipments (China Grant)	N/A	3952	<u>13,000</u>
			<u>23,228</u>
Total Foreign Assistance Fund			\$ <u><u>24,201</u></u>

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

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, 1999

<u>Account Title</u>	<u>Kosrae Org. #</u>	<u>1999 Fiscal Year Expenditures</u>
Kosrae State Court	4612	\$ 47,862
Joint Law Enforcement	4632	65,884
FY94 Broiler Project	6900	9,076
FY98 Medical Referral	9570	54,128
FY96 CFSM Education	9588	4,688
FY97 School Improvement	9600	632
FY97 Chip Seal	9610	2,349
FY97 Tourism Development	9611	2,254
Medical Supplies	9612	2,860
Senior Citizens	9613	1,243
Completion Sports	9615	2,240
Tourism/Investment	9616	19,595
Youth Development Program	9617	9,168
Aging Seniors	9618	11,697
Women's Affair	9619	8,661
Sports Equipment	9620	21,415
Dev. Rev. Com.	9621	21,937
Kosrae Scholarship	9622	49,500
DOE Equipment/Sup.	9623	33,754
Tofol Market	9624	9,961
Causeway Market	9625	2,134
Pharmaceuticals	9626	46,277
KCAP Aluminum Recycling	9627	18,264
FY99 PTI	9629	23,531
Utwe-Walung Marine	9630	15,540
Law School Scholarship '99	9631	14,895
FY99 Local Close-up	3551	<u>1,000</u>
Total CFSM CIP		<u>\$ 500,545</u>
Balance per the fund financial statements		\$ 499,545
FY99 Local Close-up transferred from U.S. direct grants fund	3551	<u>1,000</u>
		<u>\$ 500,545</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, 1999

Grantor Account Title	CFDA I.D. #	Kosrae Org. #	1999 Fiscal Year Expenditures
<u>Office of Territorial and International Affairs</u>			
FY98 School Facilities O&M	15.875	3608	\$ 141,407
FY95 School Maintenance	15.875	7320	16,454
FY95 Reorg. DPW 2nd Year	15.875	7330	<u>20,117</u>
Total operations and maintenance grants fund			\$ <u><u>177,978</u></u>

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, 1999

Grantor Account Title	CFDA I.D. #	Kosrae Org. #	1999 Fiscal Year Expenditures
<u>Office of Territorial and International Affairs</u>			
Fisheries Development	15.875	6788	\$ 1,611
Municipal Office Upgrade	15.875	6797	3,355
State, CCM Extension	15.875	6816	4,429
K0005 '93 Housing Renovation	15.875	6822	135
FY93 Municipal Water System	15.875	6826	27,106
FY94 Education OMIP Matching	15.875	6841	9,351
FY94 Utwe Sewer System	15.875	6849	452,922
FY95 Trochus Development	15.875	6853	62
FY95 OMIP Matching/Education	15.875	6855	2,800
FY95 Cadastral Program	15.875	6858	345
FY95 Utwe Office Renovation	15.875	6862	4,485
FY94 Water Resource Development	15.875	6879	(1,739)
Road Development	15.875	6895	70,300
FY98 Project Administration	15.875	6902	603
FY98 New Classrooms	15.875	6903	239,843
FY98 Building Maintenance	15.875	6904	129,697
FY98 Consultancy	15.875	6906	(150)
FY98 Water Resource Development	15.875	6907	6,097
FY98 Food Processing Plant	15.875	6908	42,687
FY98 Waste Water Facility	15.875	6909	457,806
FY98 Circumferential Road & Maintenance	15.875	6910	117,357
Shore Protection/Restoration	15.870	6911	35,647
FY98 Lands. & Drainage	15.875	6912	12,278
FY98 Road Paving	15.875	6914	231,124
Micronesia SEMO Corporation	15.875	6917	182,000
FY99 Court Construction	15.875	6919	19,664
FY98 Utwe/Malem Road	15.875	6920	225,553
FY99 Circumferential Road	15.875	6921	1,922
FY99 Classroom Construction	15.875	6922	176,832
FY99 Water Supply Development	15.875	6923	3,805
FY99 Maintenance Program	15.875	6924	274,234
FY99 Manpower Development	15.875	6925	58,073
FY99 Land Acquisition	15.875	6926	64,131
Housing Renovation Escrow	15.875	6927	250,000
FY99 Project Administration	15.875	6968	29,104
FY99 Agriculture Program	15.875	6969	39,396
Tourism Development	15.875	6970	31,035
Hospital Construction & Maintenance	15.875	6971	1,725
Marine Resources	15.875	6972	61,032
Equity loss on investment	15.875	N/A	48,931
Total Compact of Free Association Capital Projects Fund - Section 211(a) Capital Accounts			\$ 3,315,588
Balance per the general purpose financial statements			\$ 2,883,588
Micronesia SEMO Corporation	15.875	6917	182,000
Housing Renovation Escrow	15.875	6927	250,000
			\$ 3,315,588

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 Insular Affairs (OIA), U.S. Department of the Interior and bear CFDA #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, 1999

Grantor Account Title	CFDA I.D. #	Kosrae Org. #	1999 Fiscal Year Expenditures
<u>Office of Insular Affairs</u>			
Medical Referral	15.875	2499	\$ <u>118,163</u>
 Total Compact of Free Association - Section 216(a)(2)			 \$ <u><u>118,163</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 Insular Affairs (OIA), 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, 1999

<u>Account Title</u>	<u>CFDA I.D. #</u>	<u>Kosrae Org. #</u>	<u>1999 Fiscal Year Expenditures</u>
FY95 Centralized Pol.	15.875	2819	\$ 39,519
FY97 Centralized Travel	15.875	2826	19,268
Civic Action Team	15.875	2855	<u>250,000</u>
 Total Compact of Free Association - Section 212(b)			 <u>\$ 308,787</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 Insular Affairs (OIA), 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, 1999

<u>Account Title</u>	<u>CFDA I.D. #</u>	<u>Kosrae Org. #</u>	<u>1999 Fiscal Year Expenditures</u>
FY99 Scholarship Grant	15.875	2679	\$ <u>128,165</u>
Total Compact of Free Association - Section 216(a)(3)			\$ <u><u>128,165</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 Insular Affairs (OIA), 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, 1999

Grantor Account Title	CFDA I.D. #	Kosrae Org. #	1999 Fiscal Year Expenditures
<u>Office of Insular Affairs</u>			
Health Special Block Program	15.875	2075	\$ 116,749
Education Special Block Program	15.875	2128	<u>760,218</u>
 Total Compact of Free Association - Section 221(b)			 <u>\$ 876,967</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 Insular Affairs (OIA), 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 reallocates 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, 1999

Account Title	CFDA I.D. #	Kosrae Org. #	1999 Fiscal Year Expenditures
Power Generation	15.875	2803	\$ 506,250
Governor Utility Billing	15.875	2807	10,400
Agriculture Utility Billing	15.875	2808	8,704
Commerce and Industry Utility Billing	15.875	2809	4,115
Fisheries Utility Billing	15.875	2810	2,997
Education Utility Billing	15.875	2811	42,935
Health Utility Billing	15.875	2812	34,800
T & U Utility Billing	15.875	2813	25,243
DOJ Utility Billing	15.875	2814	7,652
DOA Utility Billinh	15.875	2815	15,091
Broadcast Utility Billing	15.875	2816	3,302
DRC Utility Billing	15.875	2816	739
Land Commission Utility Billing	15.875	2830	835
Sports Utility Billing	15.875	2831	1,199
Total Compact of Free Association Section 214(b)			\$ 664,262
Balance per the fund financial statements			\$ 158,012
Transfer to Kosrae Utilities Authority	15.875	2803	506,250
			\$ 664,262

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 Insular Affairs (OIA), 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, 1999

<u>Account Title</u>	<u>Kosrae Org. #</u>	<u>CFDA I.D. #</u>	<u>1999 Fiscal Year Expenditures</u>
General Fund: Current Account	Various	15.875	\$ <u>3,350,088</u>

Note: These funds are made available by Title Two, Article I, Section 211(a) of the Compact of Free Association, and are disbursed thorough the Office of Insular Affairs (OIA), 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, 1999

(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. Federal Emergency Management Agency

(2) Summary of Significant Accounting Policies

A. Basis of Accounting

For purposes of this report, certain accounting procedures were followed which help illustrate the expenditures of the individual programs. All expenses and capital outlays are reported as expenditures on the modified accrual basis of accounting.

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 1999 Expenditures</u>
U.S. Department of the Interior:		
Compact of Free Association:		
Pass through from State of Kosrae		
Energy Program Funds, Section 214(c)	15.875	\$ 506,250
Operations and Maintenance, Direct from the U.S. Department of the Interior:		
OMIP-KOS-95-1, 2nd Year	15.875	14,660
OMIP-KOS-96-1, 3rd Year	15.875	41,393
OMIP-KOS-97-1, 4th Year	15.875	<u>8,688</u>
Total expenditures		\$ <u>570,991</u>

STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA

Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 1999

(3) Component Units, Continued

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, 1999

<u>Grantor Program Title</u>	<u>CFDA No.</u>	<u>1999 Fiscal Year Expenditures</u>
<u>Major Programs</u>		
<u>U.S. Dept. of the Interior</u>		
Compact of Free Association: 211(a) Capital Account	15.875	\$ 3,315,588
<u>U.S. Department of Education</u>		
TFAS Educational Grant	84.256	<u>388,869</u>
Total U.S. Federal program expenditures selected excluding Compact Section 211 (a) Current Account expenditures		\$ <u>3,704,457</u>
Total U.S. Federal program expenditures excluding Compact Section 211 (a) Current Account expenditures		\$ <u>7,140,685</u>
% of total U.S. Federal Program expenditures covered by Major Programs excluding Compact Section 211 (a) Current Account expenditures		<u>52%</u>

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs
Year Ended September 30, 1999

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, some of which are considered to be material weaknesses.
3. An 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, one of which is considered to be a material weakness.
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 – Capital Account	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>
99-3	Inventory	\$ -
99-4	Loans Receivable	-
99-5	General Fixed Assets Account Group	-
99-6	Expendable Trust Funds	-
99-7	Equity Investments	-
99-8	Travel Advances	-
99-9	Accounts Payable	-
99-10	Bank Reconciliation	-
99-11	Stale Dated Checks	-

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 1999

Part III - Federal Award Findings and Questioned Cost Section

<u>Reference Number</u>	<u>Findings</u>	<u>Questioned Costs</u>
99-1	Compact CIP Fund	\$ -
99-2	TFAS Educational Grant	-

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 1999

Federal Award Findings and Questioned Costs

<u>Program</u>	<u>Reason for Questioned Costs</u>	<u>Questioned Costs</u>						
99-1. Compact Capital Projects Fund- CFDA # 15.875	<p><u>Criteria:</u> A functioning system of internal control requires disbursements to be properly supported by original vendor invoices.</p> <p><u>Condition:</u> Of forty-four disbursements tested for compliance, we noted two instances where disbursements were supported by a photocopy of invoices:</p> <table><tr><td><u>APV #</u></td><td><u>Org. #</u></td></tr><tr><td>114508</td><td>6911</td></tr><tr><td>118059</td><td>6849</td></tr></table> <p><u>Cause:</u> The cause of this condition is unknown.</p> <p><u>Effect:</u> The effect of this condition is potential noncompliance with the Compact treaty.</p> <p><u>Recommendation:</u> We recommend that Kosrae State ensure that expenditures are supported by original invoices.</p>	<u>APV #</u>	<u>Org. #</u>	114508	6911	118059	6849	
<u>APV #</u>	<u>Org. #</u>							
114508	6911							
118059	6849							

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 1999

Federal Award Findings and Questioned Costs

<u>Program</u>	<u>Reason for Questioned Costs</u>	<u>Questioned Costs</u>
99-2. TFAS Educational Grant- CFDA # 84.256	<p><u>Criteria:</u> Kosrae State must follow procedures to ensure compliance with applicable grantor imposed cash management requirements.</p> <p><u>Condition:</u> Kosrae State Government did not follow procedures to ensure that cash on hand are for immediate use. We noticed cash drawdowns exceeded expenditures by approximately \$140,000 incurred during the year.</p> <p><u>Cause:</u> The cause of this condition is unknown.</p> <p><u>Effect:</u> The effect of this condition is potential noncompliance with federal rules and regulations.</p> <p><u>Recommendation:</u> We recommend that the Department of Administration implement procedures whereby the Administrator for Finance and Budget reviews all federal activities for compliance.</p>	

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 1999

Financial Statements Findings Section

Inventory

Finding No. 99-3

Criteria: The stock revolving fund inventory should be reconciled at the end of each fiscal year.

Condition: We found that the stock revolving fund ending inventory balance was higher than the physical count by \$10,136 as of September 30, 1999 .

Cause: The cause of this condition is unknown.

Effect: The effect of this condition is a misstatement of inventory balances.

Prior Year Status: The above condition was reported as a finding in the Single Audit of Kosrae State Government for the fiscal year ended September 30, 1998.

Recommendation: We recommend that the Department of Administration ensure that the stock revolving fund is reconciled at the end of each fiscal year.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 1999

Financial Statements Findings Section, Continued

Loans Receivable

Finding No. 99-4

Criteria: All government funds should be properly accounted for and reliable accounting records should be maintained to substantiate proper use of funds.

Condition: Detailed schedules of loans receivable for the expendable trust funds were not available for inspection.

Cause: The cause of this condition is necessary reconciliations have not been performed.

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

Prior Year Status: The above condition was reported as a finding in the Single Audit of Kosrae State Government for the fiscal year ended September 30, 1998.

Recommendation: We recommend that the Department of Administration ensure that the loan receivables are reconciled at the end of each fiscal year.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 1999

Financial Statements Findings Section, Continued

General Fixed Assets Account Group

Finding No. 99-5

Criteria: The General Fixed Assets Account Group should be reconciled at the end of each fiscal year. Additionally, biannual inventories of fixed assets are required by the Common Rule.

Condition: Detailed schedules of fixed assets were not available for inspection. In addition, the general ledger fixed asset balances have not been updated in recent years. Additionally, biennial inventories have not been performed as required by the Common Rule.

Cause: The cause of this condition is unknown.

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

Prior Year Status: The above condition was reported as a finding in the Single Audit of Kosrae State Government for the fiscal year ended September 30, 1998.

Recommendation: We recommend that the Department of Administration ensure that the General Fixed Assets Account Group is updated and reconciled to detailed property listings at the end of each fiscal year and the required inventories be performed.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 1999

Financial Statements Findings Section, Continued

Expendable Trust Funds

Finding No. 99-6

Criteria: All government funds should be properly accounted for and reliable accounting records should be maintained to substantiate proper use of the funds.

Condition: Financial statements for the Agriculture Revolving Fund, Production Loan Fund, and the Tourism Revolving Fund were not available.

Cause: The cause of this condition is unknown.

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

Prior Year Status: The above condition was reported as a finding in the Single Audit of Kosrae State Government for the fiscal year ended September 30, 1998.

Recommendation: We recommend that the Department of Administration ensure that all government funds are included in the general purpose financial statements.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 1999

Financial Statements Findings Section, Continued

Equity Investments

Finding No. 99-7

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

Condition: Unaudited financial statements for SEMO Micronesia, and no financial statements for Pacific Tuna Industries and Kosrae Sea Ventures were furnished in support of Kosrae State equity investments.

Cause: The cause of this condition is unknown.

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

Prior Year Status: The above condition was reported as a finding in the Single Audit of Kosrae State Government for the fiscal year ended September 30, 1998.

Recommendation: We recommend that the Department of Administration ensure that audited financial statements are furnished by its material investees at the end of each fiscal year.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 1999

Financial Statements Findings Section, Continued

Travel Advances

Finding No. 99-8

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 maintain detail subsidiary travel advance ledgers.

Cause: Travel advances have not been reconciled since the software application for travel advances was modified.

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

Prior Year Status: The above condition was reported as a finding in the Single Audit of Kosrae State Government for the fiscal year ended September 30, 1998.

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, 1999

Financial Statements Findings Section, Continued

Accounts Payable

Finding No. 99-9

Criteria: Detailed listings of accounts payable should be available to support general ledger control accounts.

Condition: Kosrae State could not provide the detail of accounts payable to support the 1999 fiscal year-end general ledger accounts payable balances.

Cause: There were no personnel assigned to reconcile accounts payable on a periodic basis.

Effect: We were unable to perform alternative procedures to mitigate the effect of this condition on the financial statements.

Prior Year Status: The above condition was reported as a finding in the Single Audit of Kosrae State Government for the fiscal year ended September 30, 1998.

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

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 1999

Financial Statements Findings Section, Continued

Bank Reconciliation

Finding No. 99-10

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

Condition: The Treasury fund was out of balance by nearly \$1,298,714 as of September 30, 1999. The out of balance condition was corrected through proposed audit adjustments.

Cause: Management has not been reviewing monthly bank reconciliations for accuracy.

Effect: The effect of this condition results in an unreconciled difference of \$28,584.

Prior Year Status: The above condition was reported as a finding in the Single Audit of Kosrae State Government for the fiscal year ended September 30, 1998.

Recommendation: We recommend that the Administrator for Division of Finance and Budget review and approve all monthly bank reconciliations for accuracy.

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 1999

Financial Statements Findings Section, Continued

Stale Dated Checks

Finding No. 99-11

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 \$386,220 of checks outstanding as of September 30, 1999 have been outstanding for over one year.

Cause: The outstanding checklist was not reviewed 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.

Prior Year Status: The above condition was reported as a finding in the Single Audit of Kosrae State Government for the fiscal year ended September 30, 1998.

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

**STATE OF KOSRAE
FEDERATED STATES OF MICRONESIA**

Unresolved Prior Years' Findings and Questioned Costs
Year Ended September 30, 1999

The following is a summary of unresolved questioned costs of the State of Kosrae as of September 30, 1999:

	Questioned Costs Set Forth in Prior Audit Report <u>1998</u>	Questioned Costs Resolved in Fiscal Year <u>1999</u>	Questioned Costs at <u>September 30, 1999</u>
Unresolved Questioned Costs FY 96	\$ 274,360	\$ 274,360 (1)	\$ -
Unresolved Questioned Costs FY 98	58,080	-	58,080
Unresolved Questioned Costs FY 99	<u>-</u>	<u>-</u>	<u>-</u>
	\$ <u>332,440</u>	\$ <u>274,360</u>	\$ <u>58,080</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.



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

Director Office: (691) 370-2000 / 3163/3170* Facsimile: (691) 370-2004
Division of Planning & Statistics: (691) 370-3163/3170
Division of Finance & Budget: (691) 370-3004/3170
Division of Personnel & Employment Services: (691) 370-3401/2
Division of Conservation & Engineering: (691) 370-3163

July 12, 2000

Mr. Simao Iehsi
Deloitte & Touche
P.O. Box 753
Kolonia, Pohnpei FM 96941

Dear Mr. Iehsi:

I am pleased to submit to you Kosrae State's documented responses and proposed corrective action plans for fiscal year 1999 Audit Report findings.

I thank you for the outstanding audit performed in spite of the time limitations imposed by new audit requirements. I also thank you for the opportunity given to us to review the report and I hope that our documented responses are justified and considered.

Sincerely,

A handwritten signature in black ink, appearing to read "Boldon P. Abraham".

Boldon P. Abraham
Director

Xc Governor/Lt. Governor, Kosrae State

**KOSRAE STATE GOVERNMENT
FISCAL YEAR 1999 SINGLE AUDIT FINDINGS**

I. FEDERAL AWARD FINDINGS (REASONS FOR QUESTION COSTS)

No. 99-1 Compact Project Fund – CFDA # 15.875

Criteria: A functioning system of internal control requires disbursements to be properly supported by original vendor's invoice.

Auditee Response: We agree to this finding

Corrective Action Plan: The Director of Administration & Finance, through internal directives, will ensure that expenditures are made only if supported by original invoices.

No. 99-2 TFAS Educational Grant – CFDA # 84.256

Criteria: Kosrae State must follow procedures to ensure compliance with applicable grantor imposed cash management requirements.

Auditee Response: We agree to this finding.

Corrective Action Plan: Effective immediately, the Department of Administration & Finance will give special attention and implement procedures whereby the Administrator of Finance closely reviews all federal draw-down activities for compliance. We are also discussing this in our regular federal program managers quarterly meetings.

II. FINANCIAL STATEMENTS FINDINGS

No. 99-3 Inventory

Criteria: The stock revolving fund inventory should be reconciled at the end of each fiscal year.

Auditee Response: We generally agree with this finding. However, as stated in prior year auditee response, and the fact that we are in the transition period for accounting system migration, we suspended charges and activities in the stock revolving fund until such time we have the inventory reconciliation mechanism set up in our new system.

Corrective Action Plan: The Director of Administration & Finance should ensure that all charges and activities in the stock revolving fund remain suspended while reconciliation activities are on-going until satisfactory outcome are achieved. This should be implemented immediately.

No. 99-4 Loans Receivable

Criteria: All government funds should be properly accounted for and reliable accounting records should be maintained to substantiate proper use of funds.

Auditee Response: We agree to this finding.

Corrective Action Plan: The Department of Administration & Finance will ensure that all loan receivables are reconciled at the end of each fiscal year. This will be done through the establishment of a loan receivable tracking mechanism in the new financial accounting system currently being implemented.

No. 99-5 General Fixed Assets Account Group

Criteria: The General Fixed Assets Account Group should be reconciled at the end of each fiscal year. Additionally, biannual inventories of fixed assets are required by the Common Rule.

Auditee Response: We agree to this finding generally. However, as mentioned in our previous year's response, we do have the complete and up-to-date listing and information on our fixed assets now, but the GFAAG module in the old accounting system was not utilized and functioned properly, thus created the difficulties in reconciliation activities.

Corrective Action Plan: The new financial accounting system will be able to account for the General Fixed Assets Account Group. This is also required in the new Financial Management Regulations, which became effective July 1, 2000.

No. 99-6 Expendable Trust Funds

Criteria: All government funds should be properly accounted for and reliable accounting records should be maintained to substantiate proper use of the funds.

Auditee Response: We agree with this finding.

Corrective Plan of Action: As mentioned in previous year's response, the Department of Administration will ensure, through a new financial management regulation, which became effective July 1, 2000, that all required expendable trust funds' financial statements are submitted on a regular basis as required.

No. 99-7 Equity Investments

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

Auditee Response: We generally agree with this finding. However, we would like to shed some understanding on the reasons why audited statements are difficult to get. The companies/joint ventures established in which the government owns equities, like any other new ventures in the federation, take time to grow, much less afford audit costs on their financial statements within their 2nd to 3rd year of existence.

Corrective Action Plan: The Department of Administration & Finance, in collaborations with the newly established Office of the State Public Auditor, will ensure that all financial statements in support of Kosrae State Equity Investments are audited and submitted at the end of each fiscal year.

No. 99-8 Travel Advances

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

Auditee Response: We agree to this finding.

Corrective Action Plan: The Director of Administration & Finance will ensure that the existing travel advance software application currently in use be reconciled and updated before the finalization of the next years' statements.

No. 99-9 Accounts Payables

Criteria: Detailed listings of accounts payable should be available to support general ledger control accounts.

Auditee Response: We agree to this finding.

Corrective Action Plan: As part of our on-going Financial Management Improvement Project (FMIP), accounts payables tracking and monitoring, which include detail listings of accounts payables, is an area identified to be included in the new financial accounting system. We will ensure that the newly installed financial accounting system will be able to perform this function.

No. 99-10 Bank Reconciliation

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

Auditee Response: We agree to this finding.

Corrective Plan of Action: The Director of Administration & Finance will ensure that bank reconciliation is done on a weekly basis.

No. 99-11 Stale Dated Checks

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.

Auditee Response: We agree with this finding.

Corrective Action Plan: The Director of Administration & Finance will ensure, through internal directive, that periodic review of outstanding checklist for stale dated checks done within the Department.