

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

YEAR ENDED SEPTEMBER 30, 2002

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

YEAR ENDED SEPTEMBER 30, 2002

INDEX

	<u>Page No.</u>
INDEPENDENT AUDITORS' REPORT, GENERAL PURPOSE FINANCIAL STATEMENTS AND ADDITIONAL INFORMATION	1 - 48
INDEPENDENT AUDITORS' REPORTS ON INTERNAL CONTROL AND ON COMPLIANCE	49 - 86

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Table of Contents
Year Ended September 30, 2002

	<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 (Deficit) - All Governmental Fund Types and Expendable Trust Fund	5
Statement of Revenues, Expenditures and Changes in Unreserved Fund Balance, Budget and Actual, Budgetary Basis - General Fund	6
Combined Statement of Revenues, Expenses and Changes in Fund Equity - 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 Fund	30
General Fund:	
Introduction to the General Fund	31
Balance Sheet	32
Statement of Revenues, Expenditures by Account and Changes in Fund Balance	33
Statement of Revenues, Expenditures by Function and Department and Changes in Fund Balance	34
Special Revenue Funds:	
Introduction to the Special Revenue Funds	36
Combining Balance Sheet	38
Combining Statement of Revenues, Expenditures by Function and Changes in Fund Balances (Deficit)	39
Combining Statement of Revenues, Expenditures by Account and Changes in Fund Balances (Deficit)	40

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Table of Contents, Continued
Year Ended September 30, 2002

	<u>Page No.</u>
III. Additional Information, Continued	
Capital Projects Funds:	
Introduction to the Capital Projects Funds	41
Combining Balance Sheet	42
Combining Statement of Revenues, Expenditures by Function and Changes in Fund Balances (Deficit)	43
Combining Statement of Revenues, Expenditures by Account and Changes in Fund Balances (Deficit)	44
Component Units-Proprietary Funds:	
Introduction to the Component Units-Proprietary Funds	45
Combining Balance Sheet	46
Combining Statement of Revenues, Expenses and Changes in Fund Equity	47
Combining Statement of Cash Flows	48
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 Government Auditing Standards	49
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	51
Schedule of Expenditures of Federal Awards	53
Notes to Schedule of Expenditures of Federal Awards	60
Pohnpei Utilities Corporation Schedule of Expenditures of Federal Awards	62
Schedule of Programs Selected for Audit in Accordance with OMB Circular A-133	63
Schedule of Findings and Questioned Costs	64
Summary Schedule of Prior Audit Findings and Questioned Costs	86

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

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

YEAR ENDED SEPTEMBER 30, 2002

INDEPENDENT AUDITORS' REPORT

Honorable Johnny P. David
Governor, State of Pohnpei
Federated States of Micronesia:

We have audited the accompanying general purpose financial statements of the State of Pohnpei, as set forth in Section II of the foregoing table of contents, as of September 30, 2002, and for the year then ended. These general purpose financial statements are the responsibility of the management of the State of Pohnpei. Our responsibility is to express an opinion on these general purpose financial statements based on our audit. We did not audit the financial statements of the Small Business Guarantee and Finance Corporation, which represent 3% and 0.1%, respectively, of the assets and revenues of the Component Units – Proprietary Funds. Those statements were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for the Component Unit – Proprietary Funds, is based solely on the report of the other auditors.

Except as discussed in the following paragraphs, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the general purpose financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the general purpose financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall general purpose financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

The general purpose financial statements referred to above do not include the Pohnpei Economic Development Authority, the Pohnpei Fisheries Corporation and the Pohnpei State Housing Authority, Component Units - Proprietary Funds, which, in our opinion, should be included to conform with accounting principles generally accepted in the United States of America.

The general purpose financial statements referred to above include unaudited financial statements supporting the financial activities of the Pohnpei Transportation Authority which comprises the Proprietary Fund Type – Enterprise Fund.

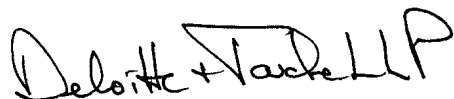
We were not able to apply sufficient alternative procedures to assure ourselves as to the propriety of cash and cash equivalents, advances receivable, accounts payable, expenditures and continuing appropriations for all Governmental Fund Types, and accounts payable and related expenses of the Pohnpei Port Authority, a Component Unit – Proprietary Fund as of and for the year ended September 30, 2002.

The State of Pohnpei has not adequately updated its General Fixed Assets Account Group during the year ended September 30, 2002, 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.

In our opinion, based on our audit and the report of the other auditors, 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 cash and cash equivalents, advances receivable, accounts payable, expenditures, and continuing appropriations of all Governmental Fund Types, accounts payable and related expenses of the Pohnpei Port Authority, a Component Unit – Proprietary Fund, and the correctness of the balances recorded in the General Fixed Assets Account Group; 2) obtain the financial statements of the Pohnpei Economic Development Authority, the Pohnpei Fisheries Corporation and the Pohnpei State Housing Authority, Component Units – Proprietary Funds; and 3) obtain the audited financial statements of the Pohnpei Transportation Authority, a Proprietary Fund Type – Enterprise Fund, as discussed in the third through sixth paragraphs above, such general purpose financial statements, as set forth in Section II of the table of contents, with the exception of the General Fixed Assets Account Group upon which we are unable to express an opinion because of the matters set forth in the sixth paragraph above, present fairly, in all material respects, the financial position of the State of Pohnpei as of September 30, 2002, and the results of its operations and the cash flows of its proprietary fund types for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the general purpose financial statements taken as a whole. The combining and individual fund financial statements and schedules listed in Section III of the foregoing table of contents, which are also the responsibility of the management of the State of Pohnpei, are presented for purposes of additional analysis and are not a required part of the general purpose financial statements of the State of Pohnpei. Such additional 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 matters specified in the third through fifth paragraphs above, 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 September 2, 2003, on our consideration of the State of Pohnpei'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 that reads "Deloitte + Stacke LLP". The signature is written in a cursive, stylized font.

September 2, 2003

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Combined Balance Sheet - All Fund Types, Account Groups and Discretely Presented Component Unit
September 30, 2002
(With comparative totals as of September 30, 2001)

	Governmental Fund Type:				Proprietary	Fiduciary	Account Groups		Totals	Component	Totals	
	General	Special	Capital	Debt	Enterprise	Expendable	General	General	Primary		Units	Reporting
		Revenue	Projects	Service		Trust	Fixed	Long-Term	Government	Proprietary	Entity	
						Assets	Debt	(Memorandum		(Memorandum Only)		
								Only)		2002	2001	
ASSETS												
Cash and cash equivalents	\$ 1,007,749	\$ 383,518	\$ 488,524	\$ -	\$ -	\$ -	\$ -	\$ 1,879,791	\$ 2,536,322	\$ 4,416,113	\$ 4,706,775	
Cash - restricted	559,791	-	792,600	2,933,005	-	-	-	4,285,396	417,261	4,702,657	6,345,244	
Investments	4,399,400	1,747,170	5,396,958	-	-	-	-	11,543,528	-	11,543,528	5,625,947	
Investments - other	-	-	-	-	-	-	-	-	474,511	474,511	542,429	
Receivables from other governments	1,408,644	2,499,891	562,895	-	14,201	-	-	4,485,631	-	4,485,631	4,184,181	
Receivables, federal agencies	-	2,168,668	200,419	-	-	-	-	2,369,087	292	2,369,379	1,253,006	
General receivables, net	45,526	3,928	30,344	-	607,031	1,851	-	688,680	4,041,715	4,730,395	3,354,747	
Taxes and leases receivable	2,034,915	-	-	-	-	-	-	2,034,915	-	2,034,915	2,034,915	
Allowance for uncollectibles	(2,034,915)	-	-	-	-	-	-	(2,034,915)	-	(2,034,915)	(2,034,915)	
Interest receivable	24,227	-	-	-	-	-	-	24,227	10,097	34,324	168,132	
Advances	390,367	486,913	121,539	-	-	10,676	-	1,009,495	14,027	1,023,522	1,000,643	
Loans receivable, net	-	-	2,544,697	-	-	-	-	2,544,697	16,445	2,561,142	2,560,510	
Due from other funds	2,184,241	2,389,064	3,508,555	42,473	-	-	-	8,124,333	-	8,124,333	7,265,085	
Inventory	8,806	43,100	-	-	246,559	-	-	298,465	1,148,320	1,446,785	1,613,479	
Self insurance fund	-	-	-	-	-	-	-	-	123,390	123,390	121,331	
Scholarship fund	-	-	-	-	-	-	-	-	3,881	3,881	3,881	
Prepayments and other assets	-	-	-	-	-	-	-	-	44,445	44,445	42,100	
Fixed assets, net	-	-	-	-	940,543	-	49,323,802	50,264,345	35,682,109	85,946,454	89,591,523	
Amount available in debt service fund	-	-	-	-	-	-	2,975,478	2,975,478	-	2,975,478	2,777,682	
Amount to be provided for retirement of long-term debt	-	-	-	-	-	-	2,151,853	2,151,853	-	2,151,853	2,705,650	
Due from primary government	-	-	-	-	-	-	-	-	-	-	4,313	
Total assets	\$ 10,028,751	\$ 9,722,252	\$ 13,646,531	\$ 2,975,478	\$ 1,808,334	\$ 12,527	\$ 49,323,802	\$ 5,127,331	\$ 92,645,006	\$ 44,512,815	\$ 137,157,821	\$ 133,866,658

See accompanying notes to financial statements

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Combined Balance Sheet - All Fund Types, Account Groups and Discretely Presented Component Units, Continue
September 30, 2002
(With comparative totals as of September 30, 2001)

	Governmental Fund Type:				Proprietary	Fiduciary	Account Groups		Totals	Component Units Proprietary	Totals		
	General	Special Revenue	Capital Projects	Debt Service	Enterprise	Expendable Trust	General	General	Primary		Reporting Entity (Memorandum Only)	2002	2001
							Fixed Assets	Long-Term Debt	Government (Memorandum Only)				
LIABILITIES AND FUND EQUITY (DEFICIENCY)													
Liabilities:													
Accounts payable	\$ 121,081	\$ 299,750	\$ 36,745	\$ -	\$ 271,435	\$ 8,653	\$ -	\$ -	\$ 737,664	\$ 729,808	\$ 1,467,472	\$ 3,964,341	
Accrued payroll and others	910,470	195,435	2,958	-	21,288	167	-	-	1,130,318	485,993	1,616,311	1,331,604	
Due to other funds	1,597,043	4,814,964	1,021,630	-	603,997	86,699	-	-	8,124,333	-	8,124,333	7,265,085	
Deferred revenue	-	-	-	-	5,100	-	-	-	5,100	394,285	399,385	374,563	
Notes payable	-	-	-	-	-	-	-	4,200,000	4,200,000	2,180,962	6,380,962	9,281,790	
Vacation leave accrual	-	-	-	-	-	-	-	527,331	527,331	-	527,331	527,332	
Other payables	1,758,816	-	-	-	-	-	-	400,000	2,158,816	-	2,158,816	2,514,816	
Total liabilities	4,387,410	5,310,149	1,061,333	-	901,820	95,519	-	5,127,331	16,883,562	3,791,048	20,674,610	25,259,531	
Contingencies and commitments													
Fund equity (deficiency):													
Investment in general fixed assets	-	-	-	-	-	-	49,323,802	-	49,323,802	-	49,323,802	49,323,802	
Retained earnings	-	-	-	-	906,514	-	-	-	906,514	40,721,767	41,628,281	39,204,107	
Fund balances (deficit):													
Reserved for:													
Related assets	6,739,917	265,757	4,337,297	-	-	-	-	-	11,342,971	-	11,342,971	7,962,722	
Encumbrances	637,284	1,634,960	2,105,725	-	-	-	-	-	4,377,969	-	4,377,969	4,530,227	
Continuing appropriations	97,340	-	6,956,925	-	-	-	-	-	7,054,265	-	7,054,265	7,006,265	
Long-term debt	-	-	-	2,975,478	-	-	-	-	2,975,478	-	2,975,478	2,777,682	
Unreserved fund balance (deficit)	(1,833,200)	2,511,386	(814,749)	-	-	(82,992)	-	-	(219,555)	-	(219,555)	(2,197,678)	
Total fund equity (deficiency)	5,641,341	4,412,103	12,585,198	2,975,478	906,514	(82,992)	49,323,802	-	75,761,444	40,721,767	116,483,211	108,607,127	
Total liabilities and fund equity (deficiency)	\$ 10,028,751	\$ 9,722,252	\$ 13,646,531	\$ 2,975,478	\$ 1,808,334	\$ 12,527	\$ 49,323,802	\$ 5,127,331	\$ 92,645,006	\$ 44,512,815	\$ 137,157,821	\$ 133,866,658	

See accompanying notes to financial statements

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Combined Statement of Revenues, Expenditures and Changes in Fund Balances (Deficit)
All Governmental Fund Types and Expendable Trust Fund
Year Ended September 30, 2002
(With Comparative Totals for the Year Ended September 30, 2001)

	Governmental Fund Types				Fiduciary Fund Type	Totals Reporting Entity (Memorandum Only)	
	General	Special Revenue	Capital Projects	Debt Service	Expendable Trust	2002	2001
Revenues:							
Compact of Free Association:							
Base grant	\$ 7,112,100	\$ 3,181,116	\$ 5,123,933	\$ -	\$ -	\$ 15,417,149	\$ 12,971,783
Inflation adjustment	4,125,018	541,333	2,971,881	-	-	7,638,232	6,005,440
Revenue sharing	5,219,889	-	2,087,957	-	-	7,307,846	6,387,377
Net increase (decrease) in the fair value of investments	(373,631)	-	16,846	(400,204)	-	(756,989)	(1,422,338)
Interest income	13,242	-	-	-	-	13,242	71,627
Federal grants	-	3,400,199	-	-	-	3,400,199	3,141,682
Taxes and licenses	2,150,178	383,323	-	-	-	2,533,501	2,756,962
Fines and penalties	292,773	-	-	-	-	292,773	141,647
Public service charges	3,789	-	-	-	-	3,789	26,296
CFSM grants	-	839,048	-	-	-	839,048	1,247,203
Other	112,657	220,594	-	-	43,770	377,021	511,085
Total revenues	18,656,015	8,565,613	10,200,617	(400,204)	43,770	37,065,811	31,838,764
Expenditures:							
General government	5,321,254	1,440,953	-	-	-	6,762,207	5,936,124
Education	4,087,550	4,209,661	-	-	-	8,297,211	8,028,483
Health services	3,305,837	1,252,588	-	-	-	4,558,425	4,158,783
Land and natural resources	370,152	-	-	-	27,619	397,771	453,806
Public works	-	708,983	-	-	-	708,983	1,761,579
Public safety	988,904	98,763	-	-	-	1,087,667	1,090,928
Boards, commissions and other appropriations	873,638	-	-	-	-	873,638	947,714
Capital projects	-	-	7,194,654	-	-	7,194,654	5,872,420
Municipal governments	1,999,808	-	-	-	-	1,999,808	1,954,380
Repayment of notes payable	-	-	-	-	-	-	2,640,000
Other expenditures	-	-	-	42,000	-	42,000	106,283
Other	-	10,831	-	-	-	10,831	29,893
Total expenditures	16,947,143	7,721,779	7,194,654	42,000	27,619	31,933,195	32,980,393
Excess (deficiency) of revenues over (under) expenditures	1,708,872	843,834	3,005,963	(442,204)	16,151	5,132,616	(1,141,629)
Other financing sources (uses):							
Transfers in	-	460,450	-	640,000	-	1,100,450	1,471,075
Transfers out	(192,232)	(570,849)	-	-	-	(763,081)	(1,608,394)
Total other financing sources (uses), net	(192,232)	(110,399)	-	640,000	-	337,369	(137,319)
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	1,516,640	733,435	3,005,963	197,796	16,151	5,469,985	(1,278,948)
Fund balances (deficit) at beginning of year, as restated	4,124,701	3,678,668	9,579,235	2,777,682	(99,143)	20,061,143	21,358,166
Fund balances (deficit) at end of year	\$ 5,641,341	\$ 4,412,103	\$ 12,585,198	\$ 2,975,478	\$ (82,992)	\$ 25,531,128	\$ 20,079,218

See accompanying notes to financial statements

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Statement of Revenues, Expenditures and Changes in Unreserved Fund Balance
Budget and Actual, Budgetary Basis - General Fund
Year Ended September 30, 2002

	<u>Budget</u>	<u>Actual</u>	Variance Favorable <u>(Unfavorable)</u>
Revenues:			
Compact	\$ 8,704,080	\$ 11,237,118	\$ 2,533,038
Local revenues	6,845,000	7,792,528	947,528
Net increase (decrease) in the fair value of investments	<u>946,583</u>	<u>(373,631)</u>	<u>(1,320,214)</u>
Total revenues	<u>16,495,663</u>	<u>18,656,015</u>	<u>2,160,352</u>
Expenditures:			
General government	5,498,391	5,542,106	(43,715)
Health services	3,452,204	3,313,286	138,918
Education	4,193,048	4,087,788	105,260
Public safety	988,904	985,278	3,626
Resources and development	424,552	390,555	33,997
Boards, commissions and other external appropriations	835,587	697,514	138,073
Municipal governments	<u>2,002,650</u>	<u>1,999,807</u>	<u>2,843</u>
Total expenditures, budgetary basis	<u>17,395,336</u>	<u>17,016,334</u>	<u>379,002</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(899,673)</u>	<u>1,639,681</u>	<u>2,539,354</u>
Other financing sources (uses):			
Operating transfers out	<u>(123,844)</u>	<u>(192,232)</u>	<u>(68,388)</u>
Total other financing sources (uses), net	<u>(123,844)</u>	<u>(192,232)</u>	<u>(68,388)</u>
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	(1,023,517)	1,447,449	2,470,966
Unreserved fund balance at beginning of year	(35,920)	(35,920)	-
Other changes in unreserved fund balance: Increase in reserve for related assets	<u>-</u>	<u>(3,244,729)</u>	<u>(3,244,729)</u>
Unreserved fund balance at end of year	<u><u>\$ (1,059,437)</u></u>	<u><u>\$ (1,833,200)</u></u>	<u><u>\$ (773,763)</u></u>

See accompanying notes to financial statements.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Combined Statement of Revenues, Expenses, and Changes in Fund Equity -
All Proprietary Fund Types and Discretely Presented Component Units
Year Ended September 30, 2002
(With comparative totals for the year ended September 30, 2001)

	Proprietary Fund Types	Totals Primary Government (Memorandum Only)	Component Units	Totals Reporting Entity (Memorandum Only)	
	Enterprise		Proprietary	2002	2001
Operating revenues:					
Charges for goods and services	\$ 2,281,336	\$ 2,281,336	\$ 7,993,188	\$ 10,274,524	\$ 12,889,100
Rental income	-	-	258,528	258,528	248,113
Other	294,415	294,415	15,670	310,085	542,689
Total operating revenues	2,575,751	2,575,751	8,267,386	10,843,137	13,679,902
Operating expenses:					
Cost of sales	2,498,082	2,498,082	-	2,498,082	3,627,079
Personnel services	-	-	2,168,789	2,168,789	2,281,771
Travel	-	-	97,739	97,739	97,536
Supplies and materials	-	-	169,384	169,384	224,701
Fuel	-	-	3,214,133	3,214,133	3,571,797
Contractual services	-	-	20,857	20,857	11,179
Bad debts	-	-	39,597	39,597	998,920
Utilities	-	-	56,591	56,591	36,984
Communications	-	-	59,474	59,474	57,798
Depreciation	-	-	2,976,070	2,976,070	2,640,224
Repairs and maintenance	-	-	491,985	491,985	724,009
Employee benefits	-	-	433,356	433,356	501,845
Training and safety	-	-	56,663	56,663	86,366
Other	-	-	352,667	352,667	501,086
Total operating expenses	2,498,082	2,498,082	10,137,305	12,635,387	15,361,295
Operating income (loss)	77,669	77,669	(1,869,919)	(1,792,250)	(1,681,393)
Nonoperating revenues (expenses):					
Federal grants and subsidies	-	-	434,132	434,132	-
Interest income (expense)	-	-	(8,350)	(8,350)	93,306
Spurline projects	-	-	29,569	29,569	127,207
Loss on investment	-	-	(67,918)	(67,918)	-
Recovery of bad debts	-	-	1,647,946	1,647,946	-
Other	-	-	(53,774)	(53,774)	(111,419)
Total nonoperating revenues (expenses), net	-	-	1,981,605	1,981,605	109,094
Net income (loss)	77,669	77,669	111,686	189,355	(1,572,299)
Retained earnings at beginning of year	828,845	828,845	40,610,081	41,438,926	40,776,406
Retained earnings at end of year	<u>\$ 906,514</u>	<u>\$ 906,514</u>	<u>\$ 40,721,767</u>	<u>\$ 41,628,281</u>	<u>\$ 39,204,107</u>

See accompanying notes to financial statements.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Combined Statement of Cash Flows
All Proprietary Fund Types and Discretely Presented Component Units
Year Ended September 30, 2002
(With comparative totals for the year ended September 30, 2001)

	Totals		Component Units	Totals	
	Proprietary Fund Types	Primary Government (Memorandum Only)		Reporting Entity (Memorandum Only)	Reporting Entity (Memorandum Only)
	Enterprise		Proprietary	2002	2001
Cash flows from operating activities:					
Operating income (loss)	\$ 77,669	\$ 77,669	\$ (1,869,919)	\$ (1,792,250)	\$ (1,590,225)
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:					
Depreciation	-	-	2,976,070	2,976,070	3,186,583
Bad debts	-	-	39,597	39,597	998,920
Other income	-	-	1,601,824	1,601,824	(48,134)
Non-operating expenses, net	-	-	(53,839)	(53,839)	(640,409)
Prior year adjustment	-	-	619	619	-
	<u>77,669</u>	<u>77,669</u>	<u>2,694,352</u>	<u>2,772,021</u>	<u>1,906,735</u>
Changes in assets and liabilities:					
General receivables	-	-	(1,470,763)	(1,470,763)	(954,134)
Advances	-	-	10,409	10,409	(9,702)
Investments	-	-	(8,421)	(8,421)	-
Loans receivable	-	-	(633)	(633)	12,207
Due from other funds	(78,916)	(78,916)	-	(78,916)	(1,269,977)
Inventory	-	-	79,473	79,473	10,038
Prepaid expenses and other assets	-	-	(2,757)	(2,757)	21,760
Other receivables	-	-	133,809	133,809	(56,077)
Due from primary government	-	-	4,313	4,313	-
Accounts payable	(3,548)	(3,548)	24,833	21,285	527,600
Accrued payroll and others	4,795	4,795	(58,736)	(53,941)	44,936
Deferred revenue	-	-	24,822	24,822	3,021
Other payables	-	-	(2,024)	(2,024)	-
	<u>(77,669)</u>	<u>(77,669)</u>	<u>(1,265,675)</u>	<u>(1,343,344)</u>	<u>(1,670,328)</u>
Net cash provided by operating activities	<u>-</u>	<u>-</u>	<u>1,428,677</u>	<u>1,428,677</u>	<u>236,407</u>
Cash flows from noncapital financing activities:					
Proceeds from notes payable, net	-	-	639,322	639,322	594,976
Operating grants received	-	-	475,376	475,376	-
Other noncapital financing activities	-	-	179	179	660,346
Spurline projects	-	-	29,569	29,569	127,207
Net cash provided by noncapital financing activities	<u>-</u>	<u>-</u>	<u>1,144,446</u>	<u>1,144,446</u>	<u>1,382,529</u>
Cash flows from capital and related financing activities:					
Acquisition of fixed assets	-	-	(2,069,606)	(2,069,606)	(1,702,764)
Repayment of debt	-	-	(41,128)	(41,128)	(95,167)
Proceeds from sale of fixed assets	-	-	2,100	2,100	-
Net cash used in capital and related financing activities	<u>-</u>	<u>-</u>	<u>(2,108,634)</u>	<u>(2,108,634)</u>	<u>(1,797,931)</u>
Cash flows from investing activities:					
Payment to self-insurance and scholarship funds, net	-	-	(2,059)	(2,059)	(5,699)
Increase in time certificate of deposit	-	-	(100,000)	(100,000)	-
Interest income	-	-	37,772	37,772	12,710
Decrease in PUC sinking fund, restricted investments	-	-	-	-	59,864
Other	-	-	-	-	1,002,370
Net cash provided by (used in) investing activities	<u>-</u>	<u>-</u>	<u>(64,287)</u>	<u>(64,287)</u>	<u>1,069,245</u>
Net increase in cash and cash equivalents	-	-	400,202	400,202	890,250
Cash and cash equivalents at beginning of year	-	-	2,136,120	2,136,120	1,276,109
Cash and cash equivalents at end of year	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,536,322</u>	<u>\$ 2,536,322</u>	<u>\$ 2,166,359</u>

See accompanying notes to financial statements.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2002

(1) Summary of Significant Accounting Policies

The general purpose financial statements of Pohnpei State have been prepared in conformity with accounting principles generally accepted in the United States of America (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 Pohnpei State's accounting policies are described below.

A. Reporting Entity

The general purpose financial statements of the State of Pohnpei have been prepared in conformity with GAAP as applied to government units. 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 Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989. The State of Pohnpei has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

As required by GAAP, the general purpose financial statements of the State of Pohnpei 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. Each blended and discretely presented component unit has a September 30 year end.

1. Blended Component Units

The Pohnpei Transportation Authority (PTA) is responsible to promote, develop, and improve transportation facilities of Pohnpei State. PTA was established in fiscal year 1969 by State Law No. 169-69 and is governed by a Board of Directors appointed by the Governor. PTA is reported as an enterprise fund as substantially all of its services are provided on behalf of the primary government. PTA is the only enterprise fund of the State.

2. Discretely Presented Component Units

a) The Pohnpei Port Authority was established by Public Law 2L-224-91. The primary purpose of the Authority is to oversee the use and maintenance of Pohnpei State's sea and air ports. The Authority began operating as a separate entity in fiscal year 1993 although accounting for the Authority was not transferred from the Pohnpei State Department of Treasury until January 1994.

The affairs of the Authority are managed by a seven-member board, consisting of representatives of the Pohnpei State Government appointed by the Governor to four year terms. Daily operation of the Authority is delegated to a General Manager, who is appointed by and serves at the pleasure of the Board.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2002

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

2. Discretely Presented Component Units, Continued

- b) The Pohnpei Utilities Corporation (the Corporation) was established in 1991 by State Law No. 2L-179-91. The primary purpose of the Corporation is to provide electrical, water and sewer services to the people of Pohnpei through the operation of the electric power, water and sewer systems. The affairs of the Corporation are managed by a seven member board appointed by the Governor with the advice and consent of the Legislature.
- c) The Small Business Guarantee and Finance Corporation was established by State Law No. 3L-86-95 to provide, promote, develop and widen in both scope and services reach various alternative modes of financing for small enterprises, including, but not limited to, direct and indirect project lending, venture capital, financial leasing, secondary mortgage and rediscounting of loan papers to small businesses. The affairs of the Corporation are managed by a seven-member board of directors with three members from the private sector appointed by the Governor.

3. Component Units Not Included in the General Purpose Financial Statements

- a) The Pohnpei Economic Development Authority was established in 1978 by Public Law 4L-159-78 for the purpose of promoting economic development through expansion of agriculture, marine resources, tourism, industry, energy development, banking, transportation and community development in Pohnpei. The Authority is also designated to succeed the Ponape District Fishing Authority as the sole entity to promote, develop, and support commercial utilization of living marine resources as provided in Public Law No. 7-110 of the Trust Territory Code.

All functions and powers of the Authority are vested and exercised by a seven member Board of Developers appointed by the Governor with the advice and consent of the Legislature. The enabling legislation also place responsibilities of the administration of the Authority's day-to-day operations on the Executive Director, an ex-officio member of the board, who is appointed by the Board of Developers with the advice and consent of the Legislature Committee on Resources and Development.

- b) The Pohnpei Fisheries Corporation (PFC) was established in 1993 by Public Law 3L-28-93 to operate and manage the Fish Processing Plant and any boats owned by the plant. The affairs of the Corporation are managed by a seven member board appointed by the Governor with the advice and consent of the Legislature.
- c) The Pohnpei State Housing Authority was established in 1988 by Public Law 2L-81-88. The purpose of the Authority is to facilitate, through low-interest loans, the construction of safe and sanitary residential housing for low income families of Pohnpei State. Additionally, the Authority monitors the Housing Preservation Grant (HPG) loan funds extended by United States Department of Agriculture Rural Development.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2002

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

3. Component Units Not Included in the General Purpose Financial Statement, Continued

The affairs of the Pohnpei State Housing Authority are managed by a five-member board, consisting of representatives of the Pohnpei State Government appointed by the Governor to four year terms. Daily operation of the Authority is delegated to an executive director, who is also appointed by the Governor. The operation of the Authority is funded by annual appropriations from the State Legislature and interest income earned on loan funds.

B. Fund Accounting

The State of Pohnpei 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 Pohnpei 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. The Debt Service Fund accounts for the accumulation of revenues for the repayment of interest and principal on an Early Retirement Scheme (see note 11).

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).

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2002

(1) Summary of Significant Accounting Policies, Continued

B. Fund Accounting, Continued

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 Pohnpei. 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 Pohnpei is under an obligation to maintain the trust principal. Only one expendable trust fund exists which is the Public Land Trust Fund.

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 long-term 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. 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 Pohnpei 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.

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 POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2002

(1) Summary of Significant Accounting Policies, Continued

D. Budget

An annual appropriated budget is adopted by the Legislature for the General Fund and Compact Programs through an Appropriations Act. Budgets for Special Revenue Funds are not included in the annual Appropriations Act. Accordingly, a budget to actual presentation for Special Revenue Funds is not required or presented. Project-length financial plans are generally adopted for all capital project funds.

Encumbrance accounting is utilized for budgetary control purposes. Encumbrances outstanding at year-end are reported as reservations of fund balance and will be funded as expenditures in the ensuing year. Encumbrances remain reservations of fund balance until becoming expended or canceled. If an encumbrance is subsequently canceled, the funds revert to the applicable unreserved fund balance unless otherwise required by law.

Budgetary expenditures, which are on a basis other than GAAP, represent current charges against appropriations; current charges consist of all current year liquidated and unliquidated encumbrances. Budgetary expenditures are therefore determined by subtracting both current year liquidations of prior year encumbrances and unliquidated prior year encumbrances from the combined total of current year expenditures and encumbrances. When reviewed in relation to respective budgets, budgetary expenditures provide the principal means of evaluating current year operating performance and management stewardship. Amounts included on the Statement of Revenues, Expenditures and Changes in Fund Balance, Budget and Actual, Budgetary Basis - 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.

E. Cash and Cash Equivalents

For purposes of the Combined Balance Sheet and Combined Statement of Cash Flows, cash and cash equivalents is defined as cash in bank checking and savings accounts, cash management accounts held by a trustee and time certificates of deposit with an initial maturity of ninety days or less.

F. Investments

Investments are recorded at market value. 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 notes 2 and 6).

G. Receivables

Receivables in the State's governmental funds primarily consist of taxes and federal revenues. Federal receivables include those funds which are earned, primarily from FSM National Government administered federal grants, which have yet to be reimbursed by applicable grantor.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2002

(1) Summary of Significant Accounting Policies, Continued

H. Due From/To Other Funds

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 Due From/To Other Funds Account therefore represents a net interest in the State's actual cash. Interest earned on the "pooled" funds benefits the General Fund.

I. Advances and Prepayments

Prepayments represent amounts paid in advance to vendors. Certain advances and prepayments are offset by inclusion in a fund balance reserve account as they do not constitute expendable available resources and are therefore not available for appropriation.

J. Inventories

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

K. Fixed Assets

Fixed assets used in governmental fund type operations (general fixed assets) are accounted for in the General Fixed Assets Account Group rather than in governmental funds. All fixed assets are valued at historical cost or estimated historical cost if actual historical cost is not available. Donated fixed assets are valued at their estimated fair value on the date donated.

The State follows a policy of capitalizing infrastructure costs. However, applicable additions have not been inventoried and added to the General Fixed Assets Account Group and eligible interest expense is not capitalized.

Depreciation is not charged on assets in the General Fixed Assets Account Group. However, depreciation is charged on proprietary fund fixed assets and is provided over the estimated useful lives of the assets through use of the straight line method.

L. 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, 2002 is \$527,331. No expenditure is reported for these amounts. No liability is recorded for nonvesting accumulating rights to receive sick pay benefits.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2002

(1) Summary of Significant Accounting Policies, Continued

M. Long-Term Obligations

Long-term debt is recognized as a liability of a governmental fund when due, or when resources have been accumulated for payment early in the following year. For other long-term obligations, only that portion expected to be financed from expendable available financial resources is reported as a fund liability of a governmental fund. The remaining portion of such obligations is reported in the General Long-Term Debt Account Group. Accrued annual leave has been presented in the accompanying General Long-Term Debt Account Group. No current portion of accrued annual leave has been recorded in the governmental funds as the amounts are immaterial to those funds.

N. Fund Equity

Reserves represent those portions of fund equity not appropriable for expenditure or legally segregated for a specific future use. Designated fund balances represent tentative plans for future use of financial resources.

O. Interfund Transactions

Quasi-external transactions are accounted for as revenues, expenditures or expenses. Transactions that constitute reimbursements to a fund for expenditures/expenses initially made from it that are properly applicable to another fund, are recorded as expenditures/expenses in the reimbursing fund and as reductions of expenditures/expenses in the fund that is reimbursed.

All other interfund transactions, except quasi-external transactions and reimbursements, are reported as transfers. Nonrecurring or nonroutine permanent transfers of equity are reported as residual equity transfers. All other interfund transfers are reported as operating transfers.

P. Memorandum Only - Total Columns

Total columns on the general purpose financial statements are captioned "memorandum only" to indicate that they are presented only to facilitate financial analysis. Data in these columns do not present financial position, result of operations or changes in financial position in conformity with GAAP. Neither are such data comparable to a consolidation. Interfund eliminations have not been made in the aggregation of this data.

Q. Comparative Data/Reclassification

Comparative total data for the prior year have been presented in selected sections of the accompanying financial statements in order to provide an understanding of the changes in the State of Pohnpei's financial position and operations. Also, certain amounts presented in the prior year data have been reclassified in order to be consistent with the current year presentation.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2002

(1) Summary of Significant Accounting Policies, Continued

R. Fund Balance Reserves and Designations, Continued

The Pohnpei State Government's fund balance reserves represent those portions of fund balance (1) not appropriable for expenditure or (2) legally segregated for a specific future use. In the accompanying combined balance sheet, reserves for related assets such as investments and advances are examples of the former. Reserves for encumbrances, contracts and continuing appropriations are examples of the latter.

Reserves for related assets as of September 30, 2002, are as follows:

	General <u>Fund</u>	Special Revenue <u>Funds</u>	Capital Projects <u>Funds</u>	<u>Total</u>
Receivables and advances	\$ 24,255	\$ 265,757	\$ -	\$ 290,012
Federal grants receivable	2,168,668	-	-	2,168,668
U.S. Federal Assistance fund deficit	158,828	-	-	158,828
Other Direct Assistance fund deficit	61,140	-	-	61,140
CFSM State Projects fund deficit	37,783	-	-	37,783
Expendable Trust fund deficit	82,993	-	-	82,993
Internal Service fund deficit	10,005	-	-	10,005
Advances to PTA	621,234	-	-	621,234
CFSM grants receivable	2,150,070	-	-	2,150,070
TTPI CIP receivables	200,419	-	-	200,419
Loan guarantee escrow fund and deficiency	-	-	792,600	792,600
Investment in Pacific Islands				
Development Bank	-	-	1,000,000	1,000,000
Loans receivable from Pohnpei Fisheries Corporation, a Component Unit – Proprietary Fund	-	-	2,450,000	2,450,000
Loan Receivable – FHA delinquent loan	-	-	94,697	94,697
Reserved for Early Retirement debt	<u>1,224,522</u>	<u>-</u>	<u>-</u>	<u>1,224,522</u>
	<u>\$ 6,739,917</u>	<u>\$ 265,757</u>	<u>\$ 4,337,297</u>	<u>\$ 11,342,971</u>

S. Management Estimates

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

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2002

(2) Cash and Cash Equivalents 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 the accounting system and records necessary to account for investment funds placed with the Authority on behalf of Pohnpei 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 are:
1. Stocks - A "B" rating by a national rating service. Non-rated or international 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 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 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 FSM 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.

Funds held with Bank of Hawaii and invested on behalf of Pohnpei State as of September 30, 2002, as summarized below:

Investments

Cash and cash equivalents	\$ 1,641,189
Pooled investment securities	<u>10,543,528</u>
Cash management and pooled investment securities	\$ <u>12,184,717</u>

Investments per the accompanying financial statements include the above \$10,543,528 and the amount explained in note 6a.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2002

(2) Cash and Cash Equivalents and Investments, Continued

- D. The State's net decrease in the fair value of investments for the year ended September 30, 2002, is summarized below:

	<u>General</u>	<u>Debt Service</u>
Interest	\$ 335,411	\$ 2,641
Dividends	36,022	59,023
Realized loss	(645,161)	-
Unrealized loss	(39,023)	(444,275)
Management fees	<u>(60,880)</u>	<u>(17,593)</u>
Total	\$ <u>(373,631)</u>	\$ <u>(400,204)</u>

- E. The State of Pohnpei does not require collateralization of its bank accounts. Therefore, \$300,000 is subject to FDIC insurance with the remaining balance being uncollateralized.

At September 30, 2002, the State has deposits and cash on hand as follows (in each situation, cost approximates market value):

General Fund

Cash management fund	\$ 769,147
Net bank balances in checking and savings accounts with FDIC insured banks	238,602
Restricted cash with FDIC insured bank	<u>559,791</u>
Total General Fund cash and cash equivalents and restricted cash	\$ <u>1,567,540</u>

Capital Project Funds

Cash management fund	\$ 488,524
Restricted cash with FDIC insured banks	<u>792,600</u>
Total Capital Projects Fund cash and cash equivalents and restricted cash	\$ <u>1,281,124</u>

Debt Service Fund

Cash management fund	\$ 2,293,005
Cash with FSM National Government	<u>640,000</u>
Total Debt Service Fund cash and cash equivalents and restricted cash	\$ <u>2,933,005</u>

Component Units - Proprietary Funds

Pohnpei Utilities Corporation (PUC):	
Cash in checking and savings accounts with FDIC insured bank	\$ 626,421
Pohnpei Port Authority (PPA):	
Cash in checking accounts with FDIC insured bank	191,792
Small Business Guarantee & Finance Corporation:	
Cash in savings accounts and time certificate of deposits with FDIC insured bank	<u>1,718,109</u>
Total Component Units - Proprietary Funds cash and cash equivalents	\$ <u>2,536,322</u>

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2002

(2) Cash and Equivalents and Investments, Continued

Special Revenue Projects Fund

Cash management fund

\$ 383,518

Cash - Restricted (Loan Guarantee Escrow Account-Capital Projects Fund)

The Pohnpei State Legislature appropriated a total of \$500,000 through a continuing appropriation for the sole purpose of loan collateralization made through the USDA Rural Development. The escrow account may be drawn down in the event of a borrower's default on the obligation under the terms of the promissory note and the deed of trust security instrument supporting such note and for which such note is guaranteed by the Pohnpei State Housing Authority, the trustee of the Loan Guarantee Escrow Account. During the year, Pohnpei State accounted for the Escrow Account under the Compact Capital Projects Fund. As of September 30, 2002, the escrow account has earned and reinvested \$24,602 of interest earnings. Therefore a total of \$524,602 has been reserved as restricted cash in the foregoing financial statements.

Cash - Restricted (TTPI Deficiency Fund-Capital Projects Fund)

As of September 30, 2002, Pohnpei State had \$267,998 held in deposit with local banks for TTPI CIP Deficiency Projects. Funds can only be used for renovation of the Pohnpei International Airport and Pohnpei State Hospital. This deposit is recorded in the Compact Capital Projects Fund.

Cash - Restricted (Early Retirement Program)

As of September 30, 2002, Pohnpei State had \$2,293,005 held on deposit with Bank of Hawaii which funds relate to the early retirement program. This deposit is recorded in the debt service fund.

Cash – Restricted – Component Units

Restricted cash primarily consist of a time certificate deposit that is restricted for capital improvement purposes by a donor government.

GASB Statement No. 3 requires government entities to categorize investments in the following categories to give an indication of the level of risk assumed by the entity at year end.

- 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.

The State's demand and time deposits are non-categorized investments in accordance with GASB Statement No. 3. All other investments held by the State or Trustee have been classified as category 2 investments in accordance with GASB #3 as all investments are held in the name of the Federated Development Authority.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2002

(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 in its role as the primary grant recipient of U.S. federal assistance programs, Congress of the Federated States of Micronesia public project grants, and U.S. Department of the Interior capital project grants through the Trust Territory Government and amounts due to Pohnpei State Government under the FSM tax revenue sharing program:

	<u>General Fund</u>	<u>Special Revenue Funds</u>	<u>Capital Projects Funds</u>
Receivables from other Governments:			
Revenue sharing	\$ 1,408,644	\$ -	\$ 562,895
CFMS grants	-	2,558,123	-
Compact other grants	-	347,448	-
Other Federal and direct assistance	<u>-</u>	<u>2,373</u>	<u>-</u>
	\$ <u>1,408,644</u>	\$ <u>2,499,891</u>	\$ <u>562,895</u>
Receivables, federal agencies:			
Federal grants	\$ -	\$ 3,280,266	\$ -
Trust Territory Government	-	-	200,419
Less allowance for uncollectibles	<u>-</u>	<u>(1,111,598)</u>	<u>-</u>
	\$ <u>-</u>	\$ <u>2,168,668</u>	\$ <u>200,419</u>

(4) General Receivables, Advances, Taxes Receivable and Others

A summary of general receivables against which allowances for doubtful accounts have been recorded as of September 30, 2002, is presented below:

<u>General Fund Receivables- General Fund</u>	<u>Gross</u>	<u>Allowance</u>	<u>Net</u>
Delinquent taxes	\$ 1,380,927	\$ (1,380,927)	\$ -
Delinquent lease payments	653,988	(653,988)	-
Interest receivable	<u>24,227</u>	<u>-</u>	<u>24,227</u>
	\$ <u>2,059,142</u>	\$ <u>(2,034,915)</u>	\$ <u>24,227</u>
 <u>General Receivables - Component Units</u>			
<u>-Proprietary Funds</u>			
Pohnpei Port Authority	\$ 230,190	\$ (89,719)	\$ 140,471
Pohnpei Utilities Corporation	4,680,320	(785,987)	3,894,333
Small Business Guarantee and Finance Corporation	<u>26,318</u>	<u>(19,407)</u>	<u>6,911</u>
	\$ <u>4,936,828</u>	\$ <u>(895,113)</u>	\$ <u>4,041,715</u>
 <u>General Receivables – Enterprise Fund</u>			
Pohnpei Transportation Authority	\$ <u>1,080,749</u>	\$ <u>(473,718)</u>	\$ <u>607,031</u>

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2002

(5) Fixed Assets

The State has not updated the General Fixed Assets Account Group in recent years. Balances carried in the General Fixed Assets Account Group as of September 30, 2002, are as follows:

Building	\$ 10,055,450
Infrastructure	34,590,935
Equipment	<u>4,677,417</u>
	\$ <u>49,323,802</u>

The State's investment in general fixed assets as of September 30, 2002, by source, is summarized below:

General Fund	\$ 3,466,551
U.S. Federal Grants	1,443,729
U.S. Department of the Interior-Capital Projects	43,498,229
FSM Congressional Fund	739,554
Other	<u>175,739</u>
	\$ <u>49,323,802</u>

Fixed Assets - Component Units-Proprietary Funds

Component unit fixed assets are recorded at cost or estimated cost. The assets are being depreciated principally on a straight line basis over estimated useful lives ranging from 5 to 40 years. The assets, at September 30, 2002, are as follows:

	Pohnpei Port Authority	Pohnpei Utilities Corporation	Small Business Guarantee & Finance Corporation	Total
Electric plant	\$ -	\$ 36,231,424	\$ -	\$ 36,231,424
Water and sewer plant	-	11,779,097	-	11,779,097
Land	2,776,034	-	-	2,776,034
Buildings	12,726,445	-	-	12,726,445
Vehicles	-	-	3,844	3,844
Furniture, fixtures and office equipment	485,183	-	23,830	509,013
Less accumulated depreciation	(11,087,787)	(20,448,664)	(17,532)	(31,553,983)
Construction in progress	<u>570,884</u>	<u>2,639,351</u>	<u>-</u>	<u>3,210,235</u>
Total fixed assets, net	\$ <u>5,470,759</u>	\$ <u>30,201,208</u>	\$ <u>10,142</u>	\$ <u>35,682,109</u>

Fixed Assets – Enterprise Fund

Pohnpei Transportation Authority's fixed assets are recorded at cost or estimated cost. The assets are being depreciated principally on a straight line basis over estimated useful lives ranging from 2 to 15 years. The assets, at September 30, 2002, are as follows:

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2002

(5) Fixed Assets, Continued

<u>Description</u>	<u>Useful Life</u>	
Buildings	15 years	\$ 70,000
Communication equipment	2 years	30,650
Heavy equipment	5-10 years	5,456,406
Machinery, tools and equipment	2 years	79,593
Furniture and fixtures	3 years	55,883
Vehicles	5 years	<u>426,598</u>
		6,119,130
Less accumulated depreciation		<u>(5,178,587)</u>
Total fixed assets, net		\$ <u>940,543</u>

(6) Other Investments

a) Equity Investments

The State currently holds 21.5% of the shares of the Pacific Islands Development Bank, carried at a cost of \$1,000,000. The investment is recorded in the Capital Projects 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. 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 fund balance.

On August 21, 1998, Pohnpei State became a 100% owner of Caroline Fisheries Corporation.

b) Component Unit Investments

During 1993, Pohnpei State Economic Development Authority (EDA), a component unit - proprietary fund, invested \$500,000 in the Bank of the Federated States of Micronesia. This investment is recorded at cost. Financial activities of EDA are not presented in the general purpose financial statements.

During 1990, EDA invested \$2,000,000 for a 1/3 interest in the Caroline Fishing Corporation Inc. (CFC), a company incorporated in the FSM. The CFC commenced fishing operations during 1990. Under the equity method of accounting, which has been adopted for EDA's investment in CFC, EDA's share of loss has been deducted from the carrying value (original value of \$2,000,000 less EDA's share of loss of \$2,000,000). Therefore, this investment is recorded at a net value of \$0.

During fiscal year 1998, Pohnpei Utilities Corporation (PUC) established a sinking fund. The purpose of this fund is to finance future expansion and upgrade of the power plant and equipment. The goal of PUC is to build this fund to \$2,000,000 by June 2003, in anticipation of equipment purchases and upgrades. At September 30, 2002, the balance maintained within this sinking fund amounted to \$474,511, which is invested in various U.S. Government obligations, corporate bonds and other equity securities.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2002

(7) Loans Receivable

On August 21, 1998, Caroline Fisheries Corporation, Pohnpei State Government, the National Fisheries Corporation (NFC) (a component unit of the FSM National Government) and the Pohnpei Economic Development Authority agreed as follows:

- In return for the transfer of the National Fisheries Corporation's shares in Caroline Fisheries Corporation, and as Caroline Fisheries Corporation paid a sum of \$500,000 to Pohnpei State Government in May 1998 to be applied to interest owed the State on loans to Caroline Fisheries Corporation and as Caroline Fisheries Corporation owns a judgment and writ of execution against Pohnpei Fisheries Corporation in the amount of \$979,793, the State of Pohnpei agreed to forgive the two loans due from Caroline Fisheries Corporation in the amounts of \$3,750,000 and \$1,000,000, respectively, and all interest accrued on such for the payment of \$500,000, the receipt of the NFC shares and the assignment of the Pohnpei Fisheries Corporation judgment to the State.

Under its enabling legislation, Public Law 3L-28-93, Pohnpei Fisheries Corporation (PFC) is to pay back the portion of MTN funds used in its operations. The drawdown of these funds for operations at September 30, 2002, is \$2,450,000 and is therefore classified as loans receivable. As this balance does not represent a currently appropriable amount as of September 30, 2002, it is reserved against fund balance as a related asset.

The Pohnpei Utilities Corporation entered into several settlement agreements with customers with large outstanding balances due to inaccurate billings from previous years. The agreements carry terms of one to five years, with interest of eight to fifteen percent. Management of PUC is of the opinion that the current portion of notes receivable is not material to the financial statements.

(8) Operating Transfers In/Out

Material operating transfers in/out for the year ended September 30, 2002, are as follows:

	<u>Transfers In/Out</u>
Transfers out to Component Units:	
Economic Development Authority	\$ (21,789)
Small Business Guarantee & Finance Corporation	(74,843)
Pohnpei Housing Authority	<u>(95,600)</u>
Total Transfers Out – General Fund	\$ <u>(192,232)</u>
Transfers in (out) of the Special Revenue Funds are as follows:	
Compact Other Grants to Pohnpei State Housing Authority	\$ (110,399)
Compact Special Block to Compact Other Grants	(460,450)
Compact Other Grants from Compact Special Block	<u>460,450</u>
Total Transfers Out – Special Revenue Fund	\$ <u>(110,399)</u>
Transfer in to the Debt Service Fund	\$ <u>640,000</u>

The transfer into the Debt Service Fund represents a deposit to a sinking fund (see note 11) issued in fiscal year 2001 but not recognized until fiscal year 2002.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2002

(9) Contingencies and Commitments

Federal Program Questioned Costs

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

Currently, \$1,008,224 in questioned costs exist for the operation of fiscal year 1996 through 2002 grants. If these questioned costs are ultimately disallowed, the General Fund may bear responsibility for absorbing the amount disallowed. No provision for any liability that may result from this matter has been recorded in the accompanying general purpose financial statements.

Pursuant to Title I, Section 105 of United States Public Law 99-239, the Government of the Federated States of Micronesia (FSM) (which includes the State of Pohnpei) 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.

Sick Leave

It is the policy of the State of Pohnpei 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, 2002, was not available.

Litigation

The State of Pohnpei is party to numerous legal proceedings, many of which are normal recurrences in governmental operations. The State Attorney General of Pohnpei is of the opinion that the probable outcome of suits existing at September 30, 2002, is not predictable but could have a material impact on the accompanying financial statements. Such impact has currently been estimated to approximate \$400,000. Accordingly, this amount has been accrued within the General Long-Term Debt Account Group.

Risk Management

The State of Pohnpei does not carry insurance to cover its potential risks. The State of Pohnpei is substantially self-insured for all risks. Management is of the opinion that no material losses have been sustained as a result of this practice.

PUC Loans

As of September 30, 2002, Pohnpei Utilities Corporation, a Component Unit, has drawn \$1,651,676 on a note payable facilitated by an Asian Development Bank loan to the FSM. The loan is ultimately collateralized by a Pohnpei State pledge of Compact of Free Association revenues to the FSM National Government. The State of Pohnpei has not imposed collateralization on PUC.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2002

(10) Material Fund Deficits

The following presents material fund deficits as of September 30, 2002. If operations of these funds cannot recover prior losses, the State's General Fund may have to absorb these amounts or a portion thereof.

	<u>Fund Deficit</u>
<u>Special Revenue Funds</u>	
U.S. Federal Assistance Fund	\$ (158,828)
Other Federal and Direct Assistance Fund	(61,140)
CFMS State Projects Fund	(37,783)
Early Retirement Fund	<u>(10,831)</u>
	<u>\$ (268,582)</u>
<u>Capital Projects Fund</u>	
TTPI CIP	\$ <u>(18,387)</u>
<u>Expendable Trust Fund (Deficit)</u>	
Public Land Trust Fund	\$ <u>(82,992)</u>

(11) Notes Payable

During fiscal year 1997, Pohnpei State Government implemented an early retirement program for all eligible public service system employees. This program is funded through a \$4,200,000 loan from the Asian Development Bank (ADB) through the FSM National Government. There is a 1% service charge on the loan, but no interest is charged.

Pursuant to the terms of the financing agreement between the State of Pohnpei and the FSM National Government, the State is required to deposit into the Early Retirement Scheme Trust Account (debt service fund) held in the name of the State within the FSM National Government's investment portfolio, 100% of the outstanding principal balance by September 30, 2002. Funds for the repayment of the loan are expected to be derived from annual appropriations for salaries and wages earmarked for the positions abolished under the Early Retirement Scheme. The loan is to be repaid by the FSM National Government, through accessing the State's debt service fund, in semiannual installments commencing February 2008.

The ADB loan has a grace period of 10 years and no payments commence until February 2008. The State was not able to produce a schedule of future interest payments attendant to the maturing debt.

Notes Payable – Component Units:

Pohnpei Utilities Corporation:

Payable to FSM Development Bank, interest at 9%, collateralized by the Corporation's assignment of restricted investment of \$602,000 to FSM Development Bank	\$ 462,426
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**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2002

(11) Notes Payable, Continued

Notes Payable – Component Units, Continued:

Pohnpei Utilities Corporation, Continued:

Amount drawn on a note payable with an available total of \$1,851,000 to the State of Pohnpei, facilitated by an Asian Development Bank loan to the FSM, due in semi-annual principal installments commencing October 10, 2007. The loan is ultimately collateralized by a Pohnpei State pledge of Compact of Free Association revenues to the FSM National Government. The State of Pohnpei has not imposed collateralization on the Corporation and has waived its rights to receive from PUC 6.82% in interest on the principal sum of the loan withdrawn and outstanding.

1,651,676

Pohnpei Port Authority:

Loan of \$264,600 from the FSM Development Bank, interest at 9%, due in monthly installments of principal and interest of \$5,493, collateralized by a chattel mortgage and an assignment of lease revenue.

54,676

Notes payable to Bank of the FSM, interest at 6.6%, due in monthly installments of principal and interest of \$3,700, collateralized by TCD, accounts receivable, inventory, furniture, fixtures and equipment and an assignment of Continental Micronesia lease proceeds.

12,184

Total notes payable

\$ 2,180,962

Maturities of this debt are as follows:

<u>Years Ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2003	\$ 86,462	\$ 38,088	\$ 124,550
2004	94,486	30,064	124,550
2005	103,437	21,113	124,550
2006	113,140	11,410	124,550
2007	64,901	1,789	66,690
Thereafter	<u>1,718,536</u>	<u>-</u>	<u>1,718,536</u>
	\$ <u>2,180,962</u>	\$ <u>102,464</u>	\$ <u>2,283,426</u>

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2002

(12) Interfund Receivable and Payables

As of September 30, 2002, interfund receivables and payables resulting from various interfund transactions are as follows:

	<u>Due from Other Funds</u>	<u>Due to Other Funds</u>
General Fund	\$ 2,184,241	\$ 1,597,043
Debt Service Fund	42,473	-
Special Revenue Funds:		
Compact Special Block Grant	722,060	-
Compact Other Grants	215,352	-
U.S. Federal Assistance	-	2,421,310
Other Federal and Direct	-	124,783
CFSM Projects	-	2,258,040
Agriculture Revolving	32,934	-
SVAP Revolving	14,684	-
Airport Operations	20,131	-
Recycling Fund	22,944	-
Paved Road Maintenance	578,583	-
Medical Supplies Revolving Fund	76,823	-
Health Care Premium	603,816	-
V6AH Revolving Fund	14,045	-
Environmental Quality Fund	7,596	-
Early Retirement Fund	-	10,831
Police Special Fees	80,096	-
Capital Projects Funds:		
Compact Capital Projects	641,999	790,482
TTG Capital Projects	-	231,148
Health and Education Projects	2,866,556	-
Expendable Trust Funds:		
Public Land Trust	-	86,699
Pohnpei Transportation Authority (PTA)	<u>-</u>	<u>603,997</u>
	<u>\$ 8,124,333</u>	<u>\$ 8,124,333</u>

(13) Continuing Appropriations

Continuing appropriations as of September 30, 2002, are summarized as follows:

General Fund

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

\$ 97,340

Capital Projects

Each fiscal year, Pohnpei State Legislature appropriates funds for capital projects and economic development projects.

\$ 6,956,925

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2002

(14) Self-Insurance Fund - Component Units

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

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

Pohnpei Transportation Authority, Pohnpei State Housing Authority and Pohnpei Economic Development Authority do not purchase commercial insurance covering potential risks. Management of those entities represent that no material losses have been sustained as a result of this practice during the last three years.

(15) FSM Development Bank Loan Funds

Compact Capital Account funds in an aggregate amount of \$1.7 million were transferred to the control of the FSM Development Bank (FSMDB) (a component unit of the FSM National Government) to be loaned out to borrowers from Pohnpei State mainly for economic development projects. The loan fund is administered by FSMDB in a Trust capacity. All loan decisions are made by management of Pohnpei State. These loans are not controlled by the State and are not currently recorded in the accompanying general purpose financial statements. As of December 31, 2002 (FSMDB fiscal year end), the outstanding fund balance aggregated \$719,915.

(16) Other Payables

Pohnpei State has recorded liabilities of \$1,758,816 to Municipal Governments for revenue sharing required under the State Constitution, and for other payables to vendors, all of which relate to 1996 and prior years.

(17) Reconciliation of Opening Fund Balance and Cash and Cash Equivalents

Component Units – Proprietary Fund

Retained earnings, beginning of year, as previously reported	\$ 38,393,337
Noninclusion of Pohnpei Fisheries Corporation	<u>(2,216,744)</u>
Retained earnings, beginning of year, as reported in the accompanying general purpose financial statements	\$ <u>40,610,081</u>
Cash and cash equivalents, beginning of year, as previously reported	\$ 2,166,359
Noninclusion of Pohnpei Fisheries Corporation	<u>(30,239)</u>
Cash and cash equivalents, beginning of year, as reported in the accompanying general purpose financial statements	\$ <u>2,136,120</u>

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Financial Statements
September 30, 2002

(17) Reconciliation of Opening Fund Balance and Cash and Equivalents, Continued

General Fund

Fund balance, beginning of year, as previously reported	\$ 4,142,776
Closure of Internal Service Fund to General Fund	<u>(18,075)</u>

Fund balance, beginning of year, as reported in the accompanying general purpose financial statements	\$ <u>4,124,701</u>
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Proprietary Fund Type and Discretely Presented Component Unit

Retained earnings, beginning of year, as previously reported	\$ 39,204,107
Noninclusion of Pohnpei Fisheries Corporation	2,216,744
Closure of Internal Service Fund to General Fund	<u>18,075</u>

Retained earnings, beginning of year, as reported in the accompanying general purpose financial statements	\$ <u>41,438,926</u>
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**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Combining Schedule of Expenditures by Account -
All Governmental Fund Types and Expendable Trust Funds
Year Ended September 30, 2002
(With comparative totals for the year ended September 30, 2001)

	Governmental Fund Types				Fiduciary	Totals	
	General	Special Revenue	Capital Projects	Debt Service	Expendable Trust	(Memorandum Only)	
						2002	2001
Expenditures:							
Personnel	\$ 11,439,296	\$ 2,643,775	\$ 196,636	\$ -	\$ 6,736	\$ 14,286,443	\$ 13,764,818
Travel	230,509	545,075	118,920	-	-	894,504	788,731
Supplies and materials	390,655	668,220	95,290	-	96	1,154,261	1,210,839
Fuel	17,846	291,337	(36,476)	-	-	272,707	347,513
Equipment	189,952	290,012	272,885	-	-	752,849	1,593,230
Furniture and fixtures	7,405	21,354	86,075	-	-	114,834	-
Vehicles	70,632	-	24,000	-	-	94,632	-
Contractual services, contributions and subsidies	542,476	795,391	6,238,127	-	20,787	7,596,781	7,165,869
Communications	140,816	29,968	-	-	-	170,784	-
Medical referral	5,920	233,848	-	-	-	239,768	-
Medical supplies	633,301	192,989	-	-	-	826,290	-
Office/house rental/lease	43,675	18,378	3,103	-	-	65,156	-
Scholarships	-	287,760	-	-	-	287,760	-
Food	368,150	153,596	-	-	-	521,746	-
Freight	17,142	14,876	461	-	-	32,479	-
Printing and reproduction	42,701	6,222	158,500	-	-	207,423	-
Repairs and maintenance	74,690	34,724	11,823	-	-	121,237	-
Utilities	7,975	649,193	-	-	-	657,168	-
Other	2,724,002	845,061	25,310	42,000	-	3,636,373	5,363,110
Total expenditures	\$ 16,947,143	\$ 7,721,779	\$ 7,194,654	\$ 42,000	\$ 27,619	\$ 31,933,195	\$ 30,234,110

See Accompanying Independent Auditors' Report

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

General Fund
September 30, 2002

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 United States Compact of Free Association current account and inflation adjustment funds associated with the current account are accounted for in this fund in addition to local taxes and other revenues.

See Accompanying Independent Auditors' Report.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

GENERAL FUND
Balance Sheet
September 30, 2002

(With comparative totals as of September 30, 2001)

<u>ASSETS</u>	<u>2002</u>	<u>2001</u>
Cash and cash equivalents	\$ 1,007,749	\$ 1,202,432
Cash - restricted	559,791	1,994,921
Investments	4,399,400	3,778,777
Receivables from other governments	1,408,644	1,012,501
General receivables, net	45,526	-
Taxes and leases receivable	2,034,915	2,034,915
Allowance for uncollectibles	(2,034,915)	(2,034,915)
Interest receivable	24,227	24,227
Advances	390,367	393,350
Due from other funds	2,184,241	1,222,160
Inventory	8,806	-
 Total assets	 <u>\$ 10,028,751</u>	 <u>\$ 9,628,368</u>
 <u>LIABILITIES AND FUND BALANCE</u>		
Liabilities:		
Accounts payable	\$ 121,081	\$ 737,583
Accrued payroll and others	910,470	581,773
Due to other funds	1,597,043	2,407,420
Other payables	1,758,816	1,758,816
 Total liabilities	 <u>4,387,410</u>	 <u>5,485,592</u>
Fund balance:		
Reserved for:		
Related assets	6,739,917	3,495,188
Encumbrances	637,284	568,093
Continuing appropriations	97,340	97,340
Unreserved (deficit)	(1,833,200)	(17,845)
 Total fund balance	 <u>5,641,341</u>	 <u>4,142,776</u>
 Total liabilities and fund balance	 <u>\$ 10,028,751</u>	 <u>\$ 9,628,368</u>

See Accompanying Independent Auditors' Report.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

GENERAL FUND

Statement of Revenues, Expenditures by Account and
Changes in Fund Balance

Year Ended September 30, 2002

(With comparative totals for the year ended September 30, 2001)

	2002	2001
Revenues:		
Compact of Free Association:		
Base grant	\$ 7,112,100	\$ 5,652,000
Inflation adjustment	4,125,018	3,165,120
Revenue sharing	5,219,889	4,589,177
Net decrease in the fair value of investments	(373,631)	(824,858)
Interest income	13,242	71,627
Taxes and licenses	2,150,178	2,277,381
Fines and penalties	292,773	141,647
Public service charges	3,789	26,296
Other	112,657	102,807
Total revenues	18,656,015	15,201,197
Expenditures:		
Personnel	11,439,296	10,945,102
Travel	230,509	244,389
Supplies and materials	390,655	356,706
Fuel	17,846	-
Equipment	189,952	152,052
Furniture and fixtures	7,405	-
Vehicles	70,632	-
Contractual services, contributions and subsidies	542,476	312,094
Communications	140,816	-
Medical referral	5,920	-
Medical supplies	633,301	-
Office/house rental/lease	43,675	-
Food	368,150	-
Freight	17,142	-
Printing and reproduction	42,701	-
Repairs and maintenance	74,690	-
Utilities	7,975	-
Early retirement loan repayment	-	640,000
Other	2,724,002	3,805,349
Total expenditures	16,947,143	16,455,692
Excess (deficiency) of revenues over (under) expenditures	1,708,872	(1,254,495)
Other financing sources (uses):		
Transfers out	(192,232)	(13,660)
Total other financing sources (uses), net	(192,232)	(13,660)
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	1,516,640	(1,268,155)
Fund balance at beginning of year	4,124,701	5,410,931
Fund balance at end of year	\$ 5,641,341	\$ 4,142,776

See Accompanying Independent Auditors' Report.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

GENERAL FUND

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

Year Ended September 30, 2002

(With comparative totals for the year ended September 30, 2001)

	2002		2001	
Revenues:				
Compact of Free Association:				
Base grant	\$ 7,112,100	\$	\$ 5,652,000	\$
Inflation adjustment	4,125,018	11,237,118	3,165,120	8,817,120
FSM revenue sharing		5,219,889		4,589,177
Net decrease in the fair value of investments		(373,631)		(824,858)
Interest income		13,242		71,627
State taxes and licenses:				
Beer, malt beverages and tobacco	451,879		571,445	
Motor vehicle sales tax	77,671		101,043	
General merchandise sales tax	1,488,671		1,446,734	
Hotel	63,484		56,520	
Petroleum and fuel	367		-	
Use tax	-		105	
Others	68,106	2,150,178	101,534	2,277,381
Fines and penalties		292,773		141,647
Public service charges:				
Hospital and dental		-		(25)
Transportation		3,789		26,321
Other		112,657		102,807
Total revenues		18,656,015		15,201,197
Expenditures:				
General Government:				
Executive and Support		2,455,442		1,629,763
Department of Treasury and Administration		848,250		892,169
Legislative operations		1,455,679		1,419,717
Judiciary		374,592		364,627
Public Auditor		187,291		175,532
Total General Government		5,321,254		4,481,808
Department of Education:				
Administration		293,594		359,904
Preschool and elementary		3,718,436		3,516,551
Aid to non-public school		75,020		50,000
PICS supper and weekend meals		500		9,000
Total Education		4,087,550		3,935,455
Department of Health Services:				
Administration		306,730		330,303
Medical Coordinator-Honolulu		42,041		42,630
Medical services		1,328,965		1,277,432
Dental services		238,156		208,659
Medical supplies		146,827		81,044
Primary health care		509,091		539,787
Hemodialysis		108,359		69,803
Hospital buildings & grounds		59,921		73,864
Hospital food		109,515		113,721
Outer island referral program		(130)		7,944
Health service pharmaceutical supplies		456,362		389,050
Dispensary pharmaceutical supplies		-		1,514
Total Health Services		3,305,837		3,135,751
Department of Land and Natural Resources:				
Office of the Director		37,608		74,525
Division of Resource Management & Development		(130)		-
Surveys and mapping		144,495		163,612
Historic and preservation		57,477		60,799
Forestry and marine conservation		86,693		99,579
Management and administration/public land		44,009		20,955
Total Land and Natural Resources		370,152		419,470

See Accompanying Independent Auditors' Report.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

GENERAL FUND

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

Year Ended September 30, 2002

(With comparative totals for the year ended September 30, 2001)

	2002	2001
Expenditures, continued:		
Department of Public Safety:		
Office of Director	72,131	64,322
Division of police and security	751,769	738,128
Correction and rehabilitation	159,297	135,982
Search and rescue	5,707	2,682
	988,904	941,114
Total Public Safety		
Boards, Commissions, and Other Appropriations:		
2nd Micronesian Trading Leadership Conference	39,224	-
Foreign investment commission	50,455	43,995
Supplementary Fund for PFHSP1	-	15,100
Micronesia Legal Services Corporation	35,280	35,280
Traditional affairs	-	(90)
USDA Rural Development	96,087	100,073
Alms fund	13,826	19,895
Kapinga emergency relief	20,400	-
Contract review board	5,426	-
Pohnpei public library	39,378	40,578
Environmental protection agency	137,255	124,163
Pohnpei health care plan board	-	9,470
Planning and zoning committee	16,859	3,286
Soil and water conservation	-	1,500
Economic planning committee	49,802	48,544
Pohnpei broadcasting corporation	114,317	101,422
Sports development program	18,247	143,675
Pohnpei leadership conference	-	48
Pohnpei land commission	162,222	165,230
Election Commissioner's operations	-	40,724
Food relief assistance	37,229	-
Pohnpei Visitors Bureau	35,590	51,854
Pohnpei CHC Tele. Med. Program	2,000	2,967
Early retirement loan repayment	-	640,000
Others	41	-
	873,638	1,587,714
Total Boards, Commissions, and Other Appropriations		
Municipal Governments:		
Kitti	361,299	351,425
Sokehs	340,962	331,643
Madolenihmw	338,928	329,665
Nett	244,370	234,170
Kolonias	221,043	214,283
Uh	187,545	190,787
Pingilap	110,796	91,041
Kapingamarangi	59,678	58,048
Sapwuahfik	51,524	50,067
Mwoakilloa	45,163	43,928
Kapingamarangi illegal fishing fee	-	21,875
Nukuoro	38,500	37,448
	1,999,808	1,954,380
Total Municipal Governments		
Total expenditures	16,947,143	16,455,692
Excess (deficiency) of revenues over (under) expenditures	1,708,872	(1,254,495)
Other financing sources (uses):		
Transfers out	(192,232)	(13,660)
	(192,232)	(13,660)
Total other financing sources (uses), net		
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	1,516,640	(1,268,155)
Fund balance at beginning of year	4,124,701	5,410,931
Fund balance at end of year	\$ 5,641,341	\$ 4,142,776

See Accompanying Independent Auditors' Report.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Special Revenue Funds
September 30, 2002

Specific revenues that are legally restricted to expenditures for particular purposes are accounted for in Special Revenue Funds. A brief discussion of Pohnpei State's Special Revenue Funds 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. These funds are specifically restricted for health and education programs.

Compact Other Grants Fund

This fund accounts for funds granted under the Compact of Free Association with the United States. These funds are specifically restricted for energy programs, health and medical referral, post secondary education scholarship, and special development assistant programs.

U.S. Federal Assistance Fund

This fund accounts for all financial transactions related to United States federal assistance grants utilized by the State of Pohnpei to finance general governmental operations.

Other Federal and Direct Assistance Fund

This fund accounts for all other financial transactions related to United States and other countries federal assistance received directly by the State of Pohnpei.

Agriculture Revolving Fund

This fund accounts for livestock and supplies purchased and resold to local farmers. Funding for this activity was originally established through legislative appropriation.

Student Vocational Arts Program (SVAP) Revolving Fund

This fund accounts for the financial activity of PICS High School special accounts.

Airport Operations Fund

This fund accounts for the collection of the \$10.00 per person airport departure tax. These collections are to be used to provide for the general maintenance and upkeep of Pohnpei International Airport.

See Accompanying Independent Auditors' Report.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Special Revenue Funds, Continued
September 30, 2002

CFSM State Projects Fund

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

Recycling Fund

This fund accounts for the financial activity of the aluminum can recycling project.

V6AH Revolving Fund

This fund accounts for the financial activity of V6AH, a public radio broadcasting facility.

Environmental Quality Fund

This fund accounts for proceeds from mining and dredging and the removal of mined and dredged materials.

Medical Supplies Revolving Fund

This fund was established by SL No. 3L-100-95 to account for funds collected from or on behalf of patients or clients of the Pohnpei Department of Health Services, and payments from the FSM National Health Insurance Program. Funds collected are to be used solely for the purchase of medical supplies, inclusive of pharmaceuticals.

Early Retirement Fund

This fund is used to account for the revenues and expenditures related to the early retirement program implemented by Pohnpei State Government.

Paved Road Maintenance

This fund was established to account for certain sales taxes which are restricted for the maintenance and minor repair of paved roads.

Health Care Premium

This fund was established to account for certain sales taxes which are restricted for use by the Health Care Premium Fund created by Section 8-3 of State Law 3L-39-93.

Special Police Fee

This fund was established to account for certain fees such as police clearance, driver's license, liquor license, etc. pursuant to State Law 4L-139-99.

See Accompanying Independent Auditors' Report.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

SPECIAL REVENUE FUNDS
Combining Balance Sheet
September 30, 2002
(With comparative totals as of September 30, 2001)

	Compact Health and Education	Compact Other Grants	U.S. Federal Assistance	Other Federal and Direct Assistance	CFSM State Projects	Agriculture Revolving	SVAP Revolving	Airport Operations	Recycling	Paved Road Maintenance	Medical Supplies Revolving	Health Care Premium	V6AH Revolving	Environ- mental Quality	Early Retirement	Police Special Fee	Totals		
																	2002	2001	
ASSETS																			
Cash and cash equivalents	\$ 284,175	\$ 99,343	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 383,518	\$ 500,042
Cash - restricted	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Investments	300,000	1,447,170	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	1,747,170	847,170
Receivables:																			
Other governments	-	347,448	-	2,373	2,150,070	-	-	-	-	-	-	-	-	-	-	-	-	2,499,891	2,751,451
Federal agencies, thru FSM National Government	-	-	2,168,668	-	-	-	-	-	-	-	-	-	-	-	-	-	-	2,168,668	1,011,051
General	-	-	-	-	3,928	-	-	-	-	-	-	-	-	-	-	-	-	-	3,928
Advances	2,153	55,553	275,334	67,498	81,552	-	-	2,142	-	-	-	-	1,546	1,135	-	-	-	486,913	439,232
Due from other funds	722,060	215,352	-	-	-	32,934	14,684	20,131	22,944	578,583	76,823	603,816	14,045	7,596	-	80,096	-	2,389,064	2,463,469
Inventory	-	-	-	-	-	43,100	-	-	-	-	-	-	-	-	-	-	-	-	43,100
Total assets	\$ 1,308,388	\$ 2,164,866	\$ 2,444,002	\$ 69,871	\$ 2,235,550	\$ 76,034	\$ 14,684	\$ 22,273	\$ 22,944	\$ 578,583	\$ 76,823	\$ 603,816	\$ 15,591	\$ 8,731	\$ -	\$ 80,096	\$ 9,722,252	\$ 8,032,090	
LIABILITIES AND FUND BALANCES (DEFICIT)																			
Liabilities:																			
Accounts payable	\$ 52,644	\$ 60,219	\$ 158,003	\$ 6,134	\$ 15,206	\$ 1,225	\$ 1,496	\$ -	\$ 45	\$ -	\$ 3,759	\$ -	\$ 792	\$ 202	\$ -	\$ 25	\$ 299,750	\$ 458,272	
Accrued payroll and others	37,283	134,454	23,517	94	87	-	-	-	-	-	-	-	-	-	-	-	-	195,435	184,504
Due to other funds	-	-	2,421,310	124,783	2,258,040	-	-	-	-	-	-	-	-	-	10,831	-	-	4,814,964	3,710,646
Total liabilities	89,927	194,673	2,602,830	131,011	2,273,333	1,225	1,496	-	45	-	3,759	-	792	202	10,831	25	5,310,149	4,353,422	
Fund balances (deficit):																			
Reserved for:																			
Related assets	-	40,074	82,401	67,498	30,542	43,100	-	2,142	-	-	-	-	-	-	-	-	-	265,757	395,121
Encumbrances	167,514	28,373	1,003,211	765	191,926	11,685	1,820	-	-	200,989	27,778	-	571	328	-	-	-	1,634,960	1,252,083
Unreserved (deficit)	1,050,947	1,901,746	(1,244,440)	(129,403)	(260,251)	20,024	11,368	20,131	22,899	377,594	45,286	603,816	14,228	8,201	(10,831)	80,071	-	2,511,386	2,031,464
Total fund balances (deficit)	1,218,461	1,970,193	(158,828)	(61,140)	(37,783)	74,809	13,188	22,273	22,899	578,583	73,064	603,816	14,799	8,529	(10,831)	80,071	4,412,103	3,678,668	
Total liabilities and fund balances (deficit)	\$ 1,308,388	\$ 2,164,866	\$ 2,444,002	\$ 69,871	\$ 2,235,550	\$ 76,034	\$ 14,684	\$ 22,273	\$ 22,944	\$ 578,583	\$ 76,823	\$ 603,816	\$ 15,591	\$ 8,731	\$ -	\$ 80,096	\$ 9,722,252	\$ 8,032,090	

See Accompanying Independent Auditors' Report.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

SPECIAL REVENUE FUNDS
Combining Statement of Revenues, Expenditures by Function and Changes in Fund Balances (Deficit)
Year Ended September 30, 2002
(With comparative totals for the year ended September 30, 2001)

	Compact Health and Education	Compact Other Grants	U.S. Federal Assistance	Other Federal and Direct Assistance	CFSM State Projects	Agriculture Revolving	SVAP Revolving	Airport Operations	Recycling	Paved Road Maintenance	Medical Supplies Revolving	Health Care Premium	V6AH Revolving	Environ- mental Quality	Early Retirement	Special Police Fee	Totals		
																	2002	2001	
Revenues:																			
Compact:																			
Base grant	\$ 1,890,000	\$ 1,291,116	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 3,181,116	\$ 3,247,783
Inflation adjustment	-	541,333	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	541,333	560,000
Federal grants	-	-	3,400,199	-	-	-	-	-	-	-	-	-	-	-	-	-	-	3,400,199	3,141,682
Taxes	-	-	-	-	-	-	-	-	-	191,335	-	151,101	-	-	-	40,887	-	383,323	479,581
CFSM Grants	-	271,700	-	-	567,348	-	-	-	-	-	-	-	-	-	-	-	-	839,048	1,247,203
Other	-	-	-	27,046	-	20,742	6,508	-	1,662	-	134,919	-	28,455	1,262	-	-	-	220,594	383,240
Total revenues	1,890,000	2,104,149	3,400,199	27,046	567,348	20,742	6,508	-	1,662	191,335	134,919	151,101	28,455	1,262	-	40,887	8,565,613	9,059,489	
Expenditures:																			
General government	-	925,682	439,763	2,966	53,388	(17,592)	9,733	-	-	-	-	-	25,117	1,896	-	-	-	1,440,953	1,454,316
Education	1,539,652	284,900	2,356,721	28,388	-	-	-	-	-	-	-	-	-	-	-	-	-	4,209,661	4,093,028
Health services	85,984	461,299	588,370	-	-	-	-	-	-	-	116,935	-	-	-	-	-	-	1,252,588	1,023,032
Public works	-	250,000	15,081	-	415,461	-	-	-	-	28,441	-	-	-	-	-	-	-	708,983	1,761,579
Public safety	-	-	264	-	98,499	-	-	-	-	-	-	-	-	-	-	-	-	98,763	149,814
Other	-	-	-	-	-	-	-	-	-	-	-	-	-	-	10,831	-	-	10,831	29,893
Total expenditures	1,625,636	1,921,881	3,400,199	31,354	567,348	(17,592)	9,733	-	-	28,441	116,935	-	25,117	1,896	10,831	-	7,721,779	8,511,662	
Excess (deficiency) of revenues over (under) expenditures	264,364	182,268	-	(4,308)	-	38,334	(3,225)	-	1,662	162,894	17,984	151,101	3,338	(634)	(10,831)	40,887	843,834	547,827	
Other financing sources (uses):																			
Transfers in	-	460,450	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	460,450	-
Transfers out	(460,450)	(110,399)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(570,849)	(1,594,734)
Total other financing sources (uses), net	(460,450)	350,051	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(110,399)	(1,594,734)	
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	(196,086)	532,319	-	(4,308)	-	38,334	(3,225)	-	1,662	162,894	17,984	151,101	3,338	(634)	(10,831)	40,887	733,435	(1,046,907)	
Fund balances (deficit) at beginning of year	1,414,547	1,437,874	(158,828)	(56,832)	(37,783)	36,475	16,413	22,273	21,237	415,689	55,080	452,715	11,461	9,163	-	39,184	3,678,668	4,725,575	
Fund balances (deficit) at end of year	\$ 1,218,461	\$ 1,970,193	\$ (158,828)	\$ (61,140)	\$ (37,783)	\$ 74,809	\$ 13,188	\$ 22,273	\$ 22,899	\$ 578,583	\$ 73,064	\$ 603,816	\$ 14,799	\$ 8,529	\$ (10,831)	\$ 80,071	\$ 4,412,103	\$ 3,678,668	

See Accompanying Independent Auditors' Report.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

SPECIAL REVENUE FUNDS
Combining Statement of Revenues, Expenditures by Account and Changes in Fund Balances (Deficit)
Year Ended September 30, 2002
(With comparative totals for the year ended September 30, 2001)

	Compact Health and Education	Compact Other Grants	U.S. Federal Assistance	Other Federal and Direct Assistance	CFSM State Projects	Agriculture Revolving	SVAP Revolving	Airport Operations	Recycling	Paved Road Maintenance	Medical Supplies Revolving	Health Care Premium	V6AH Revolving	Environ- mental Quality	Early Retirement	Special Police Fee	Totals		
																	2002	2001	
Revenues:																			
Compact:																			
Base grant	\$ 1,890,000	\$ 1,291,116	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 3,181,116	\$ 3,247,783
Inflation adjustment	-	541,333	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	541,333	560,000
Federal grants	-	-	3,400,199	-	-	-	-	-	-	-	-	-	-	-	-	-	-	3,400,199	3,141,682
Taxes	-	-	-	-	-	-	-	-	-	191,335	-	151,101	-	-	-	-	40,887	383,323	479,581
CFSM Grants	-	271,700	-	-	567,348	-	-	-	-	-	-	-	-	-	-	-	-	839,048	1,247,203
Other	-	-	-	27,046	-	20,742	6,508	-	1,662	-	134,919	-	28,455	1,262	-	-	-	220,594	383,240
Total revenues	1,890,000	2,104,149	3,400,199	27,046	567,348	20,742	6,508	-	1,662	191,335	134,919	151,101	28,455	1,262	-	40,887	8,565,613	9,059,489	
Expenditures:																			
Personnel	1,304,403	-	1,218,321	9,206	109,453	-	-	-	-	-	-	-	2,146	246	-	-	-	2,643,775	2,701,245
Travel	380	102,316	422,761	14,272	5,181	-	-	-	-	-	-	-	165	-	-	-	-	545,075	489,752
Supplies and materials	48,742	861	465,057	2,796	148,606	(19,181)	9,134	-	-	-	6,814	-	4,831	560	-	-	-	668,220	817,609
Fuel	-	255,178	35,229	574	356	-	-	-	-	-	-	-	-	-	-	-	-	291,337	308,738
Equipment	2,202	5,192	267,705	-	7,616	472	599	-	-	-	-	-	6,226	-	-	-	-	290,012	507,064
Furniture & fixtures	-	-	20,284	-	-	-	-	-	-	-	-	-	1,070	-	-	-	-	21,354	-
Contractual services, contributions and subsidies	16,434	91,156	437,093	-	222,267	-	-	-	-	28,441	-	-	-	-	-	-	-	795,391	2,164,060
Communications	1,134	-	25,841	-	-	-	-	-	-	-	-	-	2,993	-	-	-	-	29,968	-
Medical referral	-	233,848	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	233,848	-
Medical supplies	77,850	-	5,644	-	-	-	-	-	-	-	109,495	-	-	-	-	-	-	192,989	-
Office/house rental/lease	3,152	-	9,121	280	5,439	-	-	-	-	-	-	-	386	-	-	-	-	18,378	-
Scholarships	-	271,700	16,060	-	-	-	-	-	-	-	-	-	-	-	-	-	-	287,760	-
Food	128,344	-	17,739	518	6,232	-	-	-	-	-	-	-	763	-	-	-	-	153,596	-
Freight	40	558	11,925	256	783	130	-	-	-	-	626	-	558	-	-	-	-	14,876	-
Printing and reproduction	-	-	5,788	276	14	-	-	-	-	-	-	-	144	-	-	-	-	6,222	-
Repairs and maintenance	13,483	-	18,446	75	210	463	-	-	-	-	-	-	817	1,230	-	-	-	34,724	-
Utilities	-	637,870	4,536	1,700	862	-	-	-	-	-	-	-	4,225	-	-	-	-	649,193	-
Other	29,472	323,202	418,649	1,401	60,329	524	-	-	-	-	-	-	793	(140)	10,831	-	-	845,061	1,523,194
Total expenditures	1,625,636	1,921,881	3,400,199	31,354	567,348	(17,592)	9,733	-	-	28,441	116,935	-	25,117	1,896	10,831	-	7,721,779	8,511,662	
Excess (deficiency) of revenues over (under) expenditures	264,364	182,268	-	(4,308)	-	38,334	(3,225)	-	1,662	162,894	17,984	151,101	3,338	(634)	(10,831)	40,887	843,834	547,827	
Other financing sources (uses):																			
Transfers in	-	460,450	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	460,450	-
Transfers out	(460,450)	(110,399)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(570,849)	(1,594,734)
Total other financing sources (uses), net	(460,450)	350,051	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(110,399)	(1,594,734)	
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	(196,086)	532,319	-	(4,308)	-	38,334	(3,225)	-	1,662	162,894	17,984	151,101	3,338	(634)	(10,831)	40,887	733,435	(1,046,907)	
Fund balances (deficit) at beginning of year	1,414,547	1,437,874	(158,828)	(56,832)	(37,783)	36,475	16,413	22,273	21,237	415,689	55,080	452,715	11,461	9,163	-	39,184	3,678,668	4,725,575	
Fund balances (deficit) at end of year	\$ 1,218,461	\$ 1,970,193	\$ (158,828)	\$ (61,140)	\$ (37,783)	\$ 74,809	\$ 13,188	\$ 22,273	\$ 22,899	\$ 578,583	\$ 73,064	\$ 603,816	\$ 14,799	\$ 8,529	\$ (10,831)	\$ 80,071	\$ 4,412,103	\$ 3,678,668	

See Accompanying Independent Auditors' Report.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Capital Projects Funds
September 30, 2002

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

Compact - Capital Projects Fund

This fund accounts for various capital projects funded by the Compact of Free Association with the United States, Title Two, Article I, Section 211.

TTG - Capital Projects Fund

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

Health and Education Projects Fund

This fund accounts for revenue sharing restricted for capital projects that are health and education related.

See Accompanying Independent Auditors' Report.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

CAPITAL PROJECTS FUNDS

Combining Balance Sheet

September 30, 2002

(With comparative totals as of September 30, 2001)

	<u>Compact Capital Projects</u>	<u>TTG Capital Projects</u>	<u>Health and Education Projects</u>	<u>Totals</u>	
				2002	2001
<u>ASSETS</u>					
Cash and cash equivalents	\$ 488,524	\$ -	\$ -	\$ 488,524	\$ 837,942
Cash - restricted	792,600	-	-	792,600	1,306,274
Investments	5,396,958	-	-	5,396,958	1,000,000
Receivables from other governments	-	-	562,895	562,895	406,028
Receivables from federal agencies	-	200,419	-	200,419	200,419
General receivables, net	18,002	12,342	-	30,344	16,298
Advances	121,539	-	-	121,539	123,757
Loans receivable, net	2,544,697	-	-	2,544,697	2,544,697
Due from other funds	641,999	-	2,866,556	3,508,555	3,536,982
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total assets	\$ <u>10,004,319</u>	\$ <u>212,761</u>	\$ <u>3,429,451</u>	\$ <u>13,646,531</u>	\$ <u>9,972,397</u>
 <u>LIABILITIES AND FUND BALANCES (DEFICIT)</u>					
Liabilities:					
Accounts payable	\$ -	\$ -	\$ 36,745	\$ 36,745	\$ 99,175
Accrued payroll and others	2,958	-	-	2,958	1,939
Due to other funds	790,482	231,148	-	1,021,630	292,048
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total liabilities	793,440	231,148	36,745	1,061,333	393,162
 Fund balances (deficit):					
Reserved for:					
Related assets	4,337,297	-	-	4,337,297	4,072,413
Encumbrances	1,823,000	734	281,991	2,105,725	2,710,051
Continuing appropriations	6,956,925	-	-	6,956,925	6,908,925
Unreserved (deficit)	(3,906,343)	(19,121)	3,110,715	(814,749)	(4,112,154)
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total fund balances (deficit)	9,210,879	(18,387)	3,392,706	12,585,198	9,579,235
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total liabilities and fund balances (deficit)	\$ <u>10,004,319</u>	\$ <u>212,761</u>	\$ <u>3,429,451</u>	\$ <u>13,646,531</u>	\$ <u>9,972,397</u>

See Accompanying Independent Auditors' Report.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

CAPITAL PROJECTS FUNDS

Combining Statement of Revenues, Expenditures by Function and Changes in Fund Balances (Deficit)

Year Ended September 30, 2002

(With comparative totals for the year ended September 30, 2001)

	Compact Capital Projects	TTG Capital Projects	Health and Education Projects	Totals	
				2002	2001
Revenues:					
Compact of Free Association:					
Base grant	\$ 5,123,933	\$ -	\$ -	\$ 5,123,933	\$ 4,072,000
Inflation adjustment	2,971,881	-	-	2,971,881	2,280,320
Revenue sharing	-	-	2,087,957	2,087,957	1,798,200
Net increase (decrease) in the fair value of investments	<u>16,846</u>	<u>-</u>	<u>-</u>	<u>16,846</u>	<u>(2,588)</u>
Total revenues	<u>8,112,660</u>	<u>-</u>	<u>2,087,957</u>	<u>10,200,617</u>	<u>8,147,932</u>
Expenditures:					
Capital projects	5,666,480	-	1,528,174	7,194,654	5,872,420
Repayment of notes payable	-	-	-	-	2,000,000
Interest payments	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>64,283</u>
Total expenditures	<u>5,666,480</u>	<u>-</u>	<u>1,528,174</u>	<u>7,194,654</u>	<u>7,936,703</u>
Excess of revenues over expenditures	2,446,180	-	559,783	3,005,963	211,229
Fund balances (deficit) at beginning of year	<u>6,764,699</u>	<u>(18,387)</u>	<u>2,832,923</u>	<u>9,579,235</u>	<u>9,368,006</u>
Fund balances (deficit) at end of year	<u>\$ 9,210,879</u>	<u>\$ (18,387)</u>	<u>\$ 3,392,706</u>	<u>\$ 12,585,198</u>	<u>\$ 9,579,235</u>

See Accompanying Independent Auditors' Report.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

CAPITAL PROJECTS FUNDS

Combining Statement of Revenues, Expenditures by Account and Changes in Fund Balances (Deficit)
Year Ended September 30, 2002
(With comparative totals for the year ended September 30, 2001)

	Compact Capital Projects	TTG Capital Projects	Health and Education Projects	Totals	
				2002	2001
Revenues:					
Compact of Free Association:					
Base grant	\$ 5,123,933	\$ -	\$ -	\$ 5,123,933	\$ 4,072,000
Inflation adjustment	2,971,881	-	-	2,971,881	2,280,320
Revenue sharing	-	-	2,087,957	2,087,957	1,798,200
Net increase (decrease) in the fair value of investments	<u>16,846</u>	<u>-</u>	<u>-</u>	<u>16,846</u>	<u>(2,588)</u>
Total revenues	<u>8,112,660</u>	<u>-</u>	<u>2,087,957</u>	<u>10,200,617</u>	<u>8,147,932</u>
Expenditures:					
Personnel	196,636	-	-	196,636	94,421
Travel	118,920	-	-	118,920	54,590
Supplies and materials	95,290	-	-	95,290	31,884
Fuel	(36,476)	-	-	(36,476)	38,775
Equipment	148,247	-	124,638	272,885	934,114
Furniture & fixtures	-	-	86,075	86,075	-
Vehicles	-	-	24,000	24,000	-
Contractual services, contributions and subsidies	4,944,950	-	1,293,177	6,238,127	4,685,689
Office/house rental/lease	3,103	-	-	3,103	-
Freight	461	-	-	461	-
Printing and reproduction	158,500	-	-	158,500	-
Repairs and maintenance	11,823	-	-	11,823	-
Repayment of notes payable	-	-	-	-	2,000,000
Interest payments	-	-	-	-	64,283
Other	<u>25,026</u>	<u>-</u>	<u>284</u>	<u>25,310</u>	<u>32,947</u>
Total expenditures	<u>5,666,480</u>	<u>-</u>	<u>1,528,174</u>	<u>7,194,654</u>	<u>7,936,703</u>
Excess of revenues over expenditures	2,446,180	-	559,783	3,005,963	211,229
Fund balances (deficit) at beginning of year	<u>6,764,699</u>	<u>(18,387)</u>	<u>2,832,923</u>	<u>9,579,235</u>	<u>9,368,006</u>
Fund balances (deficit) at end of year	<u>\$ 9,210,879</u>	<u>\$ (18,387)</u>	<u>\$ 3,392,706</u>	<u>\$ 12,585,198</u>	<u>\$ 9,579,235</u>

See Accompanying Independent Auditors' Report.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Component Units - Proprietary Funds
September 30, 2002

The Component Units - proprietary funds are legally separate organizations for which the elected officials of Pohnpei 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.

Pohnpei Fisheries Corporation (PFC) was established by State Public Law 3L-28-93. The primary purpose of the Corporation is to operate and monitor the Pohnpei fish processing plant and other fisheries projects of Pohnpei State.

Pohnpei Port Authority (PPA) was established by State Public Law 2L-224-91. The primary purpose of the Authority is to oversee the use and maintenance of Pohnpei State's sea and air ports. PPA began operating as a separate entity in fiscal year 1993.

Pohnpei Utilities Corporation (PUC) was established by State Public Law 2L-179-91. The primary purpose of the Corporation is to provide electrical, water and sewage services to the public through the operation and maintenance of the State's electric power system.

Pohnpei Economic Development Authority (EDA) was established pursuant to Pohnpei State Law 4L-159-78 in 1978. The purpose of the Authority is to promote economic development projects within the State of Pohnpei. EDA was not able to provide financial statements for inclusion in the accompanying presentation.

Pohnpei State Housing Authority (PSHA) was established by State Public Law 2L-81-88. The Authority's primary purpose is to facilitate, through low interest loans, the construction of safe and sanitary residential housing for low income families of Pohnpei State. The Authority was not able to provide financial statements for the inclusion in the accompanying presentation.

Small Business Guarantee and Finance Corporation (SBGFC) was established by State Public Law 3L-86-95. The primary purpose of the Corporation is to provide loan guarantees and other financial incentives through commercial banks.

See Accompanying Independent Auditors' Report.

STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA
COMPONENT UNITS - PROPRIETARY FUNDS
Combining Balance Sheet
September 30, 2002
(With comparative totals as of September 30, 2001)

<u>ASSETS</u>	Pohnpei Port Authority	Pohnpei Utilities Corporation	Small Business Guarantee & Finance Corporation	<u>Totals</u>	
				2002	2001
Cash and cash equivalents	\$ 191,792	\$ 626,421	\$ 1,718,109	\$ 2,536,322	\$ 2,166,359
Cash - restricted	317,261	100,000	-	417,261	308,841
Investments - other	-	474,511	-	474,511	542,429
Receivables, federal agencies	-	292	-	292	41,536
General receivables, net	140,471	3,894,333	6,911	4,041,715	2,683,027
Interest receivable	6,628	1,130	2,339	10,097	143,905
Advances	11,655	-	2,372	14,027	33,628
Loans receivables, net	-	-	16,445	16,445	15,813
Inventory	-	1,148,320	-	1,148,320	1,345,204
Self insurance fund	-	123,390	-	123,390	121,331
Scholarship fund	-	3,881	-	3,881	3,881
Prepaid expenses and other assets	7,882	36,563	-	44,445	42,100
Fixed assets, net	5,470,759	30,201,208	10,142	35,682,109	39,327,178
Due from primary government	-	-	-	-	4,313
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total assets	\$ 6,146,448	\$ 36,610,049	\$ 1,756,318	\$ 44,512,815	\$ 46,779,545
 <u>LIABILITIES AND FUND EQUITY</u>					
Liabilities:					
Accounts payable	\$ 475,679	\$ 254,129	\$ -	\$ 729,808	\$ 2,388,200
Accrued payroll and others	173,533	309,306	3,154	485,993	546,755
Deferred revenue	306,250	88,035	-	394,285	369,463
Notes payable	66,860	2,114,102	-	2,180,962	5,081,790
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total liabilities	1,022,322	2,765,572	3,154	3,791,048	8,386,208
Retained earnings	<u>5,124,126</u>	<u>33,844,477</u>	<u>1,753,164</u>	<u>40,721,767</u>	<u>38,393,337</u>
	<u>\$ 6,146,448</u>	<u>\$ 36,610,049</u>	<u>\$ 1,756,318</u>	<u>\$ 44,512,815</u>	<u>\$ 46,779,545</u>

See Accompanying Independent Auditors' Report.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

COMPONENT UNITS - PROPRIETARY FUNDS
Combining Statement of Revenues, Expenses and Changes in Fund Equity
Year Ended September 30, 2002
(With comparative totals for the year ended September 30, 2001)

	Pohnpei Port Authority	Pohnpei Utilities Corporation	Small Business Guarantee & Finance Corporation	Totals	
				2002	2001
Operating revenues:					
Charges for goods and services	\$ 864,461	\$ 7,120,770	\$ 7,957	\$ 7,993,188	\$ 9,938,548
Rental income	258,528	-	-	258,528	248,113
Other	15,670	-	-	15,670	17,046
Total operating revenues	1,138,659	7,120,770	7,957	8,267,386	10,203,707
Operating expenses:					
Cost of sales	-	-	-	-	1,466,126
Personnel services	610,971	1,495,279	62,539	2,168,789	2,281,771
Travel	43,368	30,669	23,702	97,739	97,536
Supplies and materials	22,332	139,896	7,156	169,384	224,701
Fuel	11,099	3,202,041	993	3,214,133	3,571,797
Contractual services	15,857	-	5,000	20,857	11,179
Bad debts	20,190	-	19,407	39,597	998,920
Utilities	54,134	-	2,457	56,591	36,984
Communications	15,378	41,687	2,409	59,474	57,798
Depreciation	881,503	2,086,994	7,573	2,976,070	2,640,224
Repairs and maintenance	19,650	470,044	2,291	491,985	724,009
Employee benefits	-	431,361	1,995	433,356	501,845
Training and safety	618	56,045	-	56,663	86,366
Other	19,153	315,750	17,764	352,667	487,797
Total operating expenses	1,714,253	8,269,766	153,286	10,137,305	13,187,053
Operating loss	(575,594)	(1,148,996)	(145,329)	(1,869,919)	(2,983,346)
Nonoperating revenues (expenses):					
Federal grants and subsidies	-	363,602	70,530	434,132	-
Interest income (expense)	2,878	(46,122)	34,894	(8,350)	93,306
Spurline projects	-	29,569	-	29,569	127,207
Loss on investment	-	(67,918)	-	(67,918)	-
Recovery of bad debts	-	1,647,946	-	1,647,946	-
Other	(53,839)	-	65	(53,774)	(111,419)
Total nonoperating revenues (expenses), net	(50,961)	1,927,077	105,489	1,981,605	109,094
Net income (loss)	(626,555)	778,081	(39,840)	111,686	(2,874,252)
Retained earnings at beginning of year	5,750,681	33,066,396	1,793,004	40,610,081	41,267,589
Retained earnings at end of year	\$ 5,124,126	\$ 33,844,477	\$ 1,753,164	\$ 40,721,767	\$ 38,393,337

See Accompanying Independent Auditors' Report.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

COMPONENT UNITS - PROPRIETARY FUNDS
Combining Statement of Cash Flows
Year Ended September 30, 2002
(With comparative totals for the year ended September 30, 2001)

	Pohnpei Port Authority	Pohnpei Utilities Corporation	Small Business Guarantee & Finance Corporation	Totals	
				2002	2001
Cash flows from operating activities:					
Operating loss	\$ (575,594)	\$ (1,148,996)	\$ (145,329)	\$ (1,869,919)	\$ (2,892,178)
Adjustments to reconcile operating loss to net cash provided by operating activities:					
Depreciation	881,503	2,086,994	7,573	2,976,070	3,186,583
Bad debt s	20,190	-	19,407	39,597	998,920
Non-operating expenses, net	(53,839)	-	-	(53,839)	(640,409)
Other income (expense)	-	1,601,824	-	1,601,824	(48,134)
Prior year adjustment	-	-	619	619	-
	<u>272,260</u>	<u>2,539,822</u>	<u>(117,730)</u>	<u>2,694,352</u>	<u>604,782</u>
Changes in assets and liabilities:					
General receivables	(65,827)	(1,387,810)	(17,126)	(1,470,763)	(952,236)
Advances	(721)	-	11,130	10,409	(9,702)
Investments	(8,421)	-	-	(8,421)	-
Loans receivable	-	-	(633)	(633)	12,207
Inventory	-	79,473	-	79,473	10,038
Prepaid expenses and other assets	(4,609)	(1,717)	3,569	(2,757)	21,760
Other receivables	-	-	133,809	133,809	(56,077)
Due from primary government	-	-	4,313	4,313	-
Accounts payable	(83,538)	108,672	(301)	24,833	559,323
Accrued payroll and others	4,627	(62,950)	(413)	(58,736)	43,291
Deferred revenue	-	24,822	-	24,822	3,021
Other payables	-	-	(2,024)	(2,024)	-
	<u>(158,489)</u>	<u>(1,239,510)</u>	<u>132,324</u>	<u>(1,265,675)</u>	<u>(368,375)</u>
Net cash provided by operating activities	<u>113,771</u>	<u>1,300,312</u>	<u>14,594</u>	<u>1,428,677</u>	<u>236,407</u>
Cash flows from noncapital financing activities:					
Proceeds from notes payable, net	-	639,322	-	639,322	594,976
Operating grants received	-	404,846	70,530	475,376	649,425
Other noncapital financing activities	-	-	179	179	10,921
Spurline projects	-	29,569	-	29,569	127,207
Net cash provided by noncapital financing activities	<u>-</u>	<u>1,073,737</u>	<u>70,709</u>	<u>1,144,446</u>	<u>1,382,529</u>
Cash flows from capital and related financing activities:					
Acquisition of fixed assets	(54,619)	(2,007,962)	(7,025)	(2,069,606)	(1,702,764)
Repayment of debt	(41,128)	-	-	(41,128)	(95,167)
Proceeds from sale of fixed assets	-	-	2,100	2,100	-
Net cash used in capital and related financing activities	<u>(95,747)</u>	<u>(2,007,962)</u>	<u>(4,925)</u>	<u>(2,108,634)</u>	<u>(1,797,931)</u>
Cash flows from investing activities:					
Payment to self-insurance and scholarship funds, net	-	(2,059)	-	(2,059)	(5,699)
Increase in time certificate of deposit	-	(100,000)	-	(100,000)	-
Interest income	2,878	-	34,894	37,772	12,710
Decrease in PUC sinking fund, restricted investments	-	-	-	-	59,864
Other	-	-	-	-	1,002,370
Net cash provided by (used in) investing activities	<u>2,878</u>	<u>(102,059)</u>	<u>34,894</u>	<u>(64,287)</u>	<u>1,069,245</u>
Net increase in cash and cash equivalents	<u>20,902</u>	<u>264,028</u>	<u>115,272</u>	<u>400,202</u>	<u>890,250</u>
Cash and cash equivalents at beginning of year	<u>170,890</u>	<u>362,393</u>	<u>1,602,837</u>	<u>2,136,120</u>	<u>1,276,109</u>
Cash and cash equivalents at end of year	<u>\$ 191,792</u>	<u>\$ 626,421</u>	<u>\$ 1,718,109</u>	<u>\$ 2,536,322</u>	<u>\$ 2,166,359</u>

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 Johnny P. David
Governor, State of Pohnpei
Federated States of Micronesia:

We have audited the general purpose financial statements of the State of Pohnpei as of and for the year ended September 30, 2002, and have issued our report thereon dated September 2, 2003, which report was qualified due to 1) our inability to determine the propriety of cash and cash equivalents, advances receivable, accounts payable, expenditures and continuing appropriations of all Governmental Fund Types; accounts payable and related expenses of the Component Units – Proprietary Funds; and the correctness of the balances recorded in the General Fixed Assets Account Group; 2) our inability to obtain the financial statements of the Pohnpei Economic Development Authority, the Pohnpei Fisheries Corporation and the Pohnpei State Housing Authority, Component Units – Proprietary Funds; and 3) our inability to obtain the audited financial statements of the Pohnpei Transportation Authority, a Proprietary Fund Type – Enterprise Fund. Except as discussed in the preceding sentence, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

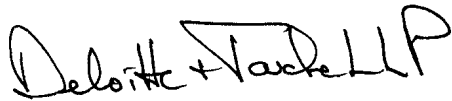
As part of obtaining reasonable assurance about whether the State of Pohnpei's general purpose financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct 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 64 through 85) in items 2002-1 through 2002-8.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the State of Pohnpei'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 operation of the internal control over financial reporting that, in our judgment, could adversely affect the State of Pohnpei's ability to record, process, summarize, and report financial data consistent with the assertions of management in the general purpose financial statements. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items 2002-1 and 2002-7 through 2002-20.

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 2002-1 and 2002-7 through 2002-13 to be material weaknesses.

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

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

September 2, 2003



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 Johnny P. David
Governor, State of Pohnpei
Federated States of Micronesia:

Compliance

We have audited the compliance of the State of Pohnpei with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended September 30, 2002. The State of Pohnpei's major federal programs are identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs (pages 64 through 85). Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the State of Pohnpei's management. Our responsibility is to express an opinion on the State of Pohnpei's compliance based on our audit.

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

As described in items 2002-1 through 2002-6 in the accompanying Schedule of Findings and Questioned Costs, the State of Pohnpei did not comply with requirements regarding equipment and real property management (all programs), allowable costs/cost principles that are applicable to its Special Education Program (CFDA #84.027), 21st Century Learning Program (CFDA #84.287) and Compact Capital Fund (CFDA #15.875); and procurement standards that are applicable to its TFAS Educational Program (CFDA #84.256). Compliance with such requirements is necessary, in our opinion, for the State of Pohnpei to comply with requirements applicable to its federal award programs.

In our opinion, except for the noncompliance described in the preceding paragraph, the State of Pohnpei 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, 2002.

Internal Control Over Compliance

The management of the State of Pohnpei 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 Pohnpei'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.

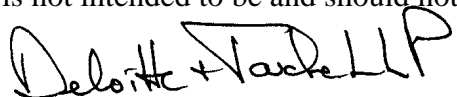
We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the State of Pohnpei'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 2002-1 through 2002-6.

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 consider items 2002-1, 2002-2 and 2002-4 through 2002-6, to be material weaknesses.

Schedule of Expenditures of Federal Awards

We have audited the general purpose financial statements of the State of Pohnpei as of and for the year ended September 30, 2002, and have issued our report thereon dated September 2, 2003, which report was qualified due to 1) our inability to determine the propriety of cash and cash equivalents, advances receivable, accounts payable, expenditures and continuing appropriations of all Governmental Fund Types; accounts payable and related expenses of the Component Units – Proprietary Funds; and the correctness of the balances recorded in the General Fixed Assets Account Group; 2) our inability to obtain the financial statements of the Pohnpei Economic Development Authority, the Pohnpei Fisheries Corporation and the Pohnpei State Housing Authority, Component Units – Proprietary Funds; and 3) our inability to obtain the audited financial statements of the Pohnpei Transportation Authority, a Proprietary Fund Type – Enterprise Fund. 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 53 through 59) 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 Pohnpei. Such information has been subjected to the auditing procedures applied in our audit of the general purpose financial statements and, in our opinion, with the exception of those matters set forth in items 1) through 3) above, 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 solely for the information and use of the management of the State of Pohnpei, federal awarding agencies, pass-through entities and the cognizant audit and other federal agencies, and is not intended to be and should not be used by anyone other than those specified parties.



September 2, 2003

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Summary of Schedule of Expenditures of Federal Awards, by Grantor
Year Ended September 30, 2002

<u>Agency/Program</u>	<u>CFDA#</u>	<u>Expenditures</u>
U.S. Department of Agriculture		\$ 22,234
U.S. Department of the Interior		21,124,981
U.S. Department of Labor		378,119
Federal Emergency Management Agency		8,495
U.S. Department of Education		2,356,721
U.S. Department of Health and Human Services		531,611
 GRAND TOTAL		 \$ <u>24,422,161</u>

Note: All awards are received in a subgrantee capacity through the FSM National Government, except for the following, which are received directly from the grantor agencies:

U.S. Department of Education:	
Freely Associated States Educational Grants	84.256A
Twenty-First Century Community Learning Center	84.287
Vocational Education Improvement Program	84.994

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
Year Ended September 30, 2002

<u>Agency/Program</u>	<u>CFDA#</u>	<u>Expenditures</u>
U.S. DEPARTMENT OF AGRICULTURE		
Cooperative Forestry Assistance	10.664	\$ <u>22,234</u>
U.S. DEPARTMENT OF AGRICULTURE TOTAL		\$ <u><u>22,234</u></u>

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
Year Ended September 30, 2002

<u>Agency/Program</u>	<u>CFDA#</u>	<u>Expenditures</u>
U.S. DEPARTMENT OF THE INTERIOR		
Economic, Social and Political Development of the Territories and the Freely Associated States:	15.875	
Compact Current Account		\$ 11,237,116
Compact Capital Improvement Projects		5,666,480
Compact Energy Grants		924,744
Compact Health and Medical Grants		461,299
Compact Scholarship Grants		271,700
Compact Special Block Grants		2,086,086
Compact Special Development Grants		374,537
Technical Assistance		61,498
Historic Preservation Fund Grants-In-Aid	15.904	<u>41,521</u>
U.S. DEPARTMENT OF THE INTERIOR TOTAL		<u>\$ 21,124,981</u>

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
Year Ended September 30, 2002

<u>Agency/Program</u>	<u>CFDA#</u>	<u>Expenditures</u>
U.S. DEPARTMENT OF LABOR		
Job Training Partnership Act	17.250	\$ 31,716
WIA Administration	17.255	34,545
WIA Adult Program	17.258	136,734
WIA Youth Activities	17.259	100,014
WIA Dislocated Worker	17.260	<u>75,110</u>
U.S. DEPARTMENT OF LABOR TOTAL		<u>\$ 378,119</u>

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
Year Ended September 30, 2002

<u>Agency/Program</u>	<u>CFDA#</u>	<u>Expenditures</u>
FEDERAL EMERGENCY MANAGEMENT AGENCY		
El Nino Drought/Public Assistance	83.516	\$ <u>8,495</u>
FEDERAL EMERGENCY MANAGEMENT AGENCY TOTAL		\$ <u><u>8,495</u></u>

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
Year Ended September 30, 2002

<u>Agency/Program</u>	<u>CFDA#</u>	<u>Expenditures</u>
U.S. DEPARTMENT OF EDUCATION		
Bilingual Education	84.003	\$ 5,555
Special Education - Grants to States	84.027	965,423
Freely Associated Educational Grants	84.256A	855,059
Goals 2000	84.276	16,907
Twenty-First Century Community Learning Center	84.287	411,512
Vocational Education Improvement Program	84.994	<u>102,265</u>
 U.S. DEPARTMENT OF EDUCATION TOTAL		 \$ <u><u>2,356,721</u></u>

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
Year Ended September 30, 2002

<u>Agency/Program</u>	<u>CFDA#</u>	<u>Expenditures</u>
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES		
CDC Project Grants and Cooperative Agreements for Tuberculosis Control Programs	93.116	\$ 12,069
Family Planning - Services	93.217	48,576
Community Health Centers	93.224	147,703
Immunization Grants	93.268	85,265
HIV Prevention Activities-Health Department Based (HIV Prevention Program)	93.940	10,096
Block Grants for Prevention and Treatment of Substance Abuse (Prevention and Treatment (SAPT) Block Grant)	93.959	123,590
Preventive Health Services - Sexually Transmitted Diseases Control Grants	93.977	7,472
Cooperative Agreements for State-Based Diabetes Control Programs and Evaluation of Surveillance Systems	93.988	3,433
Preventive Health and Health Services Block Grant	93.991	4,090
Maternal and Child Health Services Block Grant to the States	93.994	89,317
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES TOTAL		\$ 531,611
GRAND TOTAL		\$ 24,422,161

See accompanying notes to schedule of expenditures of federal awards.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 2002

1. Scope of Review

The State of Pohnpei is one of the four States of the Federated States of Micronesia. All significant operations of the State are included in the scope of the OMB Circular A-133 audit (the "Single Audit"). The U.S. Department of the Interior has been designated as the State's cognizant agency for Single Audit.

A. Programs Subject to Single Audit

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

- U.S. Department of Agriculture
- U.S. Department of Education
- U.S. Department of Health and Human Services
- U.S. Department of 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 accrual basis of accounting.

B. Reporting Entity

The State of Pohnpei, for purposes 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."

C. Subgrantees

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

D. Indirect Cost Allocation

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

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 2002

3. Component Units

The State of Pohnpei's component units separately satisfy the requirements of OMB Circular A-133. The following presents information concerning the respective component units.

Pohnpei Utilities Corporation

The Pohnpei Utilities Corporation, a Component Unit - Proprietary Fund, is the recipient of various pass-through funds from Pohnpei State. No material instances of noncompliance or questioned costs are presented in its audit reports. On page 62 is the Pohnpei Utilities Corporation's Schedule of Expenditures of Federal Awards, as extracted from the above mentioned audit reports.

**STATE OF POHNPEI
FEDERATED STATES OF MCRONESIA**

Pohnpei Utilities Corporation
Schedule of Expenditures of Federal Award
Year Ended September 30, 2002

Grantor/Program Title	CFDA No.	Total Authorizations	Prior Years' Expenditures	Expenditures for the Year Ended Sept. 30, 2002	Total Program Expenditures
<u>U.S. Department of the Interior:</u>					
Office of Insular Affairs:					
<u>Operations and Maintenance Improvement</u>					
<u>Programs (OMIP):</u>					
	15.875				
Initialization of the PUC		\$ 430,250	\$ 430,249	\$ -	\$ 430,249
Pohnpei Water, Sewerage, and Solid Waste Utilities Development, First-Year		810,000	809,999	-	809,999
Pohnpei Water, Sewerage, and Solid Waste Utilities Development, Second-Year		665,000	653,274	11,729	665,003
Pohnpei Water, Sewerage, and Solid Waste Utilities Development, Third-Year		443,500	368,949	74,564	443,513
Pohnpei Water, Sewerage, and Solid Waste Utilities Development, Fourth-Year		285,000	279,498	5,502	285,000
Pohnpei Power Generation and Distribution Second-Year		273,468	273,468	-	273,468
Pohnpei Power Generation and Distribution Third-Year		370,000	370,000	-	370,000
Pohnpei Power Generation and Distribution Fourth-Year		465,498	473,070	-	473,070
Pohnpei Power Generation and Distribution Fifth Year		456,000	456,000	-	456,000
Pohnpei Power Generation and Distribution Sixth Year-					
Apprenticeship training		60,000	52,345	-	52,345
Continuation of Prepaid Meter Program		250,000	250,000	-	250,000
Utility Development 2001		117,668	13,412	36,981	50,393
OMIP Bench		71,000	71,000	-	71,000
OMIP Bench		562,500	-	234,826	234,826
		<u>\$ 5,259,884</u>	<u>\$ 4,501,264</u>	<u>\$ 363,602</u>	<u>\$ 4,864,866</u>

Note: The above programs are received directly by the Pohnpei Utilities Corporation (PUC) from the grantor agency.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Programs Selected For
Audit in Accordance with OMB Circular A-133
Year Ended September 30, 2002

<u>Grantor</u> <u>Program Title</u>	<u>CFDA No.</u>	2002 <u>Fiscal Year</u> <u>Expenditures</u>
<u>U.S. Department of the Interior</u>		
Compact of Free Association:		
Section 211(A) Capital Account	15.875	\$ 5,666,480
Section 214 Compact Energy	15.875	924,744
Section 221(B) Compact Special Block Grant	15.875	<u>2,086,086</u>
Total Major Programs Under CFDA # 15.875, excluding Compact Section 211 (A) Current Account expenditures		<u>8,677,310</u>
<u>U.S. Department of Education</u>		
Special Education Program	84.027	965,423
TFAS Educational Grant	84.256A	855,059
Twenty-First Century Community Learning Center	84.287	<u>411,512</u>
Total Major Programs Under U.S. Department of Education		<u>2,231,994</u>
Total U.S. Federal program expenditures selected, excluding Compact Section 211 (A) Current Account expenditures		\$ <u>10,909,304</u>
Total U.S. Federal program expenditures, excluding Compact Section 211 (A) Current Account expenditures		\$ <u>13,185,045</u>
% of total U.S. Federal expenditures covered by major programs, excluding Compact Section 211 (A) Current Account expenditures		<u>83%</u>

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs
Year Ended September 30, 2002

Part I - Summary of Auditors' Results

1. The Independent Auditors' Report on the general purpose 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. Instances of noncompliance considered material to the general purpose financial statements were disclosed by the audit.
4. Reportable conditions in internal control over compliance with requirements applicable to major federal award programs were identified, which are considered to be material weaknesses.
5. The Independent Auditors' Report on compliance with requirements applicable to major federal award programs expressed a qualified opinion.
6. The audit disclosed findings required to be reported by OMB Circular A-133.
7. The State's major programs were:

<u>Name of Federal Program or Cluster</u>	<u>CFDA Number</u>
U.S. Department of the Interior - Compact of Free Association	15.875
U.S. Department of Education – Special Education Program	84.027
U.S. Department of Education - TFAS Educational Grant	84.256A
U.S. Department of Education – Twenty-First Century Community Learning Center	84.287

8. A threshold of \$395,551 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>
2002-1	Equipment and Real Property Management	\$ -
2002-9	Cash and Cash Equivalents - Bank Reconciliations	\$ -
2002-10	Travel Advances	\$ -
2002-11	Accounts Payable	\$ -
2002-12	Continuing Appropriations	\$ -
2002-13	General Receivables	\$ -
2002-14	Other Accrued Liabilities	\$ -
2002-15	Bank Reconciliations	\$ -
2002-16	Prepayments	\$ -
2002-17	Off-Site Storage	\$ -
2002-18	Timeliness of Bank Deposits	\$ -
2002-19	Missing Accounts Payable Vouchers	\$ -
2002-20	Competitive Bidding	\$ -

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Part III - Federal Award Findings and Questioned Cost Section, Continued

<u>Reference Number</u>	<u>Findings</u>	<u>Questioned Costs</u>
2002-1	Equipment and Real Property Management	\$ -
2002-2	Allowable Costs/Cost Principles	\$ 13,385
2002-3	Allowable Costs/Cost Principles	\$ -
2002-4	Procurement	\$101,317
2002-5	Allowable Costs/Cost Principles	\$716,346
2002-6	Allowable Costs/Cost Principles	\$ 11,848

Part IV - Local Findings and Questioned Cost Section

<u>Reference Number</u>	<u>Findings</u>	<u>Questioned Costs</u>
2002-7	Unfunded Expenditures	\$472,041
2002-8	Unsubstantiated Transaction	\$101,571

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Federal Award Findings and Questioned Costs Section

<u>Program</u>	<u>Reason for Questioned Costs</u>	<u>Questioned Costs</u>
<u>Equipment and Real Property Management</u>		
2002-1. All Federal Grants	<p><u>Criteria:</u> A summary schedule of the fixed asset detail produced by the automated fixed asset subsystem, classified by major asset category, should be maintained. Additionally, the Common Rule for Uniform Administration Requirements for Federal Grants, Section 33(d)(2) requires that a physical inventory of property acquired with federal funds be performed biannually.</p> <p><u>Condition:</u> A summarization of the asset data from the automated fixed asset subsystem was not available nor was a schedule of asset deletions prepared to facilitate the preparation of a statement of changes in fixed assets. Additionally, a physical inventory of property has not been performed as required by law.</p> <p><u>Cause:</u> The cause of the above condition is that the State's Property Management Section has not updated the fixed assets register.</p> <p><u>Effect:</u> A misstatement of the State's General Fixed Assets Account Group results from this condition.</p> <p><u>Prior Year Status:</u> Insufficient controls over updating fixed asset data was reported as a finding in the Single Audit of Pohnpei State for the years 1988 through 2001.</p> <p><u>Recommendation:</u> We recommend that Pohnpei State Government update the automated master fixed asset listing based on acquisition and survey activity, summarize the master listing detail appropriately and prepare a statement of changes in fixed assets on a timely basis. Additionally, biannual physical inventories should be performed.</p> <p><u>Auditee Response and Corrective Action:</u> Department of Treasury & Administration is now able to produce a schedule of the fixed asset detail through its automated fixed asset subsystem classified by major asset category. The department is in the process of updating this schedule by retiring fixed assets that had been fully depreciated as well as appraising its real property so that they can be included in the fixed master file.</p>	

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Federal Award Findings and Questioned Costs Section, Continued

<u>Program</u>	<u>Reason for Questioned Costs</u>	<u>Questioned Costs</u>															
<u>Allowable Costs/Cost Principles</u>																	
2002-2. U.S. Department of Education/Special Education Program– CFDA #84.027	<p><u>Criteria:</u> Allowable Costs/Cost Principles require that costs charged be adequately supported by underlying documentation.</p> <p><u>Condition:</u> We were not able to determine how the purchase of a John Deere backhoe, loader and mower qualifies as a charge against the federal program. These expenditures appear to be of a general operations nature.</p> <table style="margin-left: 40px; border: none;"> <tr> <td>P1024604</td> <td>765515</td> <td>\$6,395</td> <td>1/15/2002</td> <td>141851</td> </tr> <tr> <td>P1024601</td> <td>765515</td> <td>\$3,995</td> <td>1/15/2002</td> <td>141851</td> </tr> <tr> <td>P1024602</td> <td>765515</td> <td>\$2,995</td> <td>1/15/2002</td> <td>141851</td> </tr> </table>	P1024604	765515	\$6,395	1/15/2002	141851	P1024601	765515	\$3,995	1/15/2002	141851	P1024602	765515	\$2,995	1/15/2002	141851	\$ <u>13,385</u>
P1024604	765515	\$6,395	1/15/2002	141851													
P1024601	765515	\$3,995	1/15/2002	141851													
P1024602	765515	\$2,995	1/15/2002	141851													
	<u>Cause:</u> The cause of this condition is unknown.																
	<u>Effect:</u> The effect of this condition is questioned costs.																
	<u>Recommendation:</u> We recommend that management ensure that federal expenditures are reasonable and necessary.																
	<u>Auditee Response and Corrective Action Plan:</u> Department of Education which did the repairs on the subject fixed assets had maintained that the costs associated with these repairs are necessary and reasonable. Without these repairs, these fixed assets will remain idle and unused. The Department of Education also maintains that these costs are reasonable at the time of the repair because price quotations were received from only those vendors who were able to perform those repairs.																

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Federal Award Findings and Questioned Costs Section, Continued

<u>Program</u>	<u>Reason for Questioned Costs</u>	<u>Questioned Costs</u>
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Allowable Costs/Cost Principles

2002-3. U.S. Department
of Education/Special
Education Program–
CFDA #84.027

Criteria: Allowable Costs/Cost Principles require that costs charged be reasonable and necessary for program needs.

Condition: We were not able to determine whether the following costs are necessary and reasonable. Based on their nature, they do not appear to represent normal repair and maintenance expenditures.

L2245101	775492	\$1,091	148913	Windshield for Isuzu Fargo Van
				Freight on Windshield for Isuzu
L2245103	775492	\$1,130	148913	Fargo Van
				Repair of 50HP Honda, Outboard
J2034801	775020	\$1,341	147971	Motor

Cause: The cause of the above condition is that the expenditures appear to possibly result from the absence of maintenance or an accident occurring. Therefore, we cannot determine if this is a reasonable and necessary program cost or an expenditure incurred due to abuse. No questioned costs results as the items specified are less than the \$10,000 threshold.

Effect: The effect of this condition is potential questioned costs.

Recommendation: We recommend that management ensure compliance with applicable federal requirements.

Auditee Response and Corrective Action Plan: Department of Treasury & Administration will resolve the question cost not later than the end of the current fiscal year.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Federal Award Findings and Questioned Costs Section, Continued

<u>Program</u>	<u>Reason for Questioned Costs</u>	<u>Questioned Costs</u>									
<u>Procurement</u>											
2002-4. U.S. Department of Education/TFAS Educational Grant- CFDA #84.256	<p><u>Criteria:</u> Federal procurement standards require that any procurement greater than the threshold be conducted in a manner providing full and open competition.</p> <p><u>Condition:</u> We found 3 instances out of a sample of 24 transactions aggregating \$396,603 out of a total population of \$855,059 where there was no evidence of competitive procurement procedures being applied in available procurement files:</p> <table style="margin-left: 40px; border: none;"> <tr> <td style="padding-right: 20px;">C1036202</td> <td style="padding-right: 20px;">763460</td> <td>\$32,307</td> </tr> <tr> <td>C2004001</td> <td>765185</td> <td>\$39,160</td> </tr> <tr> <td>C2030301</td> <td>772450</td> <td>\$29,850</td> </tr> </table> <p><u>Cause:</u> The cause of this condition is inadequate filing.</p> <p><u>Effect:</u> The effect of this condition is a potential overstatement of expenditures.</p> <p><u>Recommendation:</u> We recommend that management ensure adherence to the criteria.</p> <p><u>Auditee Response and Corrective Action:</u> Federal finding relating to the subject question cost pertains with ongoing training that began two years previously when requests for proposals were issued. Department of Education believes that it would be impractical to replace or change consultants when the scope of the training is not fully implemented.</p>	C1036202	763460	\$32,307	C2004001	765185	\$39,160	C2030301	772450	\$29,850	\$ <u>101,317</u>
C1036202	763460	\$32,307									
C2004001	765185	\$39,160									
C2030301	772450	\$29,850									

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Federal Award Findings and Questioned Costs Section, Continued

<u>Program</u>	<u>Reason for Questioned Costs</u>	<u>Questioned Costs</u>
<u>Allowable Costs/Cost Principles</u>		
2002-5. U.S. Department of the Interior/Compact Capital Fund– CFDA #15.875	<p><u>Criteria:</u> Pursuant to the Compact of Free Association, only major or capitalizable capital improvement project costs are allowable charges against Compact Capital Funds.</p> <p><u>Condition:</u> Dry-docking costs of Micro Glory failed to meet the one year capitalizable cost principle (for any cost to be capitalizable, the useful life of the capitalizable cost must provide benefit over greater than a twelve month period). Micro Glory returned to dry-dock for major repairs after previously drydocking eight months earlier.</p>	\$ <u>716,346</u>
5651	764774	\$113,620
6711	774113	\$38,351
5543	763819	\$230,000
6356	770505	\$230,000
6961	777282	\$104,376
		6649/8303
		P20168 6649/8303
		C2003001 6649/8405
		C2003002 6649/8405
		C2003001 6649/8405
<p><u>Cause:</u> The cause of this finding is that it has been the practice that dry-docking costs are charged against Compact Capital Funds.</p> <p><u>Effect:</u> The effect of this finding is questioned costs.</p> <p><u>Recommendation:</u> We recommend that Pohnpei State Government ensure compliance with the criteria.</p> <p><u>Auditee Response and Corrective Action Plan:</u> Department of Treasury & Administration concurs with this finding but will require the assistance of the Office of Transportation & Infrastructure and the Attorney General’s office to resolve this finding not later than the end of the current fiscal year.</p>		

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Federal Award Findings and Questioned Costs Section, Continued

<u>Program</u>	<u>Reason for Questioned Costs</u>	<u>Questioned Costs</u>
<u>Allowable Costs/Cost Principles</u>		
2002-6. U.S. Department of the Interior/Compact Capital Fund– CFDA #15.875	<p><u>Criteria:</u> Pursuant to the Compact of Free Association, only major or capitalizable Capital Improvement Project costs are allowable charges against Compact Capital funds.</p> <p><u>Condition:</u> Maintenance costs aggregating \$11,848 were charged to the Compact Capital account during the fiscal year.</p> <p><u>Cause:</u> Pohnpei State appears to utilize a definition of repairs and maintenance that is not necessarily generally accepted.</p> <p><u>Effect:</u> The above transactions may not be allowable under Compact Capital funding guidelines.</p> <p><u>Recommendation:</u> We recommend that Pohnpei State Government ensure that only major capitalizable costs are charged against Compact Capital funding.</p> <p><u>Auditee Response and Corrective Action Plan:</u> Department of Treasury & Administration concurs with this finding and will resolve this finding in FY 2003.</p>	\$ <u>11,848</u>
Total Federal Findings Questioned Costs		\$ <u>842,896</u>

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Local Findings and Questioned Costs Section

<u>Program</u>	<u>Reason for Questioned Costs</u>	<u>Questioned Costs</u>
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Unfunded Expenditures

Finding No. 2002-7

Criteria: Pursuant to the fiscal year 2002 Comprehensive Budget Act, all expenditures must be authorized through legislative appropriations.

Condition: We found three expenditure accounts where there was no evidence of funds appropriated by the Legislature.

<u>Account</u>	<u>Appropriation</u>	<u>Expenditure</u>	<u>Variance</u>	
1024 Unexploded Ordinance	\$ -	\$ 53,179	\$ 53,179	
1022 Tropical Storm Faxai	\$ -	\$263,663	\$263,663	
1025 Personnel, Labor Manpower	\$235,767	\$390,966	\$155,199	\$ <u>472,041</u>

Cause: The cause of this finding is the Executive Branch has yet to request for appropriations in accordance with local laws.

Effect: The effect of this condition is local questioned costs.

Recommendation: We recommend that Pohnpei State Government follow its established procedures and ensure compliance with the criteria.

Auditee Response and Corrective Action Plan: The first two items in this finding relates to emergency declarations made by Pohnpei State governor whereby the state constitution allows the Governor to expend state funds during times of emergencies and Pohnpei Legislature appropriates state revenues to cover these emergencies but unfortunately no action was taken by the legislative branch to remedy these emergencies expenditures.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Local Findings and Questioned Costs Section

<u>Program</u>	<u>Reason for Questioned Costs</u>	<u>Questioned Costs</u>
<u>Unsubstantiated Transaction</u>		
<u>Finding No. 2002-8</u>		
	<u>Criteria:</u> Accounting transactions should be properly supported by documentary evidence.	
	<u>Condition:</u> Based on our review of journal vouchers, we found one journal voucher #V20196 (transfer of expenditures from the General Fund to the CFSM Fund amounting to \$101,571 for the Micro Games) whereby no documentation was present, such as invoices, to substantiate the propriety of the transactions.	\$ <u>101,571</u>
	<u>Cause:</u> The cause of this condition is that Pohnpei State was not able to justify the amount of the transfer.	
	<u>Effect:</u> The effect of this condition is local questioned costs.	
	<u>Recommendation:</u> We recommend that Pohnpei State ensure that all transactions are substantiated by documentary evidence.	
	<u>Auditee Response and Corrective Action Plan:</u> The subject JV reflects expenditures incurred by the FSM games. The supporting documents for the above JV is the 132P and 135P reports detailing all expenditures incurred during the games. Department of Treasury & Administration will provide invoices and other supporting documents to resolve this finding.	
	 Total Local Findings and Questioned Costs	\$ <u>573,612</u>

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Financial Statement Findings Section

Cash and Cash Equivalents - Bank Reconciliations

Finding No. 2002-9

Criteria: General ledger cash accounts should be reconciled with bank statements on a regular and timely basis.

Condition: Material reconciling items existed in the bank reconciliation for the general and payroll checking accounts. However, no documentary evidence was available to substantiate these items.

The amount of the reconciling items and their corresponding bank accounts are as follow:

General Checking – (\$231,976), net
Payroll Checking - \$311,800, net

Cause: The cause of this condition is that management did not review unusual reconciling items.

Effect: The effect of this condition is an inability to support the financial statement carrying balance of cash.

Prior Year Status: This finding was brought to management's attention in the prior year Single Audit Report.

Recommendation: We recommend that management review all bank reconciliations to ensure that bank accounts are properly reconciled on a monthly basis.

Auditee Response and Corrective Action Plan: Department of Treasury & Administration concurs with this finding and will also make necessary adjustments and corrective actions in FY2003.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Financial Statement Findings Section, Continued

Travel Advances

Finding No. 2002-10

Criteria: Pohnpei State should maintain details of travel advances to support the general ledger balance.

Condition: The details of travel advances stated at \$969,253 at September 30, 2002, were not available for inspection.

Cause: The cause of this condition is that details of travel advances were not maintained.

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

Prior Year Status: This finding was brought to management's attention in the 1999 to 2001 Single Audit Reports.

Recommendation: We recommend that Pohnpei State ensure that travel advance details are maintained to support general ledger balances.

Auditee Response and Corrective Action Plan: Department of Treasury & Administration concurs with this finding and will also implement corrective actions in FY2003.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Financial Statement Findings Section, Continued

Accounts Payable

Finding No. 2002-11

Criteria: Pohnpei State should ensure that details of the accounts payable subsidiary ledger reconcile with the general ledger balance at the end of each fiscal year.

Condition: A detailed schedule of accounts payable as of year-end did not exist. As a result, a reconciliation of accounts payable was not performed.

Cause: The cause of this finding is that details of accounts payable are not maintained.

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

Prior Year Status: This finding was brought to management's attention in the 2000 and 2001 Single Audit Reports.

Recommendation: We recommend that Pohnpei State ensure that accounts payable are reconciled at the end of each fiscal year.

Auditee Response and Corrective Action Plan: Department of Treasury & Administration concurs with this finding and will also implement corrective actions in FY2003.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Financial Statement Findings Section, Continued

Continuing Appropriations

Finding No. 2002-12

Criteria: A functioning system of internal control requires that the subsidiary ledger for continuing appropriations be reconciled with the general ledger control account.

Condition: No detail of continuing appropriations exists for the General Fund and the Compact Capital Project Fund.

Cause: The cause of this finding is that a reconciliation of continuing appropriations was not performed.

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

Prior Year Status: This finding was brought to management's attention in the 2000 and 2001 Single Audit Reports.

Recommendation: We recommend that Pohnpei State reconcile continuing appropriations on a recurring basis.

Auditee Response and Corrective Action Plan: Even though we continuously reconcile the 132P report on continuing appropriations, we concur with this finding. In order to resolve this finding, reconciliation of the continuing appropriations should be done with actual appropriations not with allotments. The department will work with our budget office and reconcile and update the continuing appropriation not later than FY2003.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Financial Statement Findings Section, Continued

General Receivables

Finding No. 2002-13

Criteria: Money owed to Pohnpei State Government should be collected in a timely manner.

Condition: Taxes and leases of \$2,034,915 owed to the State as of September 30, 2002 have been outstanding for a number of years. This amount does not reconcile to the schedule submitted by the Revenue Department. The result of this condition appears to be an overstatement of \$128,000.

Cause: The cause of this condition is that the difference between the two sets of records has not been reconciled.

Effect: The effect of this condition is a negative impact on cash flows for operations.

Prior Year Status: This finding was brought to management's attention in the 2000 and 2001 Single Audit Reports.

Recommendation: We recommend that Pohnpei State pursue the collection of funds owed through legal means. Better correspondence with other departments should also result from this condition.

Auditee Response and Corrective Action Plan: Although we have collected receivables relating to this finding, our records still show that these adjustments had not been made on our books. One of the recurring problems in collecting these receivables is the backlog at our state court where taxes cases takes a long time to litigate. Department of Treasury & Administration will implement the recommended course of action and will present a true picture of this receivable not later than the end of the current year.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Financial Statement Findings Section, Continued

Other Accrued Liabilities

Finding No. 2002-14

Criteria: A functioning system of internal control requires that all balance sheet accounts be reconciled on a recurring basis.

Condition: The following general fund and special revenue fund accounts lacked details to support the propriety of the year-end balance.

<u>Fund</u>	<u>Account</u>	<u>Balance</u>
100000	517	\$ 63,437
100000	518	\$ 9,172
200000	518	\$ 5,256
250000	518	\$ 131,066

Cause: The cause of this condition is details of the above accounts are not maintained.

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

Prior Year Status: This finding was brought to management's attention in the 2000 and 2001 Single Audit Reports.

Recommendation: We recommend that Pohnpei State Finance review general ledger accounts to ensure that all accounts are properly supported and reconciled at the end of each fiscal year.

Auditee Response and Corrective Action Plan: Department of Treasury & Administration does not concur with this finding, we have maintained supporting documents to support the propriety of the year-end balance.

Auditor Response: We have yet to be provided such documents.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Financial Statement Findings Section, Continued

Bank Reconciliations

Finding No. 2002-15

Criteria: A functioning system of internal control requires all cash accounts be reconciled with bank statements on a regular and timely basis.

Condition: As of twelve months after year-end, Pohnpei State still had material unidentified reconciling items in its bank reconciliations.

Cause: The cause of this condition is that the Division of Finance did not ensure that bank reconciliations were performed in a timely basis.

Effect: Untimely reconciliations increase the risk of error and fraud.

Prior Year Status: This finding was brought to management's attention in the 2001 Single Audit Reports.

Recommendation: We recommend that the chief accountant review and monitor monthly reconciliations to ensure their accuracy and timeliness.

Auditee Response and Corrective Action Plan: Department of Treasury & Administration concurs with this finding, however, all adjustments of the unidentifying items were adjusted in the year end reconciliation.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Financial Statement Findings Section, Continued

Prepayments

Finding No. 2002-16

Criteria: Accounting principles generally accepted in the United States of America (GAAP) require that prepaid expenditures be recorded as assets.

Condition: Due to the nature of certain procurements, prepayments have to be made. However, a detailed schedule of prepayments as of September 30, 2002 was not available for inspection. Prepayments are recorded as expenditures and are not recorded as an asset, pending receipt of the goods or services. We are unable to assess the potential materiality of this issue in relation to the general purpose financial statements.

Cause: The cause of this condition is that the Division of Finance has not created general ledger accounts to track prepayments.

Effect: The effect of this condition is potential nonconformity with GAAP.

Prior Year Status: This finding was brought to management's attention in the 2001 Single Audit Report.

Recommendation: We recommend that procedures be implemented to ensure that vendor prepayments are properly recorded in the accounting system.

Auditee Response and Corrective Action Plan: Department of Treasury & Administration concurs with this finding and will implement corrective actions in FY2003.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Financial Statement Findings Section, Continued

Off-Site Storage

Finding No. 2002-17

Criteria: Copies of back-up tapes or cartridges of accounting data should be maintained at an off-site storage location.

Condition: Accounting data back-up tapes are stored in the computer room.

Cause: The cause of this condition is unknown.

Effect: The effect of this condition is an internal control weakness.

Recommendation: We recommend that the Finance Office maintain an off-site storage facility for computer back-up tapes and cartridges.

Auditee Response and Corrective Action Plan: Department of Treasury & Administration concurs with this finding, however, will implement corrective action not later than the end of the current year.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Financial Statement Findings Section, Continued

Timeliness of Bank Deposits

Finding No. 2002-18

Criteria: A functioning system of internal control requires that all cash collections be deposited either on the same or on the next business day.

Condition: In 25 instances out of a sample population of 25 transactions, cash collections were not deposited to the bank in a timely manner. We were not able to obtain explanation as to why deposits were not made in a timely manner.

Cause: The cause of this condition is lack of oversight by management.

Effect: The effect of this condition is that opportunities for fraud or defalcation are heightened when cash is not deposited intact on a daily basis.

Recommendation: We recommend that management ensure daily cash collections are banked in a timely manner.

Auditee Response and Corrective Action Plan: Department of Treasury & Administration does not concur with this finding. The department usually makes its daily deposit at either the end of the day or does night deposit. Some direct tickets might show otherwise because our bank stamped our deposit ticket not at the time of deposit but at the time when our account is credited.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Financial Statement Findings Section, Continued

Missing Accounts Payable Vouchers

Finding No. 2002-19

Criteria: A functioning system of internal control requires that all disbursements be properly supported by underlying source documentation such as vendor invoice, etc.

Condition: Missing accounts payable vouchers continues to be a recurring problem in 2002.

Cause: The cause of this condition is misfiling.

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

Recommendation: We recommend that management ensure adherence to the criteria.

Auditee Response and Corrective Action Plan: Department of Treasury & Administration does not concur with this finding, however, the department will ensure that this finding does not happen again.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Financial Statement Findings Section, Continued

Competitive Bidding

Finding No. 2002-20

Criteria: Bidding documents should be maintained in the procurement files to show that Financial Management and Public Contract regulations have been complied with.

Condition: Pohnpei State has yet to provide bidding documents supporting procurement activities for the following Compact Capital Improvement Projects.

1. Micro Glory Drydocking
2. C0039001
3. T8005202
4. C2060701
5. C1008201
6. C2003001
7. C9017501
8. C9048201
9. C2025701
10. C2023802
11. P20168

Cause: The cause of this condition is that the results of bidding were not forwarded to the Finance Office.

Effect: The effect of this condition is potential noncompliance with local laws.

Recommendation: We recommend that bidding documents be located to support the proprietary of the above.

Auditee Response and Corrective Action Plan: Department of Treasury & Administration does not concur with this finding. All the contracts in this finding were bid out and selecting process was followed. Bidding documents were kept at Office of Transportation and Infrastructure and the Department of Treasury & Administration had started requiring the contracting office to turn over all bidding documents on any contract that is bid out. We started this process in FY03.

Auditor Response: We have yet to be provided such documents.

**STATE OF POHNPEI
FEDERATED STATES OF MICRONESIA**

Summary Schedule of Prior Audits Findings and Questioned Costs
Year Ended September 30, 2002

The following is a summary of unresolved questioned costs of the State of Pohnpei as of September 30, 2002:

	Questioned Costs Set Forth in Prior Audit Report <u>2001</u>	Questioned Costs Resolved in Fiscal Year <u>2002</u>	Questioned Costs at <u>September 30, 2002</u>
Unresolved Questioned Costs FY 96	\$ 15,182	\$ -	\$ 15,182
Unresolved Questioned Costs FY 98	24,000	-	24,000
Unresolved Questioned Costs FY 99	39,439	-	39,439
Unresolved Questioned Costs FY 00	12,375	-	12,375
Unresolved Questioned Costs FY 01	74,332	-	74,332
Unresolved Questioned Costs FY 02	<u>-</u>	<u>-</u>	<u>842,896</u>
	\$ <u>165,328</u>	\$ <u>-</u>	\$ <u>1,008,224</u>

Unresolved findings for fiscal year 1999:

<u>Page No.</u>	<u>Finding No.</u>	<u>Description</u>
74	99-2	Allowable Costs/Costs Principles
75	99-3	Allowable Costs/Costs Principles-Specific Support
77	99-4	Allowable Costs/Costs Principles-Questionable Use of Compact Funds
78	99-5	Subrecipient Monitoring – PSHA
80	99-6	Equipment and Real Property Management
81	99-7	Compact Capital Fund – Allowable Costs/Cost Principles

Unresolved findings for fiscal year 2000:

<u>Page No.</u>	<u>Finding No.</u>	<u>Description</u>
71	2000-1	Equipment and Real Property Management
72	2000-2	Allowable Costs/Costs Principles
74	2000-4	Allowable Costs/Costs Principles
75	2000-5	Allowable Costs/Costs Principles

Unresolved findings for fiscal year 2001:

<u>Page No.</u>	<u>Finding No.</u>	<u>Description</u>
71	2000-1	Equipment and Real Property Management
72	2000-2	Allowable Costs/Costs Principles