

**FEDERATED STATES OF MICRONESIA
COCONUT DEVELOPMENT AUTHORITY**

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED SEPTEMBER 30, 2003 AND 2002

INDEPENDENT AUDITORS' REPORT

Chairman
Board of Directors
Federated States of Micronesia
Coconut Development Authority:

We have audited the accompanying balance sheets of Federated States of Micronesia Coconut Development Authority (the Authority), a component unit of the National Government of the Federated States of Micronesia, as of September 30, 2003 and 2002, and the related statements of loss and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audits.

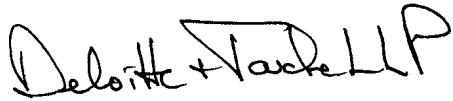
We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan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

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Authority as of September 30, 2003 and 2002, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in note 1 to the financial statements, the Authority adopted the provisions of the Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, as amended by GASB Statement No. 37, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, and GASB Statement No. 38, *Certain Financial Statement Note Disclosures*, as of October 1, 2002. The accompanying 2002 financial statements have been restated to reflect the changes required by GASB 34.

The Management Discussion and Analysis on pages 3-5 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurements and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 3, 2004 on our consideration of the Authority's internal control over financial reporting and our tests of its compliance and other matters. The purpose of that report is to describe the scope of our testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

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

September 3, 2004

**FEDERATED STATES OF MICRONESIA
COCONUT DEVELOPMENT AUTHORITY**

Management Discussion and Analysis
Year Ended September 30, 2003

This section of the FSM Coconut Development Authority (the Authority's) annual financial report presents our discussion and analysis of the Authority's financial performance for the year ended September 30, 2003.

The Federated States of Micronesia Coconut Development Authority of the Federated States of Micronesia (the Authority) was established in 1981 by Public Law 1-156 and incorporated as Chapter Two, Title 22 of the Code of the Federated States of Micronesia. The purpose of the Authority is to manufacture, process, buy, collect, market, sell, export, inspect, improve the quality, and deal with, in general, all products derived from the coconut tree. The Authority has the additional responsibility to establish prices to producers or sellers of coconut products in the Federated States of Micronesia, to collect and receive all monies derived from the sales of coconut products and to stabilize the price of these products. The Authority is a component unit of the Federated States of Micronesia National Government.

The affairs of the Authority are managed by a five-member board, consisting of representatives of the four FSM states and the FSM National Government. Management of the daily operations of the Authority is delegated to a general manager, who is hired by and serves at the pleasure of the Board.

The operations of the Authority are funded by annual appropriations from the FSM Congress. The purchase of coconut products is funded by copra subsidy appropriations from the FSM Congress and revenues generated through sales of copra and coconut by-products.

In fiscal year 2003, the Authority received a subsidy of \$150,000, still a reduction in funding from the \$200,000 average annual copra subsidy from FSM Congress. With the continued decline in the world price of copra, the Authority now depends on the copra subsidy provided yearly by the FSM Congress. If there is going to be a further reduction of the copra subsidy in fiscal 2004 the nation can expect a reduction of the copra price which will affect those people whose livelihood depends on the revenue from the copra.

The Authority has also experienced a drastic decline in the production of copra over the years. The Authority's peak production of 5,788 s/tons in 1985 has gone down steadily over the years and in the current year dropped to only 466 s/tons.

Following are the production of copra in s/tons within the past 20 years:

1984.....	2,384 s/tons	1994	909 s/tons
1985	5,788 s/tons	1995	1,210 s/tons
1986	607 s/tons	1996	717 s/tons
1987	1,774 s/tons	1997	510 s/tons
1988	2,175 s/tons	1998	928 s/tons
1989	1,140 s/tons	1999	548 s/tons
1990	2,305 s/tons	2000	757 s/tons
1991	982 s/tons	2001	529 s/tons
1992	242 s/tons	2002	754 s/tons
1993	633 s/tons	2003	466 s/tons

**FEDERATED STATES OF MICRONESIA
COCONUT DEVELOPMENT AUTHORITY**

Management Discussion and Analysis
Year Ended September 30, 2003

With the above short falls, the Authority opened up a Food Processing Division to produce virgin coconut oil and other edible products from the coconut, with the anticipation that it will help increase revenues for the copra farmers. This is a very promising project and the Authority plans to up grade it to a level where it can be commercialized and turned over for private operation. This will require establishment of good regular sources of raw materials, training of personnel, establishment of markets and upgrading of the project output. In the anticipation to meet all the above targets the Authority will continue to retain a plant chemist who works in its small Food Processing Division and provide training for the local people. The Authority also hired another consultant who assisted the Authority in its current development work and also provides technical assistance to the two oil processing plants in Pohnpei and Chuuk States.

The above outlines an anticipated restructuring of the industry from the current practice of copra production which has become a low priced trade commodity to higher value added product. More importantly, it will increase earnings of the coconut farmers and may subsequently develop this industry to be less dependent on government financial subsidies.

The industry is already experiencing the affect of the decrease in the copra subsidy and a further decrease in the copra subsidy will absolutely affect the industry especially those whose livelihood are dependent on the revenue from copra.

The following summarizes the financial condition and operations of the Authority.

Assets	<u>2003</u>	<u>2002</u>
Property, plant and equipment, net	\$ 275,723	\$ 185,836
Current assets	<u>243,630</u>	<u>275,601</u>
Total Assets	\$ <u>519,353</u>	\$ <u>461,437</u>

Liabilities & Net Assets		
Liabilities:		
Accounts payable	\$ 9,373	\$ 12,335
Other payables	<u>4,808</u>	<u>3,830</u>
	<u>14,181</u>	<u>16,165</u>
Net Assets:		
Invested in capital assets	275,723	185,926
Unrestricted	<u>229,449</u>	<u>259,346</u>
	<u>505,172</u>	<u>445,272</u>
Total Liabilities & Net Assets	\$ <u>519,353</u>	\$ <u>461,437</u>

Revenues, Expenses and Changes in Net Assets:		
Operating revenue, net	\$ (1,738)	\$ (116,648)
Operating expenses	<u>215,933</u>	<u>217,323</u>
Net operating loss	(217,671)	(333,971)
Grants and other income	<u>277,571</u>	<u>230,621</u>
Increase (decrease) in net assets	\$ <u>59,900</u>	\$ <u>(103,350)</u>

**FEDERATED STATES OF MICRONESIA
COCONUT DEVELOPMENT AUTHORITY**

Management Discussion and Analysis
Year Ended September 30, 2003

Financial Highlights

The annual copra subsidy has been reduced this fiscal year. In the previous years, prior to this reduction, the Authority received \$200,000.00 annually except that in fiscal year 2002 the Authority received \$100,000. In fiscal year 2003, the Authority received \$150,000.

The operation cost for the Authority which is provided under appropriation from the FSM Congress has not gone through any drastic change. Because of the uncertainty of the compact funding the Authority maintained its operation cost at a minimal level.

Plan of Action for 2004

The following are the course of action the Authority plans for the industry:

1. Re-examine the budget and make straightforward assessment of its expenses to minimize its operation costs.
2. Promote accountability of the Authority's records.
3. Advocate teamwork in the current operations to accomplish efficiency and enhance employee moral
4. Stopped all non essential expenses and promote cost saving measures
5. Aggressive collection of receivables
6. Venture into development of other high value added coconut products.

**FEDERATED STATES OF MICRONESIA
COCONUT DEVELOPMENT AUTHORITY**

Statements of Net Assets
September 30, 2003 and 2002

<u>ASSETS</u>	<u>2003</u>	<u>2002</u>
Current assets:		
Cash and equivalents	\$ 32,457	\$ 50,742
Investments	-	110,442
Copra buyers' revolving fund, net	36,500	41,500
Accounts receivable, net	7,793	1,987
Interest receivable	-	155
Prepayments	256	1,955
Copra bags inventory	10,429	13,860
Copra inventory, net	<u>156,195</u>	<u>54,960</u>
Total current assets	243,630	275,601
Property, plant and equipment, net	<u>275,723</u>	<u>185,836</u>
	<u>\$ 519,353</u>	<u>\$ 461,437</u>
<u>LIABILITIES AND NET ASSETS</u>		
Current liabilities:		
Accounts payable	\$ 9,373	\$ 12,335
Accrued payroll and others	2,808	1,609
Customer deposits	<u>2,000</u>	<u>2,221</u>
Total current liabilities	<u>14,181</u>	<u>16,165</u>
Contingency		
Net assets:		
Invested in capital assets, net of related debt	275,723	185,836
Unrestricted	<u>229,449</u>	<u>259,436</u>
Total net assets	<u>505,172</u>	<u>445,272</u>
	<u>\$ 519,353</u>	<u>\$ 461,437</u>

See accompanying notes to financial statements.

**FEDERATED STATES OF MICRONESIA
COCONUT DEVELOPMENT AUTHORITY**

Statements of Revenues, Expenses, and Changes in Net Assets
Years Ended September 30, 2003 and 2002

	2003	2002
Copra sales	\$ 81,666	\$ 17,694
Cost of copra sold	(83,404)	(134,342)
Gross loss	(1,738)	(116,648)
Operating expenses:		
Personnel services	73,911	66,640
Contractual services	29,090	26,695
Depreciation	28,922	22,504
Inventory shrinkage	25,815	39,605
Consumables and others	24,344	15,741
Travel	8,787	14,286
Per diem and transportation	7,857	339
Stevedoring	7,627	469
Damaged bags expense	3,431	11,258
Ocean freight	525	178
Handling	376	302
Bad debts	-	14,067
Laboratory division	-	495
Miscellaneous	5,248	4,744
Total expenses	215,933	217,323
Loss from operations	(217,671)	(333,971)
Nonoperating revenues (expenses), net:		
Operating grants and subsidies	275,904	227,706
Interest income	629	1,929
Miscellaneous income	1,038	986
Total nonoperating revenues	277,571	230,621
Change in net assets	59,900	(103,350)
Net assets at beginning of year	445,272	548,622
Net assets at end of year	\$ 505,172	\$ 445,272

See accompanying notes to financial statements.

**FEDERATED STATES OF MICRONESIA
COCONUT DEVELOPMENT AUTHORITY**

Statements of Cash Flows
Years Ended September 30, 2003 and 2002

	<u>2003</u>	<u>2002</u>
Cash flows from operating activities:		
Cash received from customers	81,015	83,543
Cash paid to suppliers	<u>(367,466)</u>	<u>(393,234)</u>
Net cash used for operating activities	<u>(286,451)</u>	<u>(309,691)</u>
Cash flows from noncapital financing activities:		
Congress of the FSM operating appropriations	<u>275,904</u>	<u>227,706</u>
Cash flows from capital and related financing activities:		
Acquisition of property, plant and equipment	<u>(118,809)</u>	<u>(11,923)</u>
Cash flows from investing activities:		
Liquidation of investments	110,442	59,165
Interest received	<u>629</u>	<u>1,929</u>
Net cash provided by investing activities	<u>111,071</u>	<u>61,094</u>
Decrease in cash	(18,285)	(32,814)
Cash and equivalents at beginning of year	<u>50,742</u>	<u>83,556</u>
Cash and equivalents at end of year	\$ <u><u>32,457</u></u>	\$ <u><u>50,742</u></u>
Reconciliation of operating loss to net cash used for operating activities:		
Cash flows from operating activities:		
Operating loss	\$ (217,671)	\$ (333,971)
Adjustments to reconcile operating loss to net cash used for operating activities:		
Depreciation	28,922	22,504
Bad debts	-	14,067
Inventory shrinkage expense	25,815	39,605
Others	1,038	986
Loss from fire	-	1,953
Accounts receivable	(651)	65,849
Inventory and prepayments	(121,920)	(75,790)
Accounts payable	(2,962)	(48,724)
Accrued payroll and others	1,199	1,609
Customer deposits	<u>(221)</u>	<u>2,221</u>
Net cash used for operating activities	\$ <u><u>(286,451)</u></u>	\$ <u><u>(309,691)</u></u>

See accompanying notes to financial statements.

**FEDERATED STATES OF MICRONESIA
COCONUT DEVELOPMENT AUTHORITY**

Notes to Financial Statements
September 30, 2003 and 2002

(1) Summary of Significant Accounting Policies

A. Reporting Entity

The Federated States of Micronesia Coconut Development Authority (the Authority) was established in 1981 by Public Law 1-145, as amended by Public Law 2-8, and incorporated as Chapter Two, Title 22 of the Code of the Federated States of Micronesia. The purpose of the Authority is to manufacture, process, buy, collect, market, sell, export, inspect, improve the quality, and deal with, in general, all products derived from the coconut tree. The Authority has the additional responsibility to establish prices to producers or sellers of coconut products in the Federated States of Micronesia, to collect and receive all monies derived from the sales of coconut products, and to stabilize the price of these products. The Authority is a component unit of the National Government of the Federated States of Micronesia.

The affairs of the Authority are managed by a five-member board, consisting of representatives of the four FSM states and the FSM National Government. Daily operations of the Authority are delegated to a general manager, who is hired by and serves at the pleasure of the board.

The operation of the Authority is funded by annual appropriations from the FSM Congress. The purchase of coconut products is funded by copra subsidy appropriations from the FSM Congress and revenues generated through sales of copra.

The financial statements of the Authority have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to government units. Government Accounting Standards Board (GASB) Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting", requires that proprietary activities apply all applicable GASB pronouncements as well as Statements and Interpretations issued by the Financial Accounting Standards Board (FASB), Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989. The Authority has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

For the year ended September 30, 2003, the Authority adopted GASB Statement No. 34, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments" (GASB 34) as amended by GASB Statement No. 37, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments", and GASB Statement No. 38, "Certain Financial Statement Note Disclosures," and applied those standards on a retroactive basis. GASB Statement Nos. 34, 37 and 38 establish standards for external financial reporting for state and local governments and require that resources be classified for accounting and reporting purposes into the following four net asset categories:

- Invested in capital assets, net of related debt:

Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.

**FEDERATED STATES OF MICRONESIA
COCONUT DEVELOPMENT AUTHORITY**

Notes to Financial Statements
September 30, 2003 and 2002

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

- Restricted:
 - Nonexpendable – Net assets subject to externally imposed stipulations that require the Authority to maintain them permanently. For the years ended September 30, 2003 and 2002, the Authority does not have nonexpendable restricted net assets.
 - Expendable – Net assets whose use by the Authority is subject to externally imposed stipulations that can be fulfilled by actions of the Authority pursuant to those stipulations or that expire by the passage of time.
- Unrestricted:

Net assets that are not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action by management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

B. Fund Structure and Basis of Accounting

The accounts of the Authority are organized in the same manner as a proprietary fund-component unit. A proprietary fund is used by governmental units that are operated in a manner similar to private business enterprises. The purpose of a proprietary fund is to provide periodic determination of revenues, expenses and net income, with maintenance of capital. Proprietary funds are accounted for on the flow of economic resources measurement focus, whereby all assets and liabilities associated with the operations of the funds are included on the balance sheet. This is in contrast to "governmental" fund type accounting, which has a measurement focus on the sources and uses of funds, and includes only current assets and current liabilities on the balance sheet.

Basis of accounting refers to when revenues and expenses are recognized in the accounts and reported in the financial statements. The Authority uses the accrual basis of accounting. Revenues are recognized when they are earned and expenses are recognized when the related liabilities are incurred, regardless of when cash is received or payment is made.

C. Reclassification

Certain accounts in the 2002 statements have been reclassified to conform with the 2003 presentation.

D. Cash and Equivalents

For the purposes of the balance sheets and the statements of cash flows, cash and equivalents are defined as cash in checking accounts and certificates of deposit with initial maturities of ninety days or less. As of September 30, 2003 and 2002, \$100,000 is subject to FDIC coverage with remaining balances being uncollateralized.

**FEDERATED STATES OF MICRONESIA
COCONUT DEVELOPMENT AUTHORITY**

Notes to Financial Statements
September 30, 2003 and 2002

(1) Summary of Significant Accounting Policies, Continued

E. Investments

Investments consist of time certificates of deposits (TCDs) with original maturity dates in excess of ninety days.

F. Management Estimates

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

G. Receivables

Receivables are carried at cost, less an allowance for doubtful accounts. The allowance for doubtful accounts is estimated using the valuation method. Accounts determined to be uncollectible are charged against the allowance. Uncollectibility of accounts is determined by management based on the financial condition and responsiveness of the debtors to the Authority's collection efforts. Amounts ultimately collected could differ materially from the amounts estimated in determining the allowance for doubtful accounts.

Copra Buyers Revolving Fund. In prior years, the Authority executed contracts with local businesses within the FSM states, wherein the businesses agreed to act on behalf of the Authority as copra purchasing agents. As part of the agreements, the Authority advances \$10,000 to each agent to be used for the purchase and collection of copra. The advances are treated as a revolving fund, whereby the agents purchase copra from the producers in their home states and submit voucher claims to the Authority for replenishment. There are ten designated purchasing agents of which only four were active during the year ended September 30, 2003.

A summary of the copra revolving fund at September 30, 2003 and 2002, is presented below:

	<u>2003</u>	<u>2002</u>
Copra revolving funds advanced	\$ 94,500	\$ 99,500
Allowance for doubtful accounts	<u>(58,000)</u>	<u>(58,000)</u>
Copra revolving funds, net	\$ <u>36,500</u>	\$ <u>41,500</u>

**FEDERATED STATES OF MICRONESIA
COCONUT DEVELOPMENT AUTHORITY**

Notes to Financial Statements
September 30, 2003 and 2002

(1) Summary of Significant Accounting Policies, Continued

G. Receivables, Continued

Accounts Receivable. Accounts receivable substantially arise from copra sales to local customers, of which one entity is considered to be a related party. The Chairman of the Board of Directors of Coconut Development Authority is also a stockholder of Pohnpei Coconut Products, from whom the total related party receivable is due. A summary at September 30, 2003 and 2002, is as follows:

	<u>2003</u>	<u>2002</u>
Trade accounts receivable	\$ 36,394	\$ 33,339
Related party accounts receivable	<u>107,415</u>	<u>104,664</u>
	143,809	138,003
Allowance for doubtful accounts	<u>(136,016)</u>	<u>(136,016)</u>
Accounts receivable, net	\$ <u><u>7,793</u></u>	\$ <u><u>1,987</u></u>

H. Inventory

The Authority purchases and collects copra from local vendors within the FSM states. Inventory consists of dried copra and copra bags which are collected and stored at designated warehouses located within the four FSM states. Copra inventory is carried at cost determined through use of average costs. Cost may ultimately exceed market value, a factor which is offset by subsidies for this purpose which are received from the FSM National Government (note 3).

Ending copra inventory at September 30, 2003 and 2002 is valued at estimated realizable market value.

The inventory of bags is recorded at cost. Provision for damaged bags and deterioration in value of usable bags is made at the end of each fiscal year.

I. Property, Plant and Equipment

Property, plant and equipment are stated at cost, less accumulated depreciation. Depreciation expense is calculated by the straight-line method over the estimated useful lives of the assets.

J. New Accounting Standards

In June 1999, the Governmental Accounting Standards Board (GASB) issued Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*. In June 2001, GASB issued Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus* and Statement No. 38, *Certain Financial Statement Disclosures*, which amended certain provisions of GASB Statement No. 34. The Authority adopted GASB Statement No. 34, as amended by GASB Statement No. 37, and certain provisions of GASB Statement No. 38 in fiscal year 2003.

**FEDERATED STATES OF MICRONESIA
COCONUT DEVELOPMENT AUTHORITY**

Notes to Financial Statements
September 30, 2003 and 2002

(1) Summary of Significant Accounting Policies, Continued

J. New Accounting Standards, Continued

These statements establish new financial reporting standards for governmental entities, which results in a significant change in the financial reporting model used by governments, including statement formats and changes in fund types and account groups. In addition to the traditional fund financial statements, governments are required to report government-wide financial statements, prepared using the accrual basis of accounting and the economic resources measurement focus, and to present Management's Discussion and Analysis (MD&A). The MD&A is considered to be required supplementary information and precedes the financial statements.

For fiscal year 2004, the Authority will be implementing GASB Statement No. 39, *Determining Whether Certain Organizations Are Component Units*. For fiscal year 2005, the Authority will be implementing GASB Statement No. 40, *Deposit and Investment Risk Disclosures (an amendment of GASB Statement No. 3)* and GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. The Authority has not evaluated the financial statement impact of GASB Statement Nos. 39, 40 and 42.

(2) Property, Plant and Equipment

Fixed assets movement for the years ended September 30, 2003 and 2002, are as follows:

	<u>Estimated Useful Life</u>	<u>October 1, 2002</u>	<u>Additions</u>	<u>Retirements</u>	<u>September 30, 2003</u>
Buildings	20 years	\$ 245,429	\$ 10,095	-	\$ 255,524
Equipment	5-10 years	74,054	105,142	-	179,196
Vehicles	5 years	30,582	1,060	-	31,642
Furniture and fixtures	5-10 years	6,422	-	-	6,422
Leasehold improvements	20 years	11,255	-	-	11,255
Water tank	10 years	<u>7,589</u>	<u>-</u>	<u>-</u>	<u>7,589</u>
		375,331	116,297	-	491,628
Less accumulated depreciation		<u>(189,495)</u>	<u>(26,410)</u>	<u>-</u>	<u>(215,905)</u>
		<u>\$ 185,836</u>	<u>\$ 89,887</u>	<u>\$ -</u>	<u>\$ 275,723</u>
	<u>Estimated Useful Life</u>	<u>October 1, 2001</u>	<u>Additions</u>	<u>Retirements</u>	<u>September 30, 2002</u>
Buildings	20 years	238,333	7,096	-	\$ 245,429
Equipment	5-10 years	74,134	2,327	(2,407)	74,054
Vehicles	5 years	28,082	2,500	-	30,582
Furniture and fixtures	5-10 years	6,422	-	-	6,422
Leasehold improvements	20 years	11,255	-	-	11,255
Water tank	10 years	<u>7,589</u>	<u>-</u>	<u>-</u>	<u>7,589</u>
		365,815	11,923	(2,407)	375,331
Less accumulated depreciation		<u>(167,444)</u>	<u>(22,748)</u>	<u>697</u>	<u>(189,495)</u>
		<u>\$ 198,371</u>	<u>\$ (10,825)</u>	<u>\$ (1,710)</u>	<u>\$ 185,836</u>

**FEDERATED STATES OF MICRONESIA
COCONUT DEVELOPMENT AUTHORITY**

Notes to Financial Statements
September 30, 2003 and 2002

(3) Grants and Subsidies

During the years ended September 30, 2003 and 2002, the Authority recognized grants and contributions from FSM Congressional appropriations as follows:

	<u>2003</u>	<u>2002</u>
Copra subsidy funds	\$ 150,000	\$ 100,000
Operational grants:		
Administrative expenses	125,904	117,213
Capital asset additions	<u>-</u>	<u>10,493</u>
Total grants and subsidies	\$ <u>275,904</u>	\$ <u>227,706</u>

(4) Risk Management

The Authority purchases insurance to cover risks associated with its warehouses and buildings. As of September 30, 2003, the Authority's Pohnpei and Chuuk warehouses and buildings were insured for coverage of \$131,500 and \$86,000, respectively. Furthermore, the contents (equipment and stock) held at the Pohnpei and Chuuk warehouses and buildings were insured for coverage of \$240,000 and \$45,000, respectively. The Authority is self insured for all other risks.

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

Chairman
Board of Directors
Federated States of Micronesia
Coconut Development Authority:

We have audited the financial statements of Federated States of Micronesia Coconut Development Authority (the Authority), as of and for the year ended September 30, 2003, and have issued our report thereon dated September 3, 2004. 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 Authority's 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 the objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements of the Authority for the year ended September 30, 2003, we considered its internal control in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operations of the internal control over financial reporting that, in our judgment, could adversely affect the Authority's ability to record, process, summarize and report financial data consistent with assertions of management in the financial statements. The reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items 2003-01 through 2003-05.

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 over financial reporting that might be material weaknesses. However, we consider none of the reportable conditions described above to be a material weakness.

This report is intended solely for the information and use of the Board of Directors and management of the Authority and is not intended to be and should not be used by anyone other than those specified parties.

Deloitte + Touche LLP

September 3, 2004

**FEDERATED STATES OF MICRONESIA
COCONUT DEVELOPMENT AUTHORITY**

Schedule of Findings and Questioned Costs
Year Ended September 30, 2003

Finding No.: 2003-1
Area: Trade Receivables

Criteria: Customer accounts receivable should be closely monitored for collection.

Condition: The Authority's customer accounts receivable appeared to be significantly delinquent. Certain trade accounts receivable balances have been outstanding for over one year.

Cause: Set procedures are not in place to monitor and enforce collection of trade accounts receivable. In addition, management has been reluctant to cut off sales to major customers (primarily Pohnpei Coconut Products).

Effect: Excessively aged accounts receivable balances increases the likelihood of uncollectible accounts.

Recommendation: To improve account collections, close attention should be given to collection of past-due accounts.

Prior Year Status: This condition was reported as an internal control finding in the audit of the Authority for the years ended September 30, 2002 and 2001.

Auditee Response and Corrective Action Plan: The Authority is aware of the situation and continues to find ways to control its receivables, especially Ponape Coconut Products. In 2001 the Authority began issuing copra to Ponape Coconut Products on cash basis including 10% of their cash purchase to be applied to their account receivable. If their purchase is \$300, an additional \$30 is included to be applied to their account. This may not be very effective as the amount is very minimal but I believe close monitoring will help the situation.

**FEDERATED STATES OF MICRONESIA
COCONUT DEVELOPMENT AUTHORITY**

Schedule of Findings and Questioned Costs
Year Ended September 30, 2003

Finding No.: 2003-2
Area: Cash Advances

Criteria: Policies and procedures should be in place to promote timely collection and verification of cash advances given to copra buyer agents.

Condition: Cash advances made to copra buyer agents have not been recovered on a timely basis upon termination/expiration of the copra buyer's agreement. In addition, there has been no verification that the balances of cash advances given to active copra buyer agents are properly maintained.

Cause: Set procedures are not in place to collect and verify cash advances to copra buyer agents.

Effect: There is an increased likelihood that cash advances will be uncollectible if management fails to ensure that cash advances are properly maintained and repaid on a timely basis.

Recommendation: We recommend that prior to termination of the copra buyer's agreement, payments for copra purchases be offset against the advance for the buyer agent. This will ensure the recovery of these advances on a timely basis. In addition, we recommend that during the term of the copra buyer's agreement, management should physically verify the amount of cash advance maintained by the copra buyer.

Prior Year Status: This condition was reported as an internal control finding in the audit of the Authority for the years ended September 30, 2002 and 2001.

Auditee Response and Corrective Action Plan: The Authority is aware of the situation and is working closely with the old buyers to collect the advances. So far the Authority has been able to collect from some of the previous buyers.

With reference to some of the existing buyers the Authority will make arrangement with the current buyers to deduct certain percentage from their purchases to be applied to their advances. This will assure that the Authority is receiving regular payment of the advances.

**FEDERATED STATES OF MICRONESIA
COCONUT DEVELOPMENT AUTHORITY**

Schedule of Findings and Questioned Costs
Year Ended September 30, 2003

Finding No.: 2003-3
Area: Fixed Assets

Criteria: Policies and procedures should be in place to control the disposition of fixed assets.

Condition: Fixed assets totaling \$3,889 were disposed of without any documented authorization. Rather the assets appear to have just been deleted from the fixed asset register.

Cause: Set procedures are not in place to control the disposition of fixed assets.

Effect: Lack of management oversight over the disposal of fixed assets could result in the misappropriation of such assets.

Recommendation: We recommend that all disposals of fixed assets be supported by written approval from the board of directors or general manager.

Prior Year Status: This condition was reported as an internal control finding in the audit of the Authority for the years ended September 30, 2002 and 2001.

Auditee Response and Corrective Action Plan: This is an oversight and the Authority will comply with recommendation that all disposals of fixed assets be supported by written approval from the Board of Directors or General Manager.

**FEDERATED STATES OF MICRONESIA
COCONUT DEVELOPMENT AUTHORITY**

Schedule of Findings and Questioned Costs
Year Ended September 30, 2003

Finding No.: 2003-4
Area: Inventory Control

Criteria: The Authority should perform periodic physical inventory observations to verify the quantity of copra in the warehouses.

Condition: The Authority's personnel do not verify the quantity of copra on hand. Inventory records are based solely on purchase and sales invoices provided by copra agents.

Cause: There appears to be no policy in place to verify that quantities of copra purchased and sold agree to the quantities per the copra agents' purchase and sales invoices.

Effect: Lack of verification of copra inventory levels could result in the misappropriation of assets.

Recommendation: We recommend that management establish and implement a policy to perform periodic physical inventory counts at all copra warehouses.

Prior Year Status: This condition was reported as an internal control finding in the audit of the Authority for the year ended September 30, 2002.

Auditee Response and Corrective Action Plan: The Authority shares the same concern. The Authority has been conducting physical inventory over the years. The discrepancies exist are results of oversights and the Authority will try to establish a system to better regulate its inventory as inventory may be costly to conduct on a periodic basis. Currently the Authority conducts inventory on an annual basis.

**FEDERATED STATES OF MICRONESIA
COCONUT DEVELOPMENT AUTHORITY**

Schedule of Findings and Questioned Costs
Year Ended September 30, 2003

Finding No.: 2003-5
Area: Copra Purchase

Criteria: A functioning system of internal control requires disbursements be free of error.

Condition: Our review of copra inventory revealed a purchase where 431 copra bags were received and the vendor was paid for 460 copra bags.

Cause: The cause of this condition is the absence of scrutiny of this transaction.

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

Recommendation: We recommend that copra purchases be strictly based on receiving reports or purchase tickets.

Auditee Response and Corrective Action Plan: This represents a report on a purchase as indicated in the finding where the representative of our copra buyer reported a purchase of 460 copra bags. Upon delivery of the copra from the outer island to the center, only 431 bags were reported after payment had already been made and disbursed. The Authority noted the error and will make every effort to assure that such problem is prevented in the future.