

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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

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**YEAR ENDED SEPTEMBER 30, 2003**

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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FINANCIAL STATEMENTS IN ACCORDANCE  
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**YEAR ENDED SEPTEMBER 30, 2003**

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

YEAR ENDED SEPTEMBER 30, 2003

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**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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

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**YEAR ENDED SEPTEMBER 30, 2003**

## INDEPENDENT AUDITORS' REPORT

Honorable Joseph J. Urusemal  
President  
Federated States of Micronesia:

We have audited the accompanying financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Federated States of Micronesia (FSM) National Government as of and for the year ended September 30, 2003, which collectively comprise the FSM National Government's basic financial statements as set forth in Section II of the foregoing table of contents. These financial statements are the responsibility of the management of the FSM National Government. Our responsibility is to express an opinion on the respective financial statements based on our audit.

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 respective financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the FSM National Government's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

Because of inadequacies in the accounting records, we were unable to form an opinion regarding the amount at which cash and cash equivalents, receivables, advances and amounts due to the FSM State Governments are recorded for the governmental activities and the General Fund; the amount at which receivables and amounts due to the FSM State Governments are recorded for the U.S. Federal Grants Fund and the aggregate remaining fund information; and the amount at which cash and cash equivalents and receivables are recorded for the Asian Development Bank Loan Fund. These amounts enter into the determination of revenues and expenditures/expenses for governmental activities, the General Fund, the U.S. Federal Grants Fund, the Asian Development Bank Loan Fund, and the aggregate remaining fund information for the year ended September 30, 2003.

The financial statements of the National Fisheries Corporation, a component unit of the FSM National Government, reports its investment in Yap Fishing Corporation, Yap Fresh Tuna, Inc., Chuuk Fresh Tuna, Inc., and Kosrae Sea Venture, Inc. all 50%-owned corporations, at cost. Accounting principles generally accepted in the United States of America requires investments to be adjusted to reflect the National Fisheries Corporation's equity in the losses of those corporations, which would decrease the investment, decrease net assets, and change the expenses of the aggregate discretely presented component units. Due to the lack of audited financial statements of Yap Fishing Corporation, Yap Fresh Tuna, Inc., Chuuk Fresh Tuna, Inc., and Kosrae Sea Venture, Inc., the amount by which this departure would affect investments, net assets, and expenses of the aggregate discretely presented component units is not reasonably determinable.

The financial statements of Micronesia Longline Fishing Company, a 97%-owned corporation of the National Fisheries Corporation, have not been audited, and we were not engaged to audit these financial statements as part of our audit of the FSM National Government's basic financial statements. The financial activities of Micronesia Longline Fishing Company are consolidated with the financial activities of the National Fisheries Corporation. The financial activities of the National Fisheries Corporation and subsidiaries are included in the FSM National Government's basic financial statements as a discretely presented component unit and represent 4% and 20% of the assets and revenues, respectively, of the FSM National Government's aggregate discretely presented component units.

In our opinion, except for the effects on the financial statements of such adjustments, if any, as might have been determined to be necessary had accounting records regarding cash and cash equivalents, receivables, advances and amounts due to the FSM State Governments for the governmental activities and the General Fund; receivables and amounts due to the FSM State Governments for the U.S. Federal Grants Fund and the aggregate remaining fund information; and cash and cash equivalents and receivables for the Asian Development Bank Loan Fund, and their effect on the determination of revenues and expenditures/expenses for governmental activities, the General Fund, the U.S. Federal Grants Fund, the Asian Development Bank Loan Fund, and the aggregate remaining fund information, been adequate, as discussed in the third paragraph above, the lack of audited financial statements of Yap Fishing Corporation, Yap Fresh Tuna, Inc., Chuuk Fresh Tuna, Inc., and Kosrae Sea Venture, Inc., as discussed in the fourth paragraph above, and the lack of audited financial statements of Micronesia Longline Fishing Company, as discussed in the fifth paragraph above, such financial statements, as set forth in Section II of the foregoing table of contents, present fairly, in all material respects, the respective financial position of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the FSM National Government as of September 30, 2003, and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

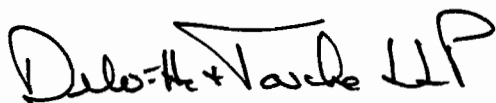
As discussed in Note 1, during the year ended September 30, 2003 the FSM National Government adopted the provisions of the Governmental Accounting Standards Board (GASB) Statements No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, GASB Statement No. 37, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments; Omnibus*, and GASB Statement No. 38, *Certain Financial Statement Note Disclosures*. The implementation of these standards changed the basic financial statement reporting model to include government-wide, full accrual statements and created a modified reporting of the fund perspective financial statements. Implementing these standards also required reporting of infrastructure assets, changed the method of reporting cash flows from the indirect method to the direct method, and included the requirement for reporting a Management's Discussion and Analysis as required supplementary information. Beginning net asset and fund balances have been restated to account for the implementation of these accounting standards.

The Management's Discussion and Analysis, on pages 4 through 10, as well as the Schedule of Revenues, Expenditures, and Changes in Deficit - Budget and Actual - General Fund and notes thereto, on pages 49 and 50, are not a required part of the basic financial statements but are supplementary information required by GASB. This supplementary information is the responsibility of the management of the FSM National Government. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.



Our audit was conducted for the purpose of forming an opinion on the FSM National Government's respective financial statements that collectively comprise the FSM National Government's basic financial statements. The combining and individual fund financial statements, as set forth in Section IV of the foregoing table of contents, which are also the responsibility of the management of the FSM National Government, are presented for purposes of additional analysis and are not a required part of the basic financial statements of the FSM National Government. Such additional information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, except for the effects of the matter discussed in the third paragraph above, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated July 25, 2006, on our consideration of the FSM National Government's (Primary Government only) internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that 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 considered in assessing 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.

July 25, 2006

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Management's Discussion and Analysis  
Year Ended September 30, 2003

This discussion and analysis of the National Government's financial performance provides an overview of the financial activities of the National Government for the year ended September 30, 2003 and of the financial position of the National Government at September 30, 2003. This report is to be read in conjunction with the financial statements of the National Government which begin on page x. The financial statements are prepared under the requirements of Government Accounting Standards Board, GASB-34.

As the reporting standards under GASB-34 are significantly different from prior years it is not possible to make meaningful comparison with 2002. However in future years, comparisons will be more meaningful and will go farther towards explaining the financial position and results of operation of the National Government

**FINANCIAL HIGHLIGHTS**

- For the fiscal year ended September 30, 2003, the FSM National Government's governmental activities total net assets amounted to \$65,508,518.
- During the year, the FSM National Government expenses for governmental activities were \$56,248,566 and were funded by program revenues of \$26,321,979 and further funded with taxes and other general revenues that totaled \$27,822,617. The balance of the expenses was funded by a reduction in Net Assets.
- At September 30, 2003, the General Fund reported an unreserved deficit of \$2,410,559.
- For budgetary reporting purposes, the General Fund reported revenues in excess of estimates by \$2,799,945 (11%), while expenditures were in less than final appropriations by \$61,298 (0.2%). The excess in revenue was largely due to Fishing Right fees and investment earnings exceeding budgetary estimates by \$1,317,041 and \$2,163,290, respectively. Adjustments were made to the continuing Legislative Appropriations in FY03 to correct posting errors made in previous years.

**OVERVIEW OF THE FINANCIAL STATEMENTS**

This Financial Statements for the Year Ended September 30, 2003 consists of four parts - management's discussion and analysis (this section), the basic financial statements, required supplementary information, and notes to financial statements.

The basic financial statements include two kinds of statements that present different views of the FSM National Government.

The Government-Wide Financial Statements

The government -wide financial statements report information about the FSM National Government as a whole using accounting method similar to those used by the private-sector companies. It provides both long-term and short-term information about the government's financial status.

The Statement of Net Assets includes all of the Government's assets and liabilities. The difference between the two is called net assets. Overtime, increases or decreases in the Government's net assets serve as an indicator to measure the Government's financial position.

The Statement of Activities, on the other hand, accounts for the FSM National Government's current year's revenues and expenses regardless of when cash is received or paid.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Management's Discussion and Analysis  
Year Ended September 30, 2003

The Statement of Net Assets and the Statement of Activities are divided into three activities:

- **Governmental Activities** - Most of the FSM National Government's basic services are reported here. These include the services provided by the Executive Branch such as health, education, foreign affairs, transportation, resources and development, finance, the Attorney General's office, and general administration; the Judicial Branch; the Legislative Branch; other National Government programs; Boards and Commissions; and other legislative appropriations. These services are funded by Compact of association funds, US Federal contributions, FSM revenue sharing, taxes and licenses, and investment income.
- **Components Units** – The FSM National Government has six (6) component units namely, College of Micronesia - FSM, National Fisheries Corporation, FSM Telecommunications Corporation, FSM Development Bank, FSM Social Security Administration and the FSM Coconut Development Authority. These components units are entities which are legally separate from the FSM National Government, but are financially accountable to the FSM National Government, or whose relationships with the FSM National Government is such that exclusion would cause the FSM National Government's basic financial statements to be misleading or incomplete.

Fund Financial Statements

The analysis of the FSM National Government's major funds begins on page 13. The Fund Financial Statements provide detailed information about the most significant funds - not the FSM National Government as a whole. Some funds are required to be established by FSM law. However, the FSM National Government establishes many other funds to help it control and manage money for particular purposes to show that it meets the legal responsibilities for using certain taxes, grants, and other money (like grants received from outsiders). The FSM National Government has two kinds of funds - government and fiduciary – each using different accounting approaches.

- **Government funds** - Most of the FSM National Government's basic services are reported in governmental funds, which focus on how money flows into and out of those funds and the balances left at year-end that are available for spending. These funds are reported using an accounting method called modified accrual accounting, which measures cash and all other financial assets that can readily be converted to cash. The government fund statements provide a detailed short-term view of the FSM National Government general operations and the basic services it provides. Government fund information helps determine whether there are more or fewer financial resources that can be spent in the near future to finance the FSM National Government's program. We describe the relationship (or differences) between governmental activities (reported in the Statement of Net Assets and the Statement of Activities) and governmental funds in a reconciliation at the bottom of the page 13.
- **Proprietary funds** - These funds are used to account for assets held by a Government unit in a trustee capacity for individuals, private organizations, and other governmental resources. This fund is used to account for operations that are financed and operated in a manner similar to private business enterprises where the intent is that costs (expenses, including amortization and depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Management's Discussion and Analysis  
Year Ended September 30, 2003

**THE NATIONAL GOVERNMENT AS A WHOLE**

Net Assets may serve overtime as a useful indicator of government's financial position. At the end of the fiscal year 2003, FSM National Government assets exceeded liabilities by \$65,508,518. Of the total net assets, \$31,467,338 are restricted as to purposes for which they may be used and \$21,251,370 are related to the FSM National Government's investment in capital assets. The FSM National Government uses these capital assets to provide services to its citizens; consequently, these assets are not available for future spending. Although the FSM National Government investments in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other source, since the capital assets themselves cannot be used to liquidate these liabilities.

Table 1 shows the schedule of the FSM National Government's net assets as of September 30, 2003.

**Table 1  
Net Assets**

|   |                      |
|---|----------------------|
| Current Assets                                  | \$ 60,419,458        |
| Other Assets                                    | 36,026,178           |
| Capital Assets                                  | <u>21,251,370</u>    |
| Total assets                                    | <u>117,697,006</u>   |
|   |                      |
| Current liabilities                             | 17,963,368           |
| Other liabilities                               | <u>34,225,120</u>    |
| Total liabilities                               | <u>52,188,488</u>    |
|   |                      |
| Net Assets:                                     |                      |
| Invested in capital assets, net of related debt | 21,251,370           |
| Restricted                                      | 28,819,488           |
| Unrestricted                                    | <u>15,437,660</u>    |
| Total net assets                                | \$ <u>65,508,518</u> |

At the end of the fiscal year 2003, the FSM National Government unrestricted net assets show a surplus of \$15,437,660.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Management's Discussion and Analysis  
Year Ended September 30, 2003

Table 2 shows the changes in Net Assets of the FSM National Government as of September 30, 2003.

**Table 2  
Changes in Net Assets**

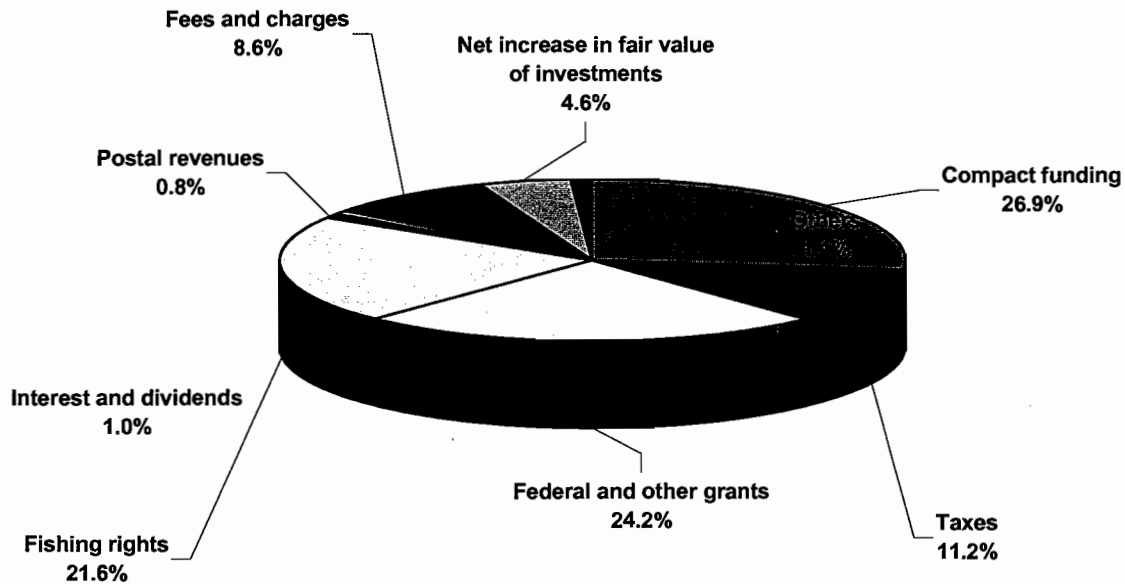
|                                    |                      |
|------------------------------------|----------------------|
| Revenues:                          |                      |
| Program Revenues:                  |                      |
| Charges for services               | \$ 5,106,365         |
| Operating Grants and Contributions | 18,231,773           |
| Capital Grants and contributions   | 2,983,841            |
| General Revenues:                  |                      |
| Taxes                              | 6,107,652            |
| Compact funding                    | 6,956,993            |
| Fishing rights fees                | 11,817,041           |
| Investment earnings                | 2,811,904            |
| Other                              | <u>129,027</u>       |
| Total revenues                     | <u>54,144,596</u>    |
| Expenses:                          |                      |
| Executive                          | 34,912,672           |
| Judicial                           | 1,065,584            |
| Legislature                        | 3,079,869            |
| Office of the Public Auditor       | 367,912              |
| Other National Government Programs | 4,239,157            |
| Boards and Commissions             | 1,181,729            |
| Other Legislative Appropriations   | 4,443,620            |
| Payments to component units        | 5,398,533            |
| Capital projects                   | <u>1,559,490</u>     |
| Total Expenditure                  | <u>56,248,566</u>    |
| Change in Net Assets               | (2,103,970)          |
| Net Assets October 1, 2002         | <u>67,612,488</u>    |
| Net Assets September 30, 2003      | \$ <u>65,508,518</u> |

FSM National Government revenues from governmental activities, including local revenues, investment increases, compact and other grants funding totaled \$54,144,596. In fiscal year 2003, the cost of governmental activities totaled \$56,248,566; the difference between the two representing a decrease in net assets of \$2,103,970. To assist in appreciating the details of governmental activities, the above governmental activities information is shown in pictorial form in the following graphs.

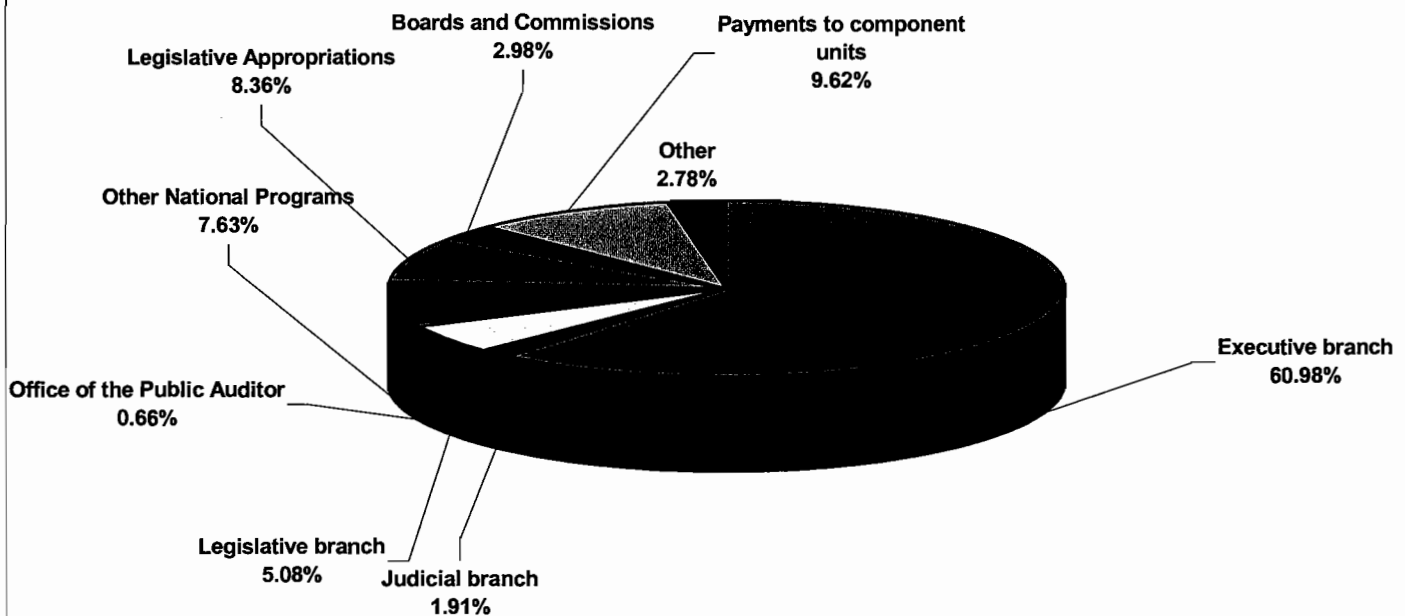
**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Management's Discussion and Analysis  
September 30 , 2003

**Exhibit-I Federated States of Micronesia  
National Government  
Sources of Revenue**



**Exhibit-II Federated States of Micronesia  
National Government  
Expenditures by Function**



**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Management's Discussion and Analysis  
Year Ended September 30, 2003

**FINANCIAL ANALYSIS OF THE NATIONAL GOVERNMENT'S FUNDS**

Table 3 shows The FSM National Government Governmental Fund changes in fund balances for the year ended September 30, 2003.

**Table 3  
Changes in Fund Balances**

|   | <u>General Fund</u>     | <u>Other Funds</u>      | <u>Total</u>            |
|---|-------------------------|-------------------------|-------------------------|
| Revenues:                                 |                         |                         |                         |
| Compact funding                           | \$ 6,956,993            | \$ 7,753,502            | \$ 14,710,495           |
| Federal and other grants                  | -                       | 13,225,383              | 13,225,383              |
| Taxes                                     | 6,107,652               | -                       | 6,107,652               |
| Fishing rights fees                       | 11,817,041              | -                       | 11,817,041              |
| Interest and dividends                    | 140,487                 | 385,343                 | 525,830                 |
| Fees and charges                          | 621,412                 | 4,484,953               | 5,106,365               |
| Net increase in fair value of Investments | 2,522,803               | -                       | 2,522,803               |
| Other                                     | <u>118,550</u>          | <u>10,477</u>           | <u>129,027</u>          |
| <br>Total revenues                        | <br>28,284,938          | <br>25,859,658          | <br>54,144,596          |
| <br>Expenditures                          | <br><u>28,728,301</u>   | <br><u>26,909,663</u>   | <br><u>55,637,964</u>   |
| Deficiency of revenues under expenditures | (443,363)               | (1,050,005)             | (1,493,368)             |
| Net Financing Sources (uses)              | <u>(486,558)</u>        | <u>3,358,159</u>        | <u>2,871,601</u>        |
| <br>Net Change in Fund Balance            | <br>\$ <u>(929,921)</u> | <br>\$ <u>2,308,154</u> | <br>\$ <u>1,378,233</u> |

**CAPITAL ASSETS AND DEBT ADMINISTRATION**

Capital Assets

At September 30, 2003, the FSM National Government had invested \$21,251,370 in capital assets, net of accumulated depreciation. These assets consist basically of office equipment and Machinery, buildings, ship, and motor vehicles. The summary of capital assets of the year is shown below:

|                                | <u>Primary Government<br/>Governmental Activities</u> |
|--------------------------------|---|
| Buildings                      | \$ 13,958,076   |
| Ships and Boats                | 13,967,241  |
| Computer Equipment             | 2,465,395   |
| Aircraft                       | 709,207   |
| Furniture, Equip and Machinery | 2,738,813   |
| Motor Vehicles                 | <u>4,881,158</u>                                      |
| <br>Subtotal                   | <br>38,719,890  |
| Accumulated Depreciation       | <u>(17,468,520)</u>                                   |
| <br>Total                      | <br>\$ <u>21,251,370</u>                              |

Further information on the FSM National Government's capital assets can be obtained from note 5 to the accompanying financial statements.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Management's Discussion and Analysis  
Year Ended September 30, 2003

Long Term Debt

At September 30, 2003, the FSM National Government had long term obligations of \$34,577,580 as shown below:

|                                     |                      |
|-------------------------------------|----------------------|
| ADB Loans - Early Retirement        | \$ 33,910,844        |
| Compensated Absences (Annual Leave) | <u>666,736</u>       |
| Total                               | \$ <u>34,577,580</u> |

Further information on the FSM National Government's long term obligations can be obtained from note 6 to the accompanying financial statements.

Economic Factors and Next year's Budget:

Fiscal year 2004 is the beginning of the implementation of the economic assistance under the Compact II/amended funding which replaces the funding sources from the Compact I. Under the amended Compact, annual funding will be available as follows:

- The education sector grant shall support and improve the educational system of the Federated States of Micronesia, including, without limitation, the systems for primary, secondary, and post secondary education
- The Health Sector grant shall support and improve the delivery of preventive, curative and environmental care, and develop the human and material resources necessary for the Federated States of Micronesia to perform these services.
- The sector grant for private sector development shall support the efforts of the Federated of Micronesia to attract new foreign investment and increase indigenous business activity. Priorities will be in advancing the private development of fisheries, tourism and agriculture; employing new telecommunications technologies; and analyzing and developing new systems, laws, and policies to foster private sector development, to facilitate investment by potential private investors, and develop business and entrepreneurial skills.
- The sector for capacity building shall support the efforts of the Federated States of Micronesia to build effective, accountable and transparent national and local government and other public sector institutions and systems.
- The environment sector shall support the efforts of the Federated States of Micronesia to protect the national land and marine environment and to conserve and achieve sustainable use of its natural resources.
- Public Infrastructure grant shall give priority to primary and secondary education capital projects and programs that directly affect health and safety including water and waste water projects, solid waste disposal projects and health care facilities.

The local revenues and the revenue from fishing right fees are expected to be within a range of \$22-23 million. The added tax revenue of 20% resulting from the revised National/State tax sharing arrangements beginning January 2004 will generate an increase in tax revenue. The carry over balances from the Compact I may be authorized to be used to fund other operations of the Government.

**FINANCIAL CONTACT**

This financial report is designed to provide all interested users with a general overview of the National Government's finances. If you have questions about this report or need additional financial information, please contact the office of the Secretary of Finance and Administration, P.O. Box PS 158, Palikir, Pohnpei, FM 96941.



**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Statement of Net Assets  
September 30, 2003

|   | Primary<br>Government | Component<br>Units |
|---|-----------------------|--------------------|
| <b>ASSETS</b>                                   |                       |                    |
| Current assets:                                 |                       |                    |
| Cash and cash equivalents                       | \$ 2,452,083          | \$ 13,595,531      |
| Time certificates of deposit                    | 94,896                | 204,189            |
| Investments                                     | 29,986,969            | 8,476,577          |
| Receivables, net                                | 21,877,857            | 11,258,113         |
| Due from component units                        | 2,169,917             | -                  |
| Due from primary government                     | -                     | 168,818            |
| Advances  | 3,432,944             | 76,060             |
| Inventories                                     | 130,299               | 1,624,036          |
| Other current assets                            | 274,493               | 449,145            |
| Total current assets                            | 60,419,458            | 35,852,469         |
| Noncurrent assets:                              |                       |                    |
| Time certificates of deposit                    | 1,149,850             | -                  |
| Investments                                     | 7,981,124             | 13,020,750         |
| Receivables, net                                | 26,895,204            | 14,356,411         |
| Capital assets, net of accumulated depreciation | 21,251,370            | 60,407,549         |
| Other noncurrent assets                         | -                     | 407,974            |
| Total noncurrent assets                         | 57,277,548            | 88,192,684         |
| Total assets                                    | \$ 117,697,006        | \$ 124,045,153     |
| <b>LIABILITIES</b>                              |                       |                    |
| Current liabilities:                            |                       |                    |
| Current portion of long-term obligations        | \$ 103,024            | \$ 8,872,527       |
| Accounts payable                                | 4,484,328             | 1,485,206          |
| Compensated absences payable                    | 249,436               | -                  |
| Other liabilities and accruals                  | 4,869,316             | 4,037,021          |
| Tax refunds payable                             | 522,098               | -                  |
| Due to FSM State Governments                    | 7,225,690             | -                  |
| Due to primary government                       | -                     | 2,169,917          |
| Deferred revenue                                | 509,476               | 2,183,864          |
| Total current liabilities                       | 17,963,368            | 18,748,535         |
| Noncurrent liabilities:                         |                       |                    |
| Noncurrent portion of long-term obligations     | 33,807,820            | 25,978,382         |
| Compensated absences payable                    | 417,300               | -                  |
| Total noncurrent liabilities                    | 34,225,120            | 25,978,382         |
| Total liabilities                               | 52,188,488            | 44,726,917         |
| <b>NET ASSETS</b>                               |                       |                    |
| Invested in capital assets, net of related debt | 21,251,370            | 32,540,607         |
| Restricted for:                                 |                       |                    |
| Compact related                                 | 28,373,872            | -                  |
| Capital projects                                | 78,822                | -                  |
| Other purposes                                  | 366,794               | 6,018,568          |
| Unrestricted                                    | 15,437,660            | 40,759,061         |
| Total net assets                                | 65,508,518            | 79,318,236         |
| Total liabilities and net assets                | \$ 117,697,006        | \$ 124,045,153     |

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

**Statement of Activities  
Year Ended September 30, 2003**

|  | Program Revenues     |                         |  |  | Net (Expenses) Revenues<br>and Changes in Net Assets |                      |
|--|----------------------|-------------------------|--|--|--|----------------------|
|  | Expenses             | Charges for<br>Services | Operating<br>Grants and<br>Contributions | Capital<br>Grants and<br>Contributions | Primary<br>Government                                | Component<br>Units   |
| <b>Functions/Programs</b>                                    |                      |                         |  |  |  |                      |
| <b>Primary government:</b>                                   |                      |                         |  |  |  |                      |
| <b>Governmental activities:</b>                              |                      |                         |  |  |  |                      |
| President's office   | \$ 945,675           | \$ -                    | \$ 211,841                               | \$ -                                   | \$ (733,834)   | \$ -                 |
| External affairs and LNOs                                    | 3,823,647            | -                       | -  | -                                      | (3,823,647)  | -                    |
| Health, education and social affairs                         | 19,182,281           | 3,823,713               | 13,328,106                               | -                                      | (2,030,462)  | -                    |
| Economic affairs   | 3,452,907            | 340,398                 | 1,261,370                                | -                                      | (1,851,139)  | -                    |
| Transportation, communication<br>and infrastructure          | 2,033,633            | -                       | 1,580,000                                | -                                      | (453,633)  | -                    |
| Finance and administration                                   | 2,275,238            | 2,200                   | -  | -                                      | (2,273,038)  | -                    |
| Justice  | 2,712,482            | 42,675                  | -  | -                                      | (2,669,807)  | -                    |
| Office of the Public Defender                                | 486,809              | -                       | -  | -                                      | (486,809)  | -                    |
| Judiciary  | 1,065,584            | 87,660                  | -  | -                                      | (977,924)  | -                    |
| Legislature  | 3,079,869            | -                       | -  | -                                      | (3,079,869)  | -                    |
| Office of the Public Auditor                                 | 367,912              | -                       | -  | -                                      | (367,912)  | -                    |
| National government programs                                 | 4,239,157            | 1,511                   | 818,571                                  | -                                      | (3,419,075)  | -                    |
| Other appropriations   | 4,443,620            | 335,040                 | 1,031,885                                | -                                      | (3,076,695)  | -                    |
| Payments to component units                                  | 5,398,533            | -                       | -  | 1,000,000                              | (4,398,533)  | -                    |
| Boards, commissions and other                                | 1,181,729            | 473,168                 | -  | -                                      | (708,561)  | -                    |
| Capital projects   | 1,559,490            | -                       | -  | 1,983,841                              | 424,351  | -                    |
| <b>Total primary government</b>                              | <b>\$ 56,248,566</b> | <b>\$ 5,106,365</b>     | <b>\$ 18,231,773</b>                     | <b>\$ 2,983,841</b>                    | <b>(29,926,587)</b>                                  | <b>-</b>             |
| <b>Component units:</b>                                      |                      |                         |  |  |  |                      |
| FSM Telecommunications<br>Corporation                        | \$ 11,203,294        | \$ 11,247,373           | \$ -                                     | \$ -                                   | -  | 44,079               |
| FSM Development Bank   | 2,157,582            | 2,175,469               | 1,250,000                                | -                                      | -  | 1,267,887            |
| National Fisheries Corporation                               | 9,792,340            | 8,418,680               | 231,178                                  | -                                      | -  | (1,142,482)          |
| College of Micronesia - FSM                                  | 16,819,483           | 13,102,664              | 4,411,000                                | 4,168,582                              | -  | 4,862,763            |
| FSM Coconut Development Authority                            | 299,337              | 81,666                  | 275,904                                  | -                                      | -  | 58,233               |
| <b>Total component units</b>                                 | <b>\$ 40,272,036</b> | <b>\$ 35,025,852</b>    | <b>\$ 6,168,082</b>                      | <b>\$ 4,168,582</b>                    | <b>-</b>   | <b>5,090,480</b>     |
| <b>General revenues:</b>                                     |                      |                         |  |  |  |                      |
| <b>Taxes:</b>  |                      |                         |  |  |  |                      |
| Income   |                      |                         |  |  | 2,318,022  | -                    |
| Import   |                      |                         |  |  | 1,949,024  | -                    |
| Gross receipts   |                      |                         |  |  | 1,702,278  | -                    |
| Fuel   |                      |                         |  |  | 138,328  | -                    |
| Grants and contributions not restricted to specific programs |                      |                         |  |  | 6,956,993  | -                    |
| Fishing rights   |                      |                         |  |  | 11,817,041   | -                    |
| Unrestricted investment earnings                             |                      |                         |  |  | 2,811,904  | 1,325,363            |
| Other  |                      |                         |  |  | 129,027  | 43,154               |
| <b>Total general revenues and transfers</b>                  |                      |                         |  |  | <b>27,822,617</b>                                    | <b>1,368,517</b>     |
| Change in net assets   |                      |                         |  |  | (2,103,970)  | 6,458,997            |
| Net assets at the beginning of the year                      |                      |                         |  |  | 67,612,488   | 72,859,239           |
| <b>Net assets at the end of the year</b>                     |                      |                         |  |  | <b>\$ 65,508,518</b>                                 | <b>\$ 79,318,236</b> |

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

**Balance Sheet  
Governmental Funds  
September 30, 2003**

|   | Special Revenue      |                     |                                    |                          |                             |                          | Total                |
|---|----------------------|---------------------|------------------------------------|--------------------------|-----------------------------|--------------------------|----------------------|
|   | General              | U.S Federal Grants  | Section 111 Investment Development | Early Retirement Program | Asian Development Bank Loan | Other Governmental Funds |                      |
| <b>ASSETS</b>   |                      |                     |                                    |                          |                             |                          |                      |
| Cash and cash equivalents   | \$ 2,192,353         | \$ 400              | \$ -                               | \$ -                     | \$ 178,367                  | \$ 80,963                | \$ 2,452,083         |
| Time certificates of deposit  | 1,149,850            | -                   | -                                  | -                        | -                           | 94,896                   | 1,244,746            |
| Equity in internal investment pool  | 9,918,108            | -                   | -                                  | -                        | -                           | 9,647,070                | 19,565,178           |
| Investments   | 1,500,000            | -                   | 8,570,619                          | 2,647,850                | 1,851,172                   | 3,833,274                | 18,402,915           |
| Receivables, net:   |                      |                     |                                    |                          |                             |                          |                      |
| General   | 3,000,342            | -                   | -                                  | -                        | 1,126,860                   | -                        | 4,127,202            |
| Taxes   | 2,953,254            | -                   | -                                  | -                        | -                           | -                        | 2,953,254            |
| Federal agencies  | -                    | 296,247             | -                                  | -                        | -                           | 726,755                  | 1,023,002            |
| Loans   | 5,161,987            | -                   | 5,033,324                          | -                        | 27,800,704                  | 1,228,636                | 39,224,651           |
| Other governments and agencies  | 840,999              | -                   | -                                  | -                        | -                           | -                        | 840,999              |
| Accrued interest  | -                    | -                   | 123,068                            | -                        | -                           | 455,812                  | 578,880              |
| Other   | -                    | -                   | -                                  | -                        | -                           | 25,073                   | 25,073               |
| Due from component units  | -                    | -                   | 2,169,917                          | -                        | -                           | -                        | 2,169,917            |
| Due from other funds  | 4,247,509            | 3,317,152           | -                                  | -                        | -                           | 2,382,222                | 9,946,883            |
| Advances  | 3,306,443            | 62,408              | -                                  | -                        | -                           | 64,093                   | 3,432,944            |
| Inventories   | 130,299              | -                   | -                                  | -                        | -                           | -                        | 130,299              |
| Other assets  | -                    | -                   | -                                  | -                        | -                           | 274,493                  | 274,493              |
| <b>Total assets</b>   | <b>\$ 34,401,144</b> | <b>\$ 3,676,207</b> | <b>\$ 15,896,928</b>               | <b>\$ 2,647,850</b>      | <b>\$ 30,957,103</b>        | <b>\$ 18,813,287</b>     | <b>\$106,392,519</b> |
| <b>LIABILITIES AND FUND BALANCES</b>  |                      |                     |                                    |                          |                             |                          |                      |
| <b>Liabilities:</b>   |                      |                     |                                    |                          |                             |                          |                      |
| Accounts payable  | \$ 1,431,088         | \$ 2,335,064        | \$ -                               | \$ 1,254                 | \$ 557                      | \$ 716,365               | \$ 4,484,328         |
| Other liabilities and accruals  | 2,795,531            | -                   | -                                  | 206,991                  | -                           | 1,866,794                | 4,869,316            |
| Tax refunds payable   | 522,098              | -                   | -                                  | -                        | -                           | -                        | 522,098              |
| Due to FSM State Governments  | 4,953,809            | 1,338,136           | -                                  | -                        | -                           | 933,745                  | 7,225,690            |
| Due to other funds  | 5,699,374            | -                   | -                                  | 2,579,150                | 621,639                     | 1,046,720                | 9,946,883            |
| Deferred revenue  | -                    | -                   | -                                  | -                        | -                           | 509,476                  | 509,476              |
| <b>Total liabilities</b>  | <b>15,401,900</b>    | <b>3,673,200</b>    | <b>-</b>                           | <b>2,787,395</b>         | <b>622,196</b>              | <b>5,073,100</b>         | <b>27,557,791</b>    |
| <b>Fund balances (deficits):</b>  |                      |                     |                                    |                          |                             |                          |                      |
| <b>Reserved for:</b>  |                      |                     |                                    |                          |                             |                          |                      |
| Related assets  | 11,560,862           | -                   | 7,203,241                          | 2,647,850                | 29,105,931                  | 5,788,665                | 56,306,549           |
| Encumbrances  | 3,956,740            | 1,715,436           | -                                  | -                        | -                           | 1,248,974                | 6,921,150            |
| Continuing appropriations   | 5,892,201            | -                   | -                                  | -                        | -                           | 5,251,367                | 11,143,568           |
| Compact programs  | -                    | -                   | 8,693,687                          | -                        | -                           | 1,903,532                | 10,597,219           |
| <b>Unreserved:</b>  |                      |                     |                                    |                          |                             |                          |                      |
| General fund  | (2,410,559)          | -                   | -                                  | -                        | -                           | -                        | (2,410,559)          |
| Special revenue funds   | -                    | (1,712,429)         | -                                  | (2,787,395)              | 1,228,976                   | 846,378                  | (2,424,470)          |
| Capital projects funds  | -                    | -                   | -                                  | -                        | -                           | (1,298,729)              | (1,298,729)          |
| <b>Total fund balances (deficit)</b>  | <b>18,999,244</b>    | <b>3,007</b>        | <b>15,896,928</b>                  | <b>(139,545)</b>         | <b>30,334,907</b>           | <b>13,740,187</b>        | <b>78,834,728</b>    |
| <b>Total liabilities and fund balances</b>  | <b>\$ 34,401,144</b> | <b>\$ 3,676,207</b> | <b>\$ 15,896,928</b>               | <b>\$ 2,647,850</b>      | <b>\$ 30,957,103</b>        | <b>\$ 18,813,287</b>     |                      |
| Amounts reported for governmental activities in the statement of net assets are different because:  |                      |                     |                                    |                          |                             |                          |                      |
| Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds  |                      |                     |                                    |                          |                             | \$ 21,251,370            |                      |
| Long-term liabilities, including loans payable, are not due and payable in the current period and, therefore, are not reported in the funds. The liabilities include: |                      |                     |                                    |                          |                             |                          |                      |
| Loans payable   |                      |                     |                                    |                          |                             | (33,910,844)             |                      |
| Compensated absences payable  |                      |                     |                                    |                          |                             | (666,736)                |                      |
|   |                      |                     |                                    |                          |                             |                          | (13,326,210)         |
| Net assets of governmental activities   |                      |                     |                                    |                          |                             |                          | <u>\$ 65,508,518</u> |

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Statement of Revenues, Expenditures, and Changes in Fund Balances (Deficits)  
Governmental Funds  
Year Ended September 30, 2003

|  | Special Revenue      |                       |  |                                |                                   |                                | Total                |
|--|----------------------|-----------------------|--|--------------------------------|-----------------------------------|--------------------------------|----------------------|
|  | General              | U.S Federal<br>Grants | Section 111<br>Investment<br>Development | Early<br>Retirement<br>Program | Asian<br>Development<br>Bank Loan | Other<br>Governmental<br>Funds |                      |
| <b>Revenues:</b>   |                      |                       |  |                                |                                   |                                |                      |
| Compact funding  | \$ 6,956,993         | \$ -                  | \$ -                                     | \$ -                           | \$ -                              | \$ 7,753,502                   | \$ 14,710,495        |
| Taxes  | 6,107,652            | -                     | -  | -                              | -                                 | -                              | 6,107,652            |
| Federal and other grants                                     | -                    | 13,089,717            | -  | -                              | -                                 | 135,666                        | 13,225,383           |
| Fishing rights   | 11,817,041           | -                     | -  | -                              | -                                 | -                              | 11,817,041           |
| Interest and dividends                                       | 140,487              | -                     | 236,729                                  | 148,614                        | -                                 | -                              | 525,830              |
| Fees and charges   | 621,412              | -                     | 135,803                                  | -                              | -                                 | 4,349,150                      | 5,106,365            |
| Net increase in the fair value of investmen                  | 2,522,803            | -                     | -  | -                              | -                                 | -                              | 2,522,803            |
| Other  | 118,550              | -                     | 1,326                                    | -                              | -                                 | 9,151                          | 129,027              |
| <b>Total revenues</b>  | <b>28,284,938</b>    | <b>13,089,717</b>     | <b>373,858</b>                           | <b>148,614</b>                 | <b>-</b>                          | <b>12,247,469</b>              | <b>54,144,596</b>    |
| <b>Expenditures:</b>   |                      |                       |  |                                |                                   |                                |                      |
| <b>Current:</b>  |                      |                       |  |                                |                                   |                                |                      |
| <b>General government:</b>                                   |                      |                       |  |                                |                                   |                                |                      |
| President's office   | 688,956              | 211,841               | -  | -                              | -                                 | -                              | 900,797              |
| External affairs and LNOs                                    | 3,822,846            | -                     | -  | -                              | -                                 | -                              | 3,822,846            |
| Health, education and social affairs                         | 937,472              | 10,861,760            | -  | -                              | -                                 | 7,520,228                      | 19,319,460           |
| Economic affairs   | 1,151,381            | 165,660               | 628,968                                  | -                              | -                                 | 1,492,024                      | 3,438,033            |
| Transportation, communication and infrastructure             | 729,842              | -                     | -  | -                              | 409,915                           | 450,546                        | 1,590,303            |
| Finance and administration                                   | 2,311,745            | -                     | -  | -                              | -                                 | -                              | 2,311,745            |
| Justice  | 2,313,517            | -                     | -  | -                              | -                                 | 33,800                         | 2,347,317            |
| Office of the Public Defender                                | 486,349              | -                     | -  | -                              | -                                 | -                              | 486,349              |
| Judiciary  | 1,071,180            | -                     | -  | -                              | -                                 | -                              | 1,071,180            |
| Legislature  | 2,848,894            | -                     | -  | -                              | -                                 | -                              | 2,848,894            |
| Office of the Public Auditor                                 | 372,699              | -                     | -  | -                              | -                                 | -                              | 372,699              |
| National government programs                                 | 3,461,163            | 818,571               | -  | -                              | -                                 | -                              | 4,279,734            |
| Other appropriations   | 3,661,196            | 1,031,860             | -  | -                              | -                                 | -                              | 4,693,056            |
| Payments to component units                                  | 3,673,533            | -                     | 250,000                                  | -                              | -                                 | 1,475,000                      | 5,398,533            |
| Boards, commissions and other                                | 1,197,528            | -                     | -  | -                              | -                                 | -                              | 1,197,528            |
| Capital projects   | -                    | -                     | -  | -                              | -                                 | 1,559,490                      | 1,559,490            |
| <b>Total expenditures</b>                                    | <b>28,728,301</b>    | <b>13,089,692</b>     | <b>878,968</b>                           | <b>-</b>                       | <b>409,915</b>                    | <b>12,531,088</b>              | <b>55,637,964</b>    |
| Excess (deficiency) of revenues over (under) expenditures    | (443,363)            | 25                    | (505,110)                                | 148,614                        | (409,915)                         | (283,619)                      | (1,493,368)          |
| <b>Other financing sources (uses):</b>                       |                      |                       |  |                                |                                   |                                |                      |
| Loan proceeds  | -                    | -                     | -  | -                              | 2,871,601                         | -                              | 2,871,601            |
| Operating transfers in                                       | 335,040              | -                     | -  | -                              | -                                 | 821,598                        | 1,156,638            |
| Operating transfers out                                      | (821,598)            | -                     | -  | -                              | -                                 | (335,040)                      | (1,156,638)          |
| <b>Total other financing sources (uses), net</b>             | <b>(486,558)</b>     | <b>-</b>              | <b>-</b>                                 | <b>-</b>                       | <b>2,871,601</b>                  | <b>486,558</b>                 | <b>2,871,601</b>     |
| <b>Net change in fund balances (deficits)</b>                | <b>(929,921)</b>     | <b>25</b>             | <b>(505,110)</b>                         | <b>148,614</b>                 | <b>2,461,686</b>                  | <b>202,939</b>                 | <b>1,378,233</b>     |
| <b>Fund balances (deficits) at the beginning of the year</b> | <b>19,929,165</b>    | <b>2,982</b>          | <b>16,402,038</b>                        | <b>(288,159)</b>               | <b>27,873,221</b>                 | <b>13,537,248</b>              | <b>77,456,495</b>    |
| <b>Fund balances (deficits) at the end of the year</b>       | <b>\$ 18,999,244</b> | <b>\$ 3,007</b>       | <b>\$ 15,896,928</b>                     | <b>\$ (139,545)</b>            | <b>\$ 30,334,907</b>              | <b>\$ 13,740,187</b>           | <b>\$ 78,834,728</b> |

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Reconciliation of the Statement of Revenues, Expenditure, and Changes in Fund  
Balances of Governmental Funds to the Statement of Activities  
Year Ended September 30, 2003

Amounts reported for governmental activities in the statement of activities on page 12 are different because:

|  |                       |
|--|-----------------------|
| Net change in fund balances - total governmental funds from page 14  | \$ 1,378,233          |
| Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which capital outlays exceeded depreciation in the current period, including increases to construction in progress                                     | (860,038)             |
| The issuance of long-term debt (e.g. bonds, leases) provides current financial resources to governmental funds, while the repayment of principal of long-term debt consumes the current financial resources of governmental funds. Neither transaction has any effect on net assets. This amount is the net effect of these differences in the treatment of long - term debt and related items | (2,871,601)           |
| Some expenses reported in the statement of activities do not require the use of current financial resources and therefore, are not reported as expenditures in governmental funds. These expenses include accrued annual leave and claims and judgment payable that are reported in the statement of activities, but not in funds  | <u>249,436</u>        |
| Change in net assets of governmental activities as presented on page 12.   | \$ <u>(2,103,970)</u> |

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

**Combining Statement of Fiduciary Net Assets  
Fiduciary Funds - Private Purpose Trusts  
September 30, 2003**

|   | <u>FSM<br/>Social Security<br/>Administration</u> | <u>Pohnpei State<br/>Development<br/>Loan Fund</u> | <u>Yap State<br/>Development<br/>Loan Fund</u> | <u>Total</u>         |
|---|---|--|--|----------------------|
| <b><u>ASSETS</u></b>                            |   |  |  |                      |
| Cash and cash equivalents                       | \$ 1,065,774                                      | \$ 122,594   | \$ 32,602                                      | \$ 1,220,970         |
| Time certificates of deposit                    | -   | 459,497  | 125,205  | 584,702              |
| Receivables, net:                               |   |  |  |                      |
| Contributions                                   | 1,712,396   | -  | -  | 1,712,396            |
| Loans   | -   | 195,768  | 152,558  | 348,326              |
| Accrued interest                                | 138,278   | 3,831  | 756  | 142,865              |
| Other   | 9,000   | -  | -  | 9,000                |
| Investments                                     | 34,423,853  | -  | -  | 34,423,853           |
| Capital assets, net of accumulated depreciation | <u>80,527</u>                                     | <u>-</u>   | <u>-</u>                                       | <u>80,527</u>        |
| Total assets                                    | <u>37,429,828</u>                                 | <u>781,690</u>                                     | <u>311,121</u>                                 | <u>38,522,639</u>    |
| <b><u>LIABILITIES</u></b>                       |   |  |  |                      |
| Accounts payable                                | 62,107  | -  | -  | 62,107               |
| Other liabilities and accruals                  | 20,819  | -  | 2,074  | 22,893               |
| Due to component units                          | <u>-</u>  | <u>61,775</u>                                      | <u>107,043</u>                                 | <u>168,818</u>       |
| Total liabilities                               | <u>82,926</u>                                     | <u>61,775</u>                                      | <u>109,117</u>                                 | <u>253,818</u>       |
| <b><u>NET ASSETS</u></b>                        |   |  |  |                      |
| Held in trust for:                              |   |  |  |                      |
| Social security benefits                        | 37,346,902  | -  | -  | 37,346,902           |
| Other purposes                                  | <u>-</u>  | <u>719,915</u>                                     | <u>202,004</u>                                 | <u>921,919</u>       |
| Total net assets                                | <u>\$ 37,346,902</u>                              | <u>\$ 719,915</u>                                  | <u>\$ 202,004</u>                              | <u>\$ 38,268,821</u> |

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Combining Statement of Changes in Fiduciary Net Assets  
Fiduciary Funds - Private Purpose Trusts  
Year Ended September 30, 2003

|   | <u>FSM<br/>Social Security<br/>Administration</u> | <u>Pohnpei State<br/>Development<br/>Loan Fund</u> | <u>Yap State<br/>Development<br/>Loan Fund</u> | <u>Total</u>         |
|---|---|--|--|----------------------|
| Additions:                                    |   |  |  |                      |
| Contributions:                                |   |  |  |                      |
| Private employees                             | \$ 5,284,263                                      | \$ -   | \$ -   | \$ 5,284,263         |
| Government employees                          | 5,960,268   | -  | -  | 5,960,268            |
| Penalties and interest                        | 154,353   | -  | -  | 154,353              |
| Total contributions                           | <u>11,398,884</u>                                 | <u>-</u>   | <u>-</u>                                       | <u>11,398,884</u>    |
| Investment earnings:                          |   |  |  |                      |
| Net increase in the fair value of investments | 4,200,871   | -  | -  | 4,200,871            |
| Interest and dividends                        | 203,732   | 7,679  | 2,647  | 214,058              |
| Total investment earnings                     | 4,404,603   | 7,679  | 2,647  | 4,414,929            |
| Less investment expense                       | 218,200   | -  | -  | 218,200              |
| Net investment earnings                       | <u>4,186,403</u>                                  | <u>7,679</u>                                       | <u>2,647</u>                                   | <u>4,196,729</u>     |
| Other   | -   | 13,418   | 11,110   | 24,528               |
| Total additions                               | <u>15,585,287</u>                                 | <u>21,097</u>                                      | <u>13,757</u>                                  | <u>15,620,141</u>    |
| Deductions:                                   |   |  |  |                      |
| Benefits                                      | 10,835,214  | -  | -  | 10,835,214           |
| Refunds                                       | 30,634  | -  | -  | 30,634               |
| Administrative expenses                       | 904,131   | 21,097   | 6,879  | 932,107              |
| Total deductions                              | <u>11,769,979</u>                                 | <u>21,097</u>                                      | <u>6,879</u>                                   | <u>11,797,955</u>    |
| Change in net assets                          | 3,815,308   | -  | 6,878  | 3,822,186            |
| Net assets at the beginning of the year       | <u>33,531,594</u>                                 | <u>719,915</u>                                     | <u>195,126</u>                                 | <u>34,446,635</u>    |
| Net assets at the end of the year             | <u>\$ 37,346,902</u>                              | <u>\$ 719,915</u>                                  | <u>\$ 202,004</u>                              | <u>\$ 38,268,821</u> |

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

**Combining Statement of Net Assets  
Component Units  
September 30, 2003**

|   | FSM Tele-<br>Communications<br>Corporation | FSM<br>Development<br>Bank | National<br>Fisheries<br>Corporation | College of<br>Micronesia-<br>FSM | FSM Coconut<br>Development<br>Authority | Total                 |
|---|--|----------------------------|--------------------------------------|----------------------------------|---|-----------------------|
| <b>ASSETS</b>                                   |  |                            |                                      |                                  |   |                       |
| <b>Current assets:</b>                          |  |                            |                                      |                                  |   |                       |
| Cash and cash equivalents                       | \$ 2,811,443                               | \$ 5,233,281               | \$ 491,167                           | \$ 5,027,183                     | \$ 32,457                               | \$ 13,595,531         |
| Time certificates of deposit                    | 204,189                                    | -                          | -                                    | -                                | -                                       | 204,189               |
| Investments                                     | 8,476,577                                  | -                          | -                                    | -                                | -                                       | 8,476,577             |
| Receivables, net:                               |  |                            |                                      |                                  |   |                       |
| General   | 1,030,028                                  | 20,561                     | 395,378                              | 2,910,538                        | 7,793                                   | 4,364,298             |
| Loans   | -  | 2,509,736                  | -                                    | -                                | -                                       | 2,509,736             |
| Interest  | 442,362                                    | 345,603                    | -                                    | -                                | -                                       | 787,965               |
| Other   | 898,784                                    | -                          | 352,245                              | 2,345,085                        | -                                       | 3,596,114             |
| Due from primary government                     | -  | 168,818                    | -                                    | -                                | -                                       | 168,818               |
| Advances  | 32,736                                     | -                          | 43,324                               | -                                | -                                       | 76,060                |
| Inventories                                     | 416,726                                    | -                          | 889,063                              | 151,623                          | 166,624                                 | 1,624,036             |
| Prepaid expenses                                | 343,232                                    | 1,000                      | 51,907                               | 16,250                           | 36,756                                  | 449,145               |
| <b>Total current assets</b>                     | <b>14,656,077</b>                          | <b>8,278,999</b>           | <b>2,223,084</b>                     | <b>10,450,679</b>                | <b>243,630</b>                          | <b>35,852,469</b>     |
| <b>Noncurrent assets:</b>                       |  |                            |                                      |                                  |   |                       |
| Capital assets, net of accumulated depreciation | 43,552,406                                 | 74,073                     | 2,738,634                            | 13,766,713                       | 275,723                                 | 60,407,549            |
| Investments                                     | 910,114                                    | 10,434,232                 | -                                    | 1,676,404                        | -                                       | 13,020,750            |
| Loans receivable                                | -  | 14,356,411                 | -                                    | -                                | -                                       | 14,356,411            |
| Grants and contacts receivable                  | 50,612                                     | -                          | -                                    | 357,362                          | -                                       | 407,974               |
| <b>Total noncurrent assets</b>                  | <b>44,513,132</b>                          | <b>24,864,716</b>          | <b>2,738,634</b>                     | <b>15,800,479</b>                | <b>275,723</b>                          | <b>88,192,684</b>     |
| <b>Total assets</b>                             | <b>\$ 59,169,209</b>                       | <b>\$ 33,143,715</b>       | <b>\$ 4,961,718</b>                  | <b>\$ 26,251,158</b>             | <b>\$ 519,353</b>                       | <b>\$ 124,045,153</b> |
| <b>LIABILITIES</b>                              |  |                            |                                      |                                  |   |                       |
| <b>Current liabilities:</b>                     |  |                            |                                      |                                  |   |                       |
| Current portion of long-term debt               | \$ 675,620                                 | \$ -                       | \$ 8,196,907                         | \$ -                             | \$ -                                    | \$ 8,872,527          |
| Accounts payable                                | 52,077                                     | 42,639                     | 910,289                              | 470,828                          | 9,373                                   | 1,485,206             |
| Other liabilities and accruals                  | 685,331                                    | 62,889                     | 2,137,616                            | 1,146,377                        | 4,808                                   | 4,037,021             |
| Due to primary government                       | -  | 2,169,917                  | -                                    | -                                | -                                       | 2,169,917             |
| Deferred revenue                                | 97,030                                     | -                          | -                                    | 2,086,834                        | -                                       | 2,183,864             |
| <b>Total current liabilities</b>                | <b>1,510,058</b>                           | <b>2,275,445</b>           | <b>11,244,812</b>                    | <b>3,704,039</b>                 | <b>14,181</b>                           | <b>18,748,535</b>     |
| <b>Noncurrent liabilities:</b>                  |  |                            |                                      |                                  |   |                       |
| Noncurrent portion of long-term debt            | 25,978,382                                 | -                          | -                                    | -                                | -                                       | 25,978,382            |
| <b>Total noncurrent liabilities</b>             | <b>25,978,382</b>                          | <b>-</b>                   | <b>-</b>                             | <b>-</b>                         | <b>-</b>                                | <b>25,978,382</b>     |
| <b>Total liabilities</b>                        | <b>27,488,440</b>                          | <b>2,275,445</b>           | <b>11,244,812</b>                    | <b>3,704,039</b>                 | <b>14,181</b>                           | <b>44,726,917</b>     |
| <b>NET ASSETS</b>                               |  |                            |                                      |                                  |   |                       |
| Invested in capital assets, net of related debt | 16,898,404                                 | 74,073                     | 1,525,694                            | 13,766,713                       | 275,723                                 | 32,540,607            |
| Restricted for:                                 |  |                            |                                      |                                  |   |                       |
| Nonexpendable                                   | -  | -                          | -                                    | 1,705,935                        | -                                       | 1,705,935             |
| Expendable                                      | -  | -                          | -                                    | 4,312,633                        | -                                       | 4,312,633             |
| Unrestricted                                    | 14,782,365                                 | 30,794,197                 | (7,808,788)                          | 2,761,838                        | 229,449                                 | 40,759,061            |
| <b>Total net assets</b>                         | <b>31,680,769</b>                          | <b>30,868,270</b>          | <b>(6,283,094)</b>                   | <b>22,547,119</b>                | <b>505,172</b>                          | <b>79,318,236</b>     |
| <b>Total liabilities and net assets</b>         | <b>\$ 59,169,209</b>                       | <b>\$ 33,143,715</b>       | <b>\$ 4,961,718</b>                  | <b>\$ 26,251,158</b>             | <b>\$ 519,353</b>                       | <b>\$ 124,045,153</b> |

See accompanying notes to basic financial statements.



**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Combining Statement of Revenues, Expenses, and Changes in Net Assets  
Component Units  
Year Ended September 30, 2003

|   | FSM Tele-<br>Communications<br>Corporation | FSM<br>Development<br>Bank | National<br>Fisheries<br>Corporation | College of<br>Micronesia-<br>FSM | FSM Coconut<br>Development<br>Authority | Total                |
|---|--|----------------------------|--------------------------------------|----------------------------------|---|----------------------|
| Operating revenues:                           |  |                            |                                      |                                  |   |                      |
| Charges for services                          | \$ 11,152,838                              | \$ 1,868,764               | \$ 8,209,498                         | \$ 12,376,349                    | \$ 81,666                               | \$ 33,689,115        |
| Other   | 94,535                                     | 306,705                    | 209,182                              | 726,315                          | -                                       | 1,336,737            |
| Total operating revenues                      | <u>11,247,373</u>                          | <u>2,175,469</u>           | <u>8,418,680</u>                     | <u>13,102,664</u>                | <u>81,666</u>                           | <u>35,025,852</u>    |
| Operating expenses:                           |  |                            |                                      |                                  |   |                      |
| Cost of services                              | 6,671,981                                  | 1,242,714                  | 8,544,984                            | 15,671,023                       | 270,415                                 | 32,401,117           |
| Depreciation                                  | 2,887,137                                  | 54,868                     | 198,159                              | 1,148,460                        | 28,922                                  | 4,317,546            |
| Administrative costs                          | 597,976                                    | 860,000                    | 805,903                              | -                                | -                                       | 2,263,879            |
| Total operating expenses                      | <u>10,157,094</u>                          | <u>2,157,582</u>           | <u>9,549,046</u>                     | <u>16,819,483</u>                | <u>299,337</u>                          | <u>38,982,542</u>    |
| Operating income (loss)                       | <u>1,090,279</u>                           | <u>17,887</u>              | <u>(1,130,366)</u>                   | <u>(3,716,819)</u>               | <u>(217,671)</u>                        | <u>(3,956,690)</u>   |
| Nonoperating revenues (expenses):             |  |                            |                                      |                                  |   |                      |
| Net increase in the fair value of investments | 973,495                                    | -                          | -                                    | 323,842                          | -                                       | 1,297,337            |
| Interest income                               | 27,397                                     | -                          | -                                    | -                                | 629                                     | 28,026               |
| Interest expense                              | (1,046,200)                                | -                          | (243,294)                            | -                                | -                                       | (1,289,494)          |
| Contributions from primary government         | -  | 1,250,000                  | 231,178                              | 4,411,000                        | 275,904                                 | 6,168,082            |
| Other income                                  | 13,422                                     | 28,694                     | -                                    | -                                | 1,038                                   | 43,154               |
| Total nonoperating revenues (expenses), net   | <u>(31,886)</u>                            | <u>1,278,694</u>           | <u>(12,116)</u>                      | <u>4,734,842</u>                 | <u>277,571</u>                          | <u>6,247,105</u>     |
| Capital contributions                         | -  | -                          | -                                    | 4,168,582                        | -                                       | 4,168,582            |
| Net income (loss)                             | 1,058,393                                  | 1,296,581                  | (1,142,482)                          | 5,186,605                        | 59,900                                  | 6,458,997            |
| Net assets at the beginning of the year       | <u>30,622,376</u>                          | <u>29,571,689</u>          | <u>(5,140,612)</u>                   | <u>17,360,514</u>                | <u>445,272</u>                          | <u>72,859,239</u>    |
| Net assets at the end of the year             | <u>\$ 31,680,769</u>                       | <u>\$ 30,868,270</u>       | <u>\$ (6,283,094)</u>                | <u>\$ 22,547,119</u>             | <u>\$ 505,172</u>                       | <u>\$ 79,318,236</u> |

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2003

(1) Summary of Significant Accounting Policies

The accompanying financial statements of the Federated States of Micronesia (FSM) National Government have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The Governmental Accounting Standards Board (GASB) is the recognized standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of the FSM National Government's accounting policies are described below.

A. Reporting Entity

The FSM is an independent sovereign nation made up of the four states of Chuuk, Kosrae, Pohnpei, and Yap (the States). The FSM National Government is a constitutional government comprised of three branches: the Legislative Branch (the Congress), consisting of 14 members (one from each State who are elected for a term of four years, and ten who are elected for a term of two years, whose seats are apportioned by population); the Executive Branch, headed by the President and Vice President who are primarily responsible for executing the laws and administering national government services; and the Judiciary Branch made up of the FSM Supreme Court, which consists of a Chief Justice and up to five Associate Justices. The Congress elects two of its four-year members at its first session following an election to serve as President and Vice President.

For financial reporting purposes, the FSM National Government has included all funds, organizations, agencies, boards, commissions and institutions. The FSM National Government has also considered all potential component units for which it is financially accountable as well as other entities for which the nature and significance of their relationship with the FSM National Government are such that exclusion would cause the FSM National Government's financial statements to be misleading or incomplete. The criteria to be considered in determining financial accountability include whether the FSM National Government, as the primary government, has appointed a voting majority of an organization's governing body and either has the ability to impose its will on that organization or there is potential for the organization to provide specific financial benefits to or impose specific financial burdens on the FSM National Government. Financial accountability also exists if an organization is determined to be fiscally dependent on the primary government, although the primary government does not appoint a voting majority of the organization's governing board.

Each blended and discretely presented component unit of the FSM National Government has a September 30 year-end except for the FSM Development Bank and the FSM Social Security Administration, which each have a December 31 year-end.

Once financial accountability has been determined for a potential component unit, that component unit is either blended into the primary government or discretely presented from the primary government. Potential component units that do not meet the financial accountability criteria, but where a voting majority of the governing board is appointed by the FSM National Government, are deemed to be related organizations. The nature and relationship of the FSM National Government's component units and related organizations are disclosed in the following section.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2003

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

Blended component units are entities that are legally separate from the FSM National Government, but are so related to the FSM National Government that they are, in substance, the same as the FSM National Government or entities providing services entirely or almost entirely to the FSM National Government. The net assets and results of operations of the following legally separate entities are presented as part of the FSM National Government's operations:

Blended Component Units

The following component units are blended within the primary government:

Employees' Health Insurance Fund (the Fund), a Governmental Fund Type - Special Revenue Fund. The Fund was established under FSM Public Law No. 3-82, as amended by FSM Public Law No. 12-77, to facilitate the payment of health costs incurred by eligible members. The Fund is governed by a seven-member Board of Directors appointed by the President with the advice and consent of the Congress.

FSM Social Security Administration (FSMSSA), a Fiduciary Fund Type - Private Purpose Trust Fund. FSMSSA was established under FSM Public Law No. 2-74 to provide retirement, disability and survivor benefits for the citizens of the FSM. FSMSSA is governed by a five-member Board of Directors nominated by the President and confirmed by the Congress.

Discretely Presented Component Units

Discretely presented component units are entities which are legally separate from the FSM National Government, but are financially accountable to the FSM National Government, or whose relationships with the FSM National Government are such that exclusion would cause the FSM National Government's basic financial statements to be misleading or incomplete. The component units' column of the basic financial statements includes the financial data of the following major component units:

FSM Telecommunications Corporation (FSMTC): FSMTC was incorporated under FSM Public Law No. 2-10 to engage in the business of providing telecommunications services, except radio and television broadcasting, throughout the FSM and to points outside the FSM. FSMTC is governed by a five-member Board of Directors, which includes one appointee by the President (with the advice and consent of the Congress) and four appointees by the Governors of each State (with the advice and consent of the respective State legislatures).

FSM Development Bank (FSMDB): FSMDB was established under FSM Public Law No. 8-47 to advance the economic development of the FSM through the provision of economic development loans. FSMDB is governed by a seven-member Board of Directors appointed by election at the annual shareholders meeting by the plurality of votes thereof. As of December 31, 2003, FSMDB has issued 2,997,883 shares to the FSM National Government (98.7%), the State of Chuuk (1%), and the State of Kosrae (0.3%).

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2003

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

Discretely Presented Component Units, Continued

National Fisheries Corporation (NFC): NFC was established under FSM Public Law No. 3-14 to promote the development of pelagic fisheries and related industries within the extended fishery zone for the benefit of the people of the FSM. NFC is governed by a seven-member Board of Directors, which includes one appointee by the President (with the advice and consent of the Congress), four appointees by the Governors of each State (with the advice and consent of the respective State legislatures), the Executive Director of the Micronesian Maritime Authority, and the Secretary of the Department of Economic Affairs.

College of Micronesia-FSM (COM-FSM): COM-FSM was established under FSM Public Law No. 7-79 to serve the varied post-secondary and adult educational needs of the FSM. COM-FSM is governed by a five-member Board of Regents appointed by the President with the advice and consent of the Congress.

FSM Coconut Development Authority (CDA): CDA was established under FSM Public Law No. 1-156 to engage in the manufacture and processing of all products derived from the coconut tree; to buy, collect, market, sell, export, inspect, improve the quality, and deal with, in general, all products derived from the coconut tree; to establish prices to producers or sellers of coconut products in the FSM; to collect and receive all monies derived from the sales of coconut products; and to stabilize the price of these products. CDA is governed by a five-member Board of Directors, which includes one appointee by the President (with the advice and consent of the Congress) and four appointees by the Governors of each State (with the advice and consent of the respective State legislatures).

The FSM National Government's component units, departments, and funds that are separately audited issue their own financial statements. These statements may be obtained by directly contacting the various entities or obtaining them directly from the Office of the Public Auditor:

P.O. Box PS05  
Palikir, Pohnpei State, FM, 96941

B. Government-Wide Financial Statements

The Statement of Net Assets and the Statement of Activities report financial information on all of the non-fiduciary activities of the primary government and its component units. For the most part, the effect of interfund activity has been eliminated from these statements except for other charges between the primary government and the discretely presented component units. Elimination of these charges would distort the direct costs and program revenues reported for the various functions concerned.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2003

(1) Summary of Significant Accounting Policies, Continued

B. Government-Wide Financial Statements, Continued

Primary government activities are defined as either governmental or business-type activities. Governmental activities, which normally are supported by taxes, intergovernmental revenues and other non-exchange revenues, are reported separately from business-type activities, which rely to a significant extent on fees charged to external parties for goods or services. As such, business-type activities account for operations similarly to a for-profit business. Likewise, the primary government is reported separately from certain legally separate component units for which the primary government is financially accountable. Discretely presented component unit activities are presented with their business-type focus.

The Statement of Net Assets presents all of the reporting entity's non-fiduciary assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories:

- Invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation and reduced by outstanding balances for bonds, notes and other debt that are attributed to the acquisition, construction or improvement of those assets.
- Restricted net assets result when constraints placed on net asset use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law.
- Unrestricted net assets consist of net assets, which do not meet the definition of the two preceding categories. Unrestricted net assets often are designated, (for example, internally restricted), to indicate that management does not consider them to be available for general operations.

The government-wide Statement of Net Assets reports \$28,819,488 of restricted net assets, of which \$366,794 is restricted by enabling legislation.

The Statement of Activities demonstrates the degree to which the direct expenses of given functions or segments are offset by program revenues. Direct expenses are those that are clearly identifiable within a specific function or segment. Program revenues include charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges that are restricted to meeting the operational or capital requirements of a particular function. Taxes and other items not meeting the definition of program revenues are, instead, reported as general revenue.

C. Fund Financial Statements

The fund financial statements present a balance sheet and a statement of revenues, expenditures, and changes in fund balances for its major and aggregated non-major funds.

Separate financial statements are provided for governmental funds and fiduciary funds even though the latter are excluded from the government-wide financial statements. Major individual governmental funds are reported as separate columns in the fund financial statements pursuant to GASB reporting standards, with nonmajor governmental funds being combined into a single column.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2003

(1) Summary of Significant Accounting Policies, Continued

C. Fund Financial Statements, Continued

The FSM National Government reports its financial position and results of operations in funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues and expenditures/expenses. Transactions between funds within a fund type, if any, have not been eliminated.

D. Measurement Focus and Basis of Accounting

The government-wide financial statements are reported using the economic resources management focus and the accrual basis of accounting, as are the proprietary fund and fiduciary fund financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements account for the general governmental activities of the FSM National Government and are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as they become susceptible to accrual; generally when they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the FSM National Government considers revenues to be available if they are collected within 60 days of the end of the current fiscal period.

Significant revenues susceptible to accrual include income and gross revenue taxes, federal grants, federal reimbursements and other reimbursements for use of materials and services. Miscellaneous revenues from other financing sources are recognized when received in cash because they are generally not measurable until actually received. Investment earnings are recorded as earned, since they are both measurable and available. Investments and related investment earnings are recorded at fair value. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Expenditures generally are recorded in the period in which the related fund liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

Amounts reported as program revenue include 1) charges to customers or applicants for goods, services, or privileges provided, 2) operating grants and contributions, and 3) capital grants and contributions. Internally dedicated resources are reported as general revenues rather than as program revenues. General revenue is derived from taxation, investment income and other fees that are not allocated to specific programs.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2003

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. All other revenues are reported as nonoperating. Operating expenses includes the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

The FSM National Government reports the following fund types:

1. Governmental Fund Types

i. General Fund

This fund is the primary operating fund of the FSM National Government. It is used to account for all governmental transactions, except those required to be accounted for in another fund.

ii. Special Revenue Funds

These funds account for specific revenue sources that have been aggregated according to enabling legislation to support specific governmental activities.

iii. Capital Projects Funds

These funds account for the acquisition or construction of major FSM National Government capital facilities financed primarily from loans and federal reimbursements.

2. Fiduciary Fund Types

i. Private Purpose Trust Funds

These funds are used to account for resources held in trust under which principal and income benefit certain individuals.

These include funds held in trust by the FSM Social Security Administration (FSMSSA) for the beneficiaries of the FSMSSA Retirement Fund, and funds held in trust by the FSM Development Bank for the State of Pohnpei and the State of Yap.

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 - Omnibus*, sets forth minimum criteria (percentage of the assets, liabilities, revenues or expenditures/expenses for either fund category or the governmental and enterprise combined) for the determination of major funds.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2003

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

Major individual governmental funds are reported as separate columns in the fund financial statements. The nonmajor funds are combined in a column in the fund financial statements and detailed in the combining statements. The FSM National Government reports the following major funds:

U.S. Federal Grants Fund, a Governmental Fund Type - Special Revenue Fund. This fund accounts for all financial transactions formally related to the Trust Territory of the Pacific Islands (TTPI) United States federally assisted funds, which are subgranted to the FSM National Government, as well as other direct federal grants that the FSM National Government received from the United States government once the FSM National Government's subgrantee status with the TTPI ceased.

Section 111 Investment Development Fund, a Governmental Fund Type - Special Revenue Fund. This fund accounts for United States Congress appropriations under United States Public Law 99-239, Compact of Free Association, Section 111, and approved by the FSM Congress. These funds are administered by the FSM Development Bank.

Early Retirement Program Fund, a Governmental Fund Type - Special Revenue Fund. This fund accounts for the Early Retirement Program activities.

Asian Development Bank Loan Fund, a Governmental Fund Type - Special Revenue Fund. This fund was established by FSM Public Law No. 7-101 mainly to carry out the purpose of the Fisheries Development Project Loan Agreement of 1992 between the Government of the Federated States of Micronesia and the Asian Development Bank (ADB), and the Technical Assistance Agreement of 1992 for Institutional Strengthening for Marine Resource Management and Conservation between the FSM and ADB.

E. Reporting Standards

As allowed by GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, the FSM National Government's proprietary funds follow all GASB pronouncements and those Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins that were issued on or before November 30, 1989, except those that conflict with a GASB pronouncement.

F. Cash and Cash Equivalents and Time Certificates of Deposit

The FSM National Government pools cash resources of its various funds in order to facilitate the management of cash. Unless otherwise required by law, interest income received on pooled cash accrues to the General Fund. Cash and cash equivalents applicable to a particular fund are readily identifiable. Cash and cash equivalents include cash held in demand accounts as well as short-term investments with a maturity date within three months of the date acquired by the FSM National Government. Deposits maintained in time certificates of deposit with original maturity dates greater than ninety days are separately classified on the statement of net assets/balance sheet.



**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2003

(1) Summary of Significant Accounting Policies, Continued

F. Cash and Cash Equivalents and Time Certificates of Deposit, Continued

As of September 30, 2003, the carrying amount of the primary government's total cash and cash equivalents and time certificates of deposit were \$3,696,829 and the corresponding bank balances were \$5,984,220. Of the bank balance amounts, \$4,834,370 is maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2003, bank deposits in the amount of \$1,678,263 were FDIC insured. The FSM National Government does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized.

As of September 30, 2003, the carrying amount of the fiduciary funds' total cash and cash equivalents and time certificates of deposit were \$1,805,672 and the corresponding bank balances were \$2,098,057. Of the bank balance amounts, \$1,638,128 is maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2003, bank deposits in the amount of \$455,082 were FDIC insured. The fiduciary funds do not require collateralization of their cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized.

As of September 30, 2003, the carrying amount of the discretely presented component units' total cash and cash equivalents and time certificates of deposit were \$13,799,720 and the corresponding bank balances were \$15,118,204. Of the bank balance amounts, \$10,388,732 is maintained in financial institutions subject to FDIC insurance. As of September 30, 2003, bank deposits in the amount of \$1,034,850 were FDIC insured. The component units do not require collateralization of their cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized.

G. Investments

Investments are carried at fair value, which is the amount at which an investment could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

An investment of 20% or more of the voting stock of an investee is presumed to give the investor significant influence. Under the equity method, the investor records, as earnings or loss, its proportionate share of the investee's earnings or loss.

H. Receivables

In general, tax revenue is recognized on the government-wide statements, when assessed or levied and on the governmental fund financial statements to the extent that it is both measurable and available. Receivables are stated net of estimated allowances for uncollectible accounts. Reimbursements due to the FSM National Government for expenditures on federally funded reimbursement and grant programs are reported as "receivables from federal agencies".

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2003

(1) Summary of Significant Accounting Policies, Continued

I. Inventories and Prepaid Items

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

Certain payments made to vendors or persons for services reflect costs applicable to future accounting periods and are recorded as prepaid items in both government-wide and fund financial statements.

J. Interfund Receivables/Payables

During the course of its operations, the FSM National Government records transactions between individual funds for goods provided or services rendered. Receivables and payables resulting from transactions between funds are classified as "due from other funds" or "due to other funds" on the governmental fund balance sheet.

These balances result from time lag between the dates that 1) interfund goods and services are provided or reimbursable expenditures occur, 2) transactions are recorded in the accounting system, and 3) payments between funds are made, and are scheduled to be collected in the subsequent year.

K. Capital Assets

Capital assets, which include property, plant, equipment and infrastructure (e.g. roads, bridges, ramps and other similar items), are reported in the applicable governmental or business-type activities columns of the government-wide financial statements. Singular pieces of equipment, vehicles, computer equipment and software that equal or exceed \$250 are capitalized. Buildings and infrastructure projects with a cost that equals or exceeds \$800 are capitalized. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at fair market value at the date of donation.

Property, plant and equipment of the primary government and the component units are depreciated using the straight-line method over their estimated useful lives, with a full year's depreciation charged in the year of acquisition and disposal, regardless of date. Estimated useful lives are as follows:

|                         |              |
|-------------------------|--------------|
| Buildings               | 50 years     |
| Improvements            | 20 years     |
| Facilities              | 3 - 40 years |
| Machinery and equipment | 3 - 20 years |
| Furniture and fixtures  | 3 - 10 years |
| Ships                   | 25 years     |
| Motor vehicles          | 3 years      |
| Over-the-road vehicles  | 3 years      |

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2003

(1) Summary of Significant Accounting Policies, Continued

L. Interfund/Intrafund Transactions

As a general rule, the effect of interfund activity has been eliminated in the government-wide statements. Exceptions to this rule are: 1) activities between funds reported as governmental activities and funds reported as business-type activities and 2) activities between funds that are reported in different functional categories in either the governmental or business-type activities column. Elimination of these activities would distort the direct costs and program revenues for the functions concerned.

M. Deferred Revenue

In the government-wide financial statements, deferred revenue is recognized when cash, receivables or other assets are recorded prior to their being earned. In the governmental fund financial statements deferred revenue represents monies received or revenues accrued which have not been earned or do not meet the "available" criterion for revenue recognition under the modified accrual basis of accounting. The deferred revenue in the governmental fund types has primarily resulted as federal funds received in advance of eligible expenditures.

N. Compensated Absences

It is the government's policy to permit employees to accumulate earned but unused vacation and sick pay benefits. There is no liability for unpaid accumulated sick leave since the government does not have a policy to pay any amounts when employees separate from service with the government. All vacation pay is accrued when incurred in the government-wide and fiduciary fund financial statements. A liability for these amounts is reported in governmental funds only if they have matured, for example, as a result of employee resignations and retirements. Annual leave accumulates at the rate of 4 hours bi-weekly, if less than 3 years of service, 6 hours bi-weekly, if between 3 and 10 years of service, and 8 hours bi-weekly if over 10 years of service, limited to 45 working days.

O. 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.

P. Fund Equity

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2003

(1) Summary of Significant Accounting Policies, Continued

P. Fund Equity, Continued

The unreserved fund balances for the governmental funds represent the amount available for budgeting future operations. The reserve for related assets as of September 30, 2003, is represented by the following assets:

|                             | General              | U.S.<br>Federal<br>Grants | Section 111<br>Investment<br>Development | Early<br>Retirement<br>Program | Asian<br>Development<br>Bank Loan | Other<br>Governmental<br>Funds | Total                |
|-----------------------------|----------------------|---------------------------|--|--------------------------------|-----------------------------------|--------------------------------|----------------------|
| Cash and cash equivalents   | \$ 512,054           | \$ -                      | \$ -                                     | \$ -                           | \$ 178,367                        | \$ -                           | \$ 690,421           |
| Time certificate of deposit | 1,149,850            | -                         | -  | -                              | -                                 | -                              | 1,149,850            |
| Investments                 | 1,500,000            | -                         | -  | 2,647,850                      | -                                 | 3,833,274                      | 7,981,124            |
| Receivables:                |                      |                           |  |                                |                                   |                                |                      |
| General                     | 1,349,252            | -                         | -  | -                              | 1,126,860                         | -                              | 2,476,112            |
| Federal agencies            | -                    | -                         | -  | -                              | -                                 | 726,755                        | 726,755              |
| Loans                       | 5,161,987            | -                         | 5,033,324                                | -                              | 27,800,704                        | 1,228,636                      | 39,224,651           |
| Other governments           | 840,999              | -                         | -  | -                              | -                                 | -                              | 840,999              |
| Due from component units    | -                    | -                         | 2,169,917                                | -                              | -                                 | -                              | 2,169,917            |
| Due from other funds        | 1,046,720            | -                         | -  | -                              | -                                 | -                              | 1,046,720            |
|                             | <u>\$ 11,560,862</u> | <u>\$ -</u>               | <u>\$ 7,203,241</u>                      | <u>\$ 2,647,850</u>            | <u>\$ 29,105,931</u>              | <u>\$ 5,788,665</u>            | <u>\$ 56,306,549</u> |

Q. Risk Financing

The FSM National Government is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. It is the policy of the primary government not to purchase commercial insurance for the risks of loss to which it is exposed. Instead, the FSM National Government management believes it is more economical to manage its risks internally. In the event of claim settlements and judgments, the FSM National Government reports all of its risk management activities in its General Fund. Claims expenditures and liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. These losses include an estimate of claims that have been incurred but not reported.

R. Reclassification and Restatements

During fiscal year 2003, the FSM National Government implemented the following new accounting standards issued by GASB:

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 - Omnibus*, establishes new financial reporting standards for state and local governments. The requirements of this statement result in a significant change in the financial reporting model used by governments, including statement formats and changes in fund types. 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. As a result, fund reclassifications and adjustments to the fund equities reported in the prior financial statements were required.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2003

(1) Summary of Significant Accounting Policies, Continued

R. Reclassification and Restatements, Continued

GASB Statement No. 38, *Certain Financial Statement Note Disclosures*, amends certain note disclosures and adds additional note disclosure requirements related to GASB Statement Nos. 34, 35 and 37.

GASB Statement No. 41, *Budgetary Comparison Schedules - Perspective Differences*, amends required supplemental information disclosure of adopted budget and actual amounts per GASB Statement No. 34. Should there be a perspective difference between these amounts and fund perspective revenues and expenditures, reconciliation is required.

Due to the implementation of GASB Statement Nos. 34 and 37, the beginning net assets of the governmental activities in the statement of net assets have been restated. Fund balances of the governmental funds at September 30, 2002 (as disclosed below) were decreased by \$9,844,007 for the cumulative effect of these changes on years prior to fiscal year 2003:

The effect of those items is as follows:

|   |                          |
|---|--------------------------|
| Fund balances reported as of September 30, 2002   | \$ 77,456,495            |
| Adjustments:                                      |                          |
| Long-term debt payable                            | (31,039,243)             |
| Compensated absences payable                      | (916,172)                |
| Capital assets                                    | 39,035,137               |
| Accumulated depreciation                          | <u>(16,923,729)</u>      |
|   | <u>(9,844,007)</u>       |
| <br>Beginning net assets as of September 30, 2002 | <br>\$ <u>67,612,488</u> |

Due to the implementation of GASB Statement No. 34, certain governmental funds have been reclassified to conform to the GASB Statement No. 34 reporting model. The effects of such are as follows:

|   | September<br>30, 2002<br>As Previously<br>Reported | Fund<br>Reclassifications | Adjustments | September<br>30, 2002<br>As<br>Restated |
|---|--|---------------------------|-------------|---|
| <u>Governmental Funds and Activities</u>                    |  |                           |             |   |
| Major governmental funds:                                   |  |                           |             |   |
| General Fund  | \$ 19,929,165                                      | \$ -                      | \$ -        | \$ 19,929,165                           |
| Previously reported as Special Revenue Funds:               |  |                           |             |   |
| U.S. Federal Grants Fund                                    | -  | 2,982                     | -           | 2,982                                   |
| Early Retirement Program Fund                               | -  | (288,159)                 | -           | (288,159)                               |
| Asian Development Bank Loan Fund                            | -  | 27,873,221                | -           | 27,873,221                              |
| Previously reported as Component Units - Proprietary Funds: |  |                           |             |   |
| Section 111 Investment Development Fund                     | -  | 16,402,038                | -           | 16,402,038                              |
|   | <u>\$ 19,929,165</u>                               | <u>\$ 43,990,082</u>      | <u>\$ -</u> | <u>\$ 63,919,247</u>                    |

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2003

(1) Summary of Significant Accounting Policies, Continued

R. Reclassification and Restatements, Continued

|   | September<br>30, 2002<br>As Previously<br>Reported | Fund<br>Reclassifications | Adjustments         | September<br>30, 2002<br>As<br>Restated |
|---|--|---------------------------|---------------------|---|
| <u>Governmental Funds and Activities, Continued</u>                 |  |                           |                     |   |
| Nonmajor governmental funds:  |  |                           |                     |   |
| Special Revenue Funds   | \$ 32,562,313                                      | \$ -                      | \$ -                | \$ 32,562,313                           |
| Previously reported as Special<br>Revenue Funds:                    |  |                           |                     |   |
| U.S. Federal Grants Fund  | -  | (2,982)                   | -                   | (2,982)                                 |
| Early Retirement Program Fund                                       | -  | 288,159                   | -                   | 288,159                                 |
| Asian Development Bank Loan Fund                                    | -  | (27,873,221)              | -                   | (27,873,221)                            |
| Previously reported as Expendable<br>Trust Funds:                   |  |                           |                     |   |
| Employees' Health Insurance Fund                                    | -  | 799,086                   | -                   | 799,086                                 |
| Student Loan Fund   | -  | 596,758                   | -                   | 596,758                                 |
|   | <u>32,562,313</u>                                  | <u>(26,192,200)</u>       | <u>-</u>            | <u>6,370,113</u>                        |
| Previously reported as Capital<br>Projects Funds:                   |  |                           |                     |   |
| Capital Projects Funds  | <u>7,167,135</u>                                   | <u>-</u>                  | <u>-</u>            | <u>7,167,135</u>                        |
| Previously reported as Expendable<br>Trust Funds:                   |  |                           |                     |   |
| Expendable Trust Funds  | 1,395,844  | -                         | -                   | 1,395,844                               |
| Employees' Health Insurance Fund                                    | -  | (799,086)                 | -                   | (799,086)                               |
| Student Loan Fund   | -  | (596,758)                 | -                   | (596,758)                               |
|   | <u>1,395,844</u>                                   | <u>(1,395,844)</u>        | <u>-</u>            | <u>-</u>                                |
| Previously reported as Component Units -<br>Higher Education Funds: |  |                           |                     |   |
| Component units - higher education<br>funds                         | 15,276,517   | -                         | -                   | 15,276,517                              |
| College of Micronesia - FSM   | -  | (15,276,517)              | -                   | (15,276,517)                            |
|   | <u>15,276,517</u>                                  | <u>(15,276,517)</u>       | <u>-</u>            | <u>-</u>                                |
| Previously reported as Component Units -<br>Governmental Funds:     |  |                           |                     |   |
| Component units - governmental funds                                | 31,991,930   | -                         | -                   | 31,991,930                              |
| FSM Social Security Administration                                  | -  | (31,991,930)              | -                   | (31,991,930)                            |
|   | <u>31,991,930</u>                                  | <u>(31,991,930)</u>       | <u>-</u>            | <u>-</u>                                |
|   | <u>\$ 88,393,739</u>                               | <u>\$ (74,856,491)</u>    | <u>\$ -</u>         | <u>\$ 13,537,248</u>                    |
| <u>Fiduciary Funds</u>  |  |                           |                     |   |
| Private Purpose Trust Funds:  |  |                           |                     |   |
| FSM Social Security Administration                                  | \$ -   | \$ 31,991,930             | \$ 1,539,664        | \$ 33,531,294                           |
| Pohnpei State Development Loan Fund                                 | -  | 719,915                   | -                   | 719,915                                 |
| Yap State Development Loan Fund                                     | -  | 195,126                   | -                   | 195,126                                 |
|   | <u>\$ -</u>  | <u>\$ 32,906,971</u>      | <u>\$ 1,539,664</u> | <u>\$ 34,446,635</u>                    |

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2003

(1) Summary of Significant Accounting Policies, Continued

R. Reclassification and Restatements, Continued

|   | September<br>30, 2002<br>As Previously<br>Reported | Fund<br>Reclassifications | Adjustments         | September<br>30, 2002<br>As<br>Restated |
|---|--|---------------------------|---------------------|---|
| <u>Discretely Presented Component Units</u> |  |                           |                     |   |
| Discretely Presented Component Units:       |  |                           |                     |   |
| Previously reported as Component Unit -     |  |                           |                     |   |
| Proprietary Funds                           | \$ 73,169,499                                      | \$ -                      | \$ -                | \$ 73,169,499                           |
| FSM Telecommunications Corporation          | -  | (30,622,376)              | -                   | (30,622,376)                            |
| FSM Development Bank:                       |  |                           |                     |   |
| Section 111 Investment Development          |  |                           |                     |   |
| Fund  | -  | (16,402,038)              | -                   | (16,402,038)                            |
| Pohnpei State Development Loan Fund         | -  | (719,915)                 | -                   | (719,915)                               |
| Yap State Development Loan Fund             | -  | (195,126)                 | -                   | (195,126)                               |
| FSM Development Bank                        | -  | (29,571,689)              | -                   | (29,571,689)                            |
| National Fisheries Corporation              | -  | 4,786,917                 | -                   | 4,786,917                               |
| FSM Coconut Development Authority           | -  | (445,272)                 | -                   | (445,272)                               |
|   | <u>73,169,499</u>                                  | <u>-</u>                  | <u>-</u>            | <u>-</u>                                |
| Discretely Presented Component Units:       |  |                           |                     |   |
| FSM Telecommunications Corporation          | -  | 30,622,376                | -                   | 30,622,376                              |
| FSM Development Bank                        | -  | 29,571,689                | -                   | 29,571,689                              |
| National Fisheries Corporation              | -  | (4,786,917)               | (353,695)           | (5,140,612)                             |
| College of Micronesia - FSM                 | -  | 15,276,517                | 2,083,997           | 17,360,514                              |
| FSM Coconut Development Authority           | -  | 445,272                   | -                   | 445,272                                 |
|   | <u>-</u>   | <u>71,128,937</u>         | <u>1,730,302</u>    | <u>72,859,239</u>                       |
|   | <u>\$ 73,169,499</u>                               | <u>\$ 71,128,937</u>      | <u>\$ 1,730,302</u> | <u>\$ 72,859,239</u>                    |

The adjustment for the fiduciary funds beginning fund balance of \$1,539,664 is due to the correction for the understatement of contributions receivable for the FSM Social Security Administration.

The adjustment for the discretely presented component units beginning net assets of \$1,730,302 is due to the correction for the understatement of capital assets and deferred revenue for the College of Micronesia - FSM of \$878,982 and \$1,205,015, respectively, and the non-inclusion of certain investee financial statements for the National Fisheries Corporation, representing a decrease in beginning net assets of \$353,695.

S. New Accounting Standards

In May 2002, GASB issued Statement No. 39, *Determining Whether Certain Organizations Are Component Units* (an amendment of GASB Statement 14), which provides additional guidance on GASB Statement No.14, in determining whether an entity should be reported as a component unit based on the nature and significance of its relationship with a primary government. The provisions of this Statement are effective for periods beginning after June 15, 2003. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the FSM National Government.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2003

(1) Summary of Significant Accounting Policies, Continued

S. New Accounting Standards, Continued

In March 2003, GASB issued Statement No. 40, *Deposit and Investment Risk Disclosures* (an amendment of GASB Statement No. 3), which addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. As an element of interest risk, GASB Statement No. 40 requires certain disclosures of investments that have fair values that are highly sensitive to changes in interest rates. The provisions of this Statement are effective for periods beginning after June 15, 2004. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the FSM National Government.

In June 2003, GASB issued Technical Bulletin No. 2003-1, *Disclosure Requirements for Derivatives Not Reported at Fair Value on the Statement of Net Assets*, which clarifies guidance on derivative disclosures, pending the results of GASB's project on reporting and measurement of derivatives and hedging activities. This Technical Bulletin applies to derivatives that are not reported at fair value on the statement of net assets. The provisions of this Technical Bulletin are effective for periods beginning after June 15, 2003. Management does not believe that the implementation of this statement will have a material effect on the financial statements of the FSM National Government.

(2) Investments

GASB Statement No. 3 requires government entities to categorize investments to give an indication of the level of credit risk assumed by the entity at year end. The three categories are described below:

- Category 1      Insured or registered, or securities held by the FSM National Government or its agent in the FSM National Government's name;
- Category 2      Uninsured and unregistered, with securities held by the broker's or dealer's trust department or agent in the FSM National Government's name; or
- Category 3      Uninsured and unregistered, with securities held by the broker or dealer, or by its trust department or agent but not in the FSM National Government's name.

FSM Public Law No. 4-77, which approved the "Internal Budget and Finance Procedures Under the Compact of Free Association", established and designated the Federated Development Authority (FDA) as the agency under which Compact funds available for investment are obligated and placed. This law also provides that all FDA investment funds shall be managed by the FSM National Government's Secretary of Finance.



**FEDERATED STATES OF MICRONESIA  
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Notes to Financial Statements  
September 30, 2003

**(2) Investments, Continued**

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

1. Investment managers may invest in stocks, bonds and cash equivalents. Minimum standards of quality for investments at the time of purchase are:
  - a. 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.
  - b. 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.
  - c. 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:
    - i. Commercial paper must be rated A-1/P-1 or higher by Standard & Poor Corporation and Moody's Investor Services.
    - ii. 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%.
2. 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 Poor 500 Index, unless prior approval is received from the FSM National Government's Secretary of Finance.
3. 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 FSM National Government's Secretary of Finance.

Investments of the primary government and the discretely presented component units as September 30, 2003, are as follows:

**Major Governmental Funds**

|  | <u>1</u>            | <u>Categories</u><br><u>2</u> | <u>3</u>    | <u>Carrying</u><br><u>Value</u> |
|--|---------------------|-------------------------------|-------------|---------------------------------|
| General Fund:                            |                     |                               |             |                                 |
| Common stock                             | \$ <u>1,500,000</u> | \$ <u>-</u>                   | \$ <u>-</u> | \$ 1,500,000                    |
| Pooled investments                       |                     |                               |             | <u>9,918,108</u>                |
|  |                     |                               |             | <u>\$ 11,418,108</u>            |
| Section 111 Investment Development Fund: |                     |                               |             |                                 |
| Pooled investments                       |                     |                               |             | \$ <u>8,570,619</u>             |

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2003

**(2) Investments, Continued**

Major Governmental Funds, Continued

|   | Categories |   |   | Carrying<br>Value   |
|---|------------|---|---|---------------------|
|   | 1          | 2 | 3 |                     |
| Early Retirement Program Fund:<br>Pooled investments    |            |   |   | \$ <u>2,647,850</u> |
| Asian Development Bank Loan Fund:<br>Pooled investments |            |   |   | \$ <u>1,851,172</u> |

The FSM National Government owns 50,000 shares of the common stock of a commercial enterprise located in the Commonwealth of the Northern Marianas. The investment of \$1,500,000 is accounted for at cost since the investment constitutes a .05% ownership share.

Fiduciary Funds

|                                     | Categories |                      |      | Carrying<br>Value              |
|-------------------------------------|------------|----------------------|------|--------------------------------|
|                                     | 1          | 2                    | 3    |                                |
| FSM Social Security Administration: |            |                      |      |                                |
| Common stock                        | \$ -       | \$ 19,688,918        | \$ - | \$ 19,688,918                  |
| U.S. Government agencies            | -          | 9,349,686            | -    | 9,349,686                      |
| U.S. Government notes and bonds     | -          | 1,006,668            | -    | 1,006,668                      |
| Corporate notes and bonds           | -          | <u>3,273,134</u>     | -    | <u>3,273,134</u>               |
| Money market funds                  | \$ -       | \$ <u>33,318,406</u> | \$ - | 33,318,406<br><u>1,105,447</u> |
|                                     |            |                      |      | <u>\$ 34,423,853</u>           |

Nonmajor Governmental Funds

|                    |                     |      |      |                      |
|--------------------|---------------------|------|------|----------------------|
| Common stock       | \$ <u>3,833,274</u> | \$ - | \$ - | \$ 3,833,274         |
| Pooled investments |                     |      |      | <u>9,647,070</u>     |
|                    |                     |      |      | <u>\$ 13,480,344</u> |

The FSM National Government owns 298,745 shares of the common stock of the Bank of the Federated States of Micronesia, which engages in commercial banking services in the FSM. The investment is accounted for on the equity method since the investment constitutes a 32% ownership share.

A summary of audited financial information as of and for the twelve months ended December 31, 2003, for investees accounted for using the equity method of accounting for investments, is as follows:

|              |                      |
|--------------|----------------------|
| Assets       | \$ <u>83,325,113</u> |
| Liabilities  | \$ <u>71,112,013</u> |
| Net earnings | \$ <u>188,719</u>    |

**FEDERATED STATES OF MICRONESIA  
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Notes to Financial Statements  
September 30, 2003

**(2) Investments, Continued**

Discretely Presented Component Units

|   | <u>Categories</u> |                     |             | <u>Carrying Value</u> |
|---|-------------------|---------------------|-------------|-----------------------|
|   | <u>1</u>          | <u>2</u>            | <u>3</u>    |                       |
| FSM Telecommunications Corporation (FSMTC): |                   |                     |             |                       |
| Common stock                                | \$ 910,114        | \$ 4,924,654        | \$ -        | \$ 5,834,768          |
| U.S. Government notes and bonds             | -                 | 1,000,986           | -           | 1,000,986             |
| Corporate notes and bonds                   | -                 | <u>2,550,937</u>    | -           | <u>2,550,937</u>      |
|   | <u>\$ 910,114</u> | <u>\$ 8,476,577</u> | <u>\$ -</u> | <u>\$ 9,386,691</u>   |
| FSM Development Bank (FSMDB):               |                   |                     |             |                       |
| Common stock                                | \$ 662,188        | \$ -                | \$ -        | \$ 662,188            |
| U.S. Government agencies                    | -                 | <u>9,772,044</u>    | -           | <u>9,772,044</u>      |
|   | <u>\$ 662,188</u> | <u>\$ 9,772,044</u> | <u>\$ -</u> | <u>\$ 10,434,232</u>  |
| College of Micronesia - FSM:                |                   |                     |             |                       |
| Common stock                                | \$ -              | \$ 1,087,052        | \$ -        | \$ 1,087,052          |
| U.S. Government agencies                    | -                 | 69,494              | -           | 69,494                |
| U.S. Government notes and bonds             | -                 | 265,677             | -           | 265,677               |
| Corporate notes and bonds                   | -                 | <u>195,453</u>      | -           | <u>195,453</u>        |
|   | <u>\$ -</u>       | <u>\$ 1,617,676</u> | <u>\$ -</u> | <u>1,617,676</u>      |
| Money market funds                          |                   |                     |             | <u>58,728</u>         |
|   |                   |                     |             | <u>\$ 1,676,404</u>   |

FSMTC owns shares in the International Telecommunications Satellite (IntelSat). The investment of \$910,114 is accounted for at cost since the investment constitutes a .05% ownership share.

FSMDB owns 100,000 shares of the common stock of the Bank of the Federal States of Micronesia. The investment of \$662,188 is accounted for at cost since the investment constitutes an 11% ownership share.

**(3) Receivables**

Receivables as of September 30, 2003, for the primary government's individual major governmental funds, and nonmajor governmental and fiduciary funds in the aggregate, including applicable allowances for uncollectible accounts, are as follows:

|                                    | <u>General</u>       | <u>U.S. Federal Grants</u> | <u>Section 111 Investment Development</u> | <u>Early Retirement Program</u> | <u>Asian Development Bank Loan</u> | <u>Nonmajor And Other Funds</u> | <u>Totals</u>        |
|------------------------------------|----------------------|----------------------------|---|---------------------------------|------------------------------------|---------------------------------|----------------------|
| Receivables:                       |                      |                            |   |                                 |                                    |                                 |                      |
| General                            | \$ 3,200,342         | \$ -                       | \$ -                                      | \$ -                            | \$ 1,126,860                       | \$ -                            | \$ 4,327,202         |
| Taxes                              | 2,953,254            | -                          | -   | -                               | -                                  | -                               | 2,953,254            |
| Federal agencies                   | -                    | 296,247                    | -   | -                               | -                                  | 726,755                         | 1,023,002            |
| Contributions                      | -                    | -                          | -   | -                               | -                                  | 1,712,396                       | 1,712,396            |
| Loans                              | 5,161,987            | -                          | 7,635,152                                 | -                               | 27,800,704                         | 3,183,915                       | 43,781,758           |
| Other governments and agencies     | 840,999              | -                          | -   | -                               | -                                  | -                               | 840,999              |
| Accrued interest                   | -                    | -                          | 123,068                                   | -                               | -                                  | 455,812                         | 578,880              |
| Other                              | -                    | -                          | -   | -                               | -                                  | 48,023                          | 48,023               |
|                                    | <u>12,156,582</u>    | <u>296,247</u>             | <u>7,758,220</u>                          | <u>-</u>                        | <u>28,927,564</u>                  | <u>6,126,901</u>                | <u>55,265,514</u>    |
| Less: allowance for uncollectibles | <u>(200,000)</u>     | <u>-</u>                   | <u>(2,601,828)</u>                        | <u>-</u>                        | <u>-</u>                           | <u>(1,620,903)</u>              | <u>(4,422,731)</u>   |
| Net receivables                    | <u>\$ 11,956,582</u> | <u>\$ 296,247</u>          | <u>\$ 5,156,392</u>                       | <u>\$ -</u>                     | <u>\$ 28,927,564</u>               | <u>\$ 4,505,998</u>             | <u>\$ 50,842,783</u> |

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September 30, 2003

(3) Receivables, Continued

Loans receivable of the primary government are as follows:

Major Governmental Funds

General Fund:

Notes receivable due from the National Fisheries Corporation (NFC), payable in various annual installments of \$1,962 to \$86,639, non-interest bearing, and due on various dates ranging from July 2007 through April 2014. \$ 3,600,000

Loan receivable due from the State of Chuuk, payable in quarterly installments of \$416,667, non-interest bearing with a service charge of 1% per annum, due on September 30, 2001. 1,561,987

\$ 5,161,987

Section 111 Investment Development Fund:

Loans receivable due from businesses and individuals at varying terms and conditions administered by the FSM Development Bank. \$ 7,635,152

Asian Development Bank Loan Fund:

Loan receivable due from Micronesia Longline Fishing Company, a majority-owned subsidiary of NFC, in the amount of SDR 3,514,000, interest at 6.64% per annum, repayments commencing January 15, 1998, with a maturity date of July 15, 2007. The loan is a subsidiary loan of a loan agreement (Loan Number 1257 FSM (SF)) between the FSM National Government and the Asian Development Bank (ADB). \$ 4,949,366

Loans receivable due from the Chuuk Public Utility Corporation (CPUC), the Pohnpei Utilities Corporation (PUC), and the Yap State Public Service Corporation (YSPSC). These loans are subsidiary loans of a loan agreement (Loan Number 1459 FSM (SF)) between the FSM National Government and the ADB. The FSM National Government entered into Financing Agreements with the States of Chuuk, Pohnpei and Yap whereby a portion of the loan proceeds under this ADB loan were lent under the same terms and conditions imposed by the ADB. The States in turn on lent the loan proceeds to CPUC, PUC, and YSPSC, respectively. As of September 30, 2003, the amounts outstanding from these corporations are as follows:

|                                      |    |                  |           |
|--------------------------------------|----|------------------|-----------|
| Chuuk Public Utility Corporation     | \$ | 3,461,734        |           |
| Pohnpei Utilities Corporation        |    | 2,118,767        |           |
| Yap State Public Service Corporation |    | <u>2,270,837</u> |           |
|                                      |    |                  | 7,851,338 |

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Notes to Financial Statements  
September 30, 2003

(3) Receivables, Continued

Major Governmental Funds, Continued

Asian Development Bank Loan Fund, Continued:

Loans receivable due from the States to assist in the implementation of an Early Retirement Scheme (ERS) in which employees holding certain nonessential positions as identified by the States were retired early with a payout of the equivalent of two-year wages. These loans are subsidiary loans of a loan agreement (Loan Number 1520 FSM (SF)) between the FSM National Government and the ADB. The FSM National Government entered into Financing Agreements with the States whereby a portion of the loan proceeds under this ADB loan were relented under the same terms and conditions imposed by the ADB. As of September 30, 2003, the amounts outstanding from the States are as follows:

|                  |                  |                      |
|------------------|------------------|----------------------|
| State of Chuuk   | \$ 5,300,000     |                      |
| State of Kosrae  | 2,000,000        |                      |
| State of Pohnpei | 4,200,000        |                      |
| State of Yap     | <u>3,500,000</u> |                      |
|                  |                  | <u>15,000,000</u>    |
|                  |                  | \$ <u>27,800,704</u> |

Nonmajor Governmental and Fiduciary Funds

Student Loan Fund:

Loans receivable due from students under a student financial assistance loan program, interest at 4% per annum, with repayment commencing ten years and nine months after completion of study. \$ 1,606,953

Compact Capital Projects Fund:

Loan receivable due from the Caroline Fisheries Corporation, a joint venture between NFC, the Pohnpei State Economic Development Authority and the Australian-owned Tuna Development Company, Pty. Ltd., interest at 8% per annum, is uncollateralized, and is due in monthly installments of \$67,841. These loans have been fully provided for in the allowance for uncollectible accounts. 1,228,636

Pohnpei Development Loan Fund:

Loans receivable due from businesses and individuals at varying terms and conditions administered by the FSM Development Bank. 195,768

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September 30, 2003

(3) Receivables, Continued

Nonmajor Governmental and Fiduciary Funds, Continued

Yap Development Loan Fund:

Loans receivable due from businesses and individuals at varying terms and conditions administered by the FSM Development Bank. 152,558

\$ 3,183,915

(4) Interfund Receivables and Payables

Receivables and payables between funds reflected as due to/from other funds in the combined balance sheet at September 30, 2003, are summarized as follows:

| <u>Receivable Fund</u>      | <u>Payable Fund</u>         | <u>Amount</u>       |
|-----------------------------|-----------------------------|---------------------|
| General                     | Early Retirement Program    | \$ 2,579,150        |
| General                     | Asian Development Bank Loan | 621,639             |
| General                     | Nonmajor governmental funds | 1,046,720           |
| U.S. Federal Grants         | General                     | 3,317,152           |
| Nonmajor governmental funds | General                     | <u>2,382,222</u>    |
|                             |                             | <u>\$ 9,946,883</u> |

Interfund receivables not expected to be repaid within the next twelve months are summarized as follows:

| <u>Receivable Fund</u> | <u>Payable Fund</u>         | <u>Amount</u>       |
|------------------------|-----------------------------|---------------------|
| General                | Nonmajor governmental funds | <u>\$ 1,046,720</u> |

Receivables between funds reflected as due from component units in the statement of net assets at September 30, 2003, are summarized as follows:

|  | <u>Due From</u>     | <u>Due To</u> |
|--|---------------------|---------------|
| Section 111 Investment Development Fund: |                     |               |
| FSM Development Bank                     | <u>\$ 2,169,917</u> | <u>\$ -</u>   |

Receivables between funds reflected as due to primary government in the statement of net assets at September 30, 2003, are summarized as follows:

|   | <u>Due From</u> | <u>Due To</u>       |
|---|-----------------|---------------------|
| FSM Development Bank:                   |                 |                     |
| Section 111 Investment Development Fund | <u>\$ -</u>     | <u>\$ 2,169,917</u> |

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**(5) Capital Assets**

Capital asset activities of the primary government for the year ended September 30, 2003, are as follows:

|                                    | Balance<br>October<br><u>1, 2002</u> | <u>Additions</u>    | <u>Retirements</u> | Balance<br>September<br><u>30, 2003</u> |
|------------------------------------|--------------------------------------|---------------------|--------------------|---|
| Governmental Activities:           |                                      |                     |                    |   |
| Buildings and improvements         | \$ 13,958,076                        | \$ -                | \$ -               | \$ 13,958,076                           |
| Boats                              | 14,929,093                           | 8,342               | (970,194)          | 13,967,241                              |
| Motor vehicles                     | 4,742,062                            | 254,228             | (115,132)          | 4,881,158                               |
| Computer equipment                 | 2,206,770                            | 288,088             | (29,463)           | 2,465,395                               |
| Aircraft                           | 709,207                              | -                   | -                  | 709,207                                 |
| Furniture, equipment and machinery | <u>2,489,929</u>                     | <u>325,271</u>      | <u>(76,387)</u>    | <u>2,738,813</u>                        |
|                                    | 39,035,137                           | 875,929             | (1,191,176)        | 38,719,890                              |
| Less accumulated depreciation      | <u>(16,923,729)</u>                  | <u>(1,735,967)</u>  | <u>1,191,176</u>   | <u>(17,468,520)</u>                     |
|                                    | <u>\$ 22,111,408</u>                 | <u>\$ (860,038)</u> | <u>\$ -</u>        | <u>\$ 21,251,370</u>                    |

Depreciation expense was charged to functions/programs of the primary government's governmental activities as follows:

|  |                     |
|--|---------------------|
| President's office                               | \$ 52,541           |
| External affairs and LNOs                        | 801                 |
| Health, education and social affairs             | 181,604             |
| Economic affairs                                 | 66,868              |
| Transportation, communication and infrastructure | 487,619             |
| Finance and administration                       | 36,526              |
| Justice  | 397,944             |
| Office of the Public Defender                    | 460                 |
| Judiciary  | 28,771              |
| Legislature                                      | 241,676             |
| Office of the Public Auditor                     | 6,188               |
| National government programs                     | 305,245             |
| Boards, commissions and other                    | <u>19,593</u>       |
|  | <u>\$ 1,735,967</u> |

**(6) Long-term Obligations**

**Primary Government**

Asian Development Bank (ADB) Loan Number 1257 FSM (SF) - Fisheries Development Project Loan (SDR 3,792,000), non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The loan is payable semiannually commencing January 15, 2004 in an amount of SDR 46,100 increasing to SDR 92,400 on January 15, 2014, with a maturity date of July 15, 2033. \$ 5,151,227

ADB Loan Number 1459 FSM (SF) - Water Supply and Sanitation Project Loan (SDR 7,233,000), non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The loan is payable semiannually commencing February 1, 2007 in an amount of SDR 69,200, increasing to SDR 138,500 on February 1, 2017, with a maturity date of August 1, 2036. 9,115,019

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(6) Long-term Obligations, Continued

Primary Government, Continued

|  |                      |
|--|----------------------|
| <p>ADB Loan Number 1520 FSM (SF) - Public Sector Reform Program Loan (SDR 12,979,000), non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The loan is payable semiannually commencing February 1, 2008 in an amount of SDR 129,800, increasing to SDR 259,600 on February 1, 2018, with a maturity date of August 1, 2037.</p>                    | 17,682,020           |
| <p>ADB Loan Number 1873 FSM (SF) - Private Sector Development Program Loan (SDR 3,912,000), non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The loan is payable semiannually commencing May 15, 2010 in an amount of SDR 122,250, at which time the service charge increases to 1.5% per annum, with a maturity date of November 15, 2025.</p> | 1,850,000            |
| <p>ADB Loan Number 1874 FSM (SF) - Private Sector Development Project Loan (SDR 6,273,000), non-interest bearing with a service charge of 1% per annum on the amount of the loan withdrawn from the Loan Account. The loan is payable semiannually commencing May 15, 2010 in an amount of SDR 130,687, at which time the service charge increases to 1.5% per annum, with a maturity date of November 15, 2033.</p> | <u>112,578</u>       |
|  | <u>\$ 33,910,844</u> |

Annual debt service requirements to maturity for principal and interest are as follows:

| <u>Year ending<br/>September 30,</u> | <u>Principal</u>     | <u>Interest and<br/>Service Charge</u> | <u>Total</u>         |
|--------------------------------------|----------------------|--|----------------------|
| 2004                                 | \$ 103,024           | \$ -                                   | \$ 103,024           |
| 2005                                 | 103,024              | -                                      | 103,024              |
| 2006                                 | 103,024              | -                                      | 103,024              |
| 2007                                 | 285,324              | -                                      | 285,324              |
| 2008                                 | 638,964              | -                                      | 638,964              |
| 2009 - 2013                          | 3,615,925            | -                                      | 3,615,925            |
| 2014 - 2018                          | 5,029,760            | -                                      | 5,029,760            |
| 2019 - 2023                          | 6,991,220            | -                                      | 6,991,220            |
| 2024 - 2028                          | 6,702,158            | -                                      | 6,702,158            |
| 2029 - 2033                          | 6,413,122            | -                                      | 6,413,122            |
| 2034 - 2037                          | <u>3,925,299</u>     | <u>-</u>                               | <u>3,925,299</u>     |
|                                      | <u>\$ 33,910,844</u> | <u>\$ -</u>                            | <u>\$ 33,910,844</u> |



**FEDERATED STATES OF MICRONESIA  
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(6) Long-term Obligations, Continued

Primary Government, Continued

Other long-term liabilities will be liquidated in the future from governmental funds. During the year ended September 30, 2003, the following changes occurred in liabilities reported as part of the primary government's long-term liabilities in the statement of net assets:

|                        | Balance<br>October 1,<br>2002 | Additions           | Reductions          | Balance<br>September 30,<br>2003 | Due Within<br>One Year |
|------------------------|-------------------------------|---------------------|---------------------|----------------------------------|------------------------|
| Loans payable:         |                               |                     |                     |                                  |                        |
| ADB Loan 1257 FSM (SF) | \$ 5,151,227                  | \$ -                | \$ -                | \$ 5,151,227                     | \$ 103,024             |
| ADB Loan 1459 FSM (SF) | 8,205,996                     | 909,023             | -                   | 9,115,019                        | -                      |
| ADB Loan 1520 FSM (SF) | 17,682,020                    | -                   | -                   | 17,682,020                       | -                      |
| ADB Loan 1873 FSM (SF) | -                             | 1,850,000           | -                   | 1,850,000                        | -                      |
| ADB Loan 1874 FSM (SF) | -                             | 112,578             | -                   | 112,578                          | -                      |
|                        | <u>31,039,243</u>             | <u>2,871,601</u>    | <u>-</u>            | <u>33,910,844</u>                | <u>103,024</u>         |
| Other:                 |                               |                     |                     |                                  |                        |
| Compensated absences   | 916,172                       | -                   | (249,436)           | 666,736                          | 249,436                |
|                        | <u>\$ 31,955,415</u>          | <u>\$ 2,871,601</u> | <u>\$ (249,436)</u> | <u>\$ 34,577,580</u>             | <u>\$ 352,460</u>      |

Discretely Presented Component Units

As of September 30, 2003, the discretely presented component units had the following long-term debt outstanding:

FSM Telecommunications Corporation (FSMTC)

Loan with the Rural Utilities Service (RUS) (formerly the Rural Electrification Administration) from the Rural Electrification and Telephone Revolving Fund, dated August 1, 1990 of \$39.6 million, with interest at 5% per annum, unconditionally guaranteed by the FSM National Government, under which the FSM National Government will make debt service payments to RUS in the event of default by FSMTC. Mortgages over specific FSMTC ground leases and essentially all assets of FSMTC have collateralized both loans. \$ 26,654,002

National Fisheries Corporation (NFC)

Notes payable to the FSM National Government, due in various annual installments of \$1,962 to \$86,639, non-interest bearing, and due on various dates ranging from July 2007 through April 2014. 3,600,000

Loan payable by the Micronesia Longline Fishing Company, a majority-owned subsidiary of NFC, to the FSM National Government, interest at 6.64% per annum, with repayments commencing January 15, 1998. The loan is a subsidiary loan of a loan agreement (Loan Number 1257 FSM (SF)) between the FSM National Government and the Asian Development Bank. 4,596,907

\$ 34,850,909

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**(6) Long-term Obligations, Continued**

Discretely Presented Component Units, Continued

Annual the debt service requirements to maturity for principal and interest are as follows:

| <u>Year ending<br/>September 30,</u> | <u>Principal</u>     | <u>Interest and<br/>Service Charge</u> | <u>Total</u>         |
|--------------------------------------|----------------------|--|----------------------|
| 2004                                 | \$ 8,872,527         | \$ 2,403,404                           | \$ 11,275,931        |
| 2005                                 | 709,401              | 1,298,919                              | 2,008,320            |
| 2006                                 | 744,871              | 1,263,449                              | 2,008,320            |
| 2007                                 | 782,114              | 1,226,206                              | 2,008,320            |
| 2008                                 | 821,220              | 1,187,100                              | 2,008,320            |
| 2009 – 2013                          | 4,764,647            | 5,276,953                              | 10,041,600           |
| 2014 – 2018                          | 6,081,032            | 3,960,568                              | 10,041,600           |
| 2019 – 2023                          | 7,761,109            | 2,280,491                              | 10,041,600           |
| 2024 – 2026                          | 4,313,988            | 373,723                                | 4,687,711            |
|                                      | <u>\$ 34,850,909</u> | <u>\$ 19,270,813</u>                   | <u>\$ 54,121,722</u> |

Changes in long-term liabilities of the discretely presented component units for the year ended September 30, 2003, are as follows:

|                | <u>Balance<br/>October 1,<br/>2002</u> | <u>Additions</u> | <u>Reductions</u>     | <u>Balance<br/>September 30,<br/>2003</u> | <u>Due Within<br/>One Year</u> |
|----------------|--|------------------|-----------------------|---|--------------------------------|
| Loans payable: |  |                  |                       |   |                                |
| FSMTC          | \$ 27,311,786                          | \$ -             | \$ (657,784)          | \$ 26,654,002                             | \$ 675,620                     |
| NFC            | 9,077,157                              | -                | (880,250)             | 8,196,907                                 | 8,196,907                      |
|                | <u>\$ 36,388,943</u>                   | <u>\$ -</u>      | <u>\$ (1,538,034)</u> | <u>\$ 34,850,909</u>                      | <u>\$ 8,872,527</u>            |

**(7) Operating Transfers In/Out**

Operating transfers in/out for each major governmental fund and nonmajor governmental funds in the aggregate, for the year ended September 30, 2003, are as follows:

| <u>Source</u>                      | <u>Recipient</u>            | <u>Transfers Out</u> | <u>Transfers In</u> |
|------------------------------------|-----------------------------|----------------------|---------------------|
| <u>Major Governmental Funds</u>    |                             |                      |                     |
| General                            | Nonmajor governmental funds | \$ <u>821,598</u>    | \$ <u>335,040</u>   |
| <u>Nonmajor Governmental Funds</u> |                             |                      |                     |
| Nonmajor governmental funds        | General                     | \$ <u>335,040</u>    | \$ <u>821,598</u>   |

Transfers are used to 1) move revenues from the fund that enabling legislation or budget requires to collect them to the fund that enabling legislation or budget requires to expend them, 2) use unrestricted revenues collected in the General Fund to finance various programs accounted for in other funds in accordance with budgetary authorizations, and 3) record reductions in interfund loans for amounts that are not expected to be repaid.

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(8) Contingencies and Commitments

Sick Leave

It is the policy of the FSM National Government to record expenditures for sick leave when leave is actually taken. Sick leave is compensated time for absence during working hours arising from employee illness or injury. The estimated accumulated amount of unused sick leave as of September 30, 2003 is \$666,736.

Insurance Coverage

The FSM National Government does not maintain insurance coverage for a significant amount of fixed assets. In the event of a catastrophe, the FSM National Government may be self-insured to a material extent.

Federal Grants

The FSM National Government participates in a number of federally assisted grant programs. These programs are subject to financial and compliance audits to ascertain if Federal laws and guidelines have been followed. Cumulative questioned costs of \$1,937,147 relating to fiscal years 1999 through 2003 have been set forth in the FSM National Government's Single Audit Report for the year ended September 30, 2003. The ultimate disposition of these questioned costs can be determined only by final action of the respective grantor agencies. Therefore, no provision for any liability that may result upon resolution of this matter has been made in the accompanying financial statements. In addition, a material amount of questioned costs exists from the four States, which receive federal funds in a subrecipient capacity. If these questioned costs are sustained, such will be funded by State resources.

Pursuant to Title I, Section 105 of United States Public Law 99-290, the FSM National Government 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. Accordingly, the States have made no adjustment to the above questioned costs for amounts which were incurred prior to the implementation of the Compact of Free Association.

Leases

The FSM National Government has entered into house lease agreements varying from one to five years. The aggregate amount of future lease payments has not been accumulated as renewal is subject to annual appropriation.

Litigation

The FSM National Government is party to numerous legal proceedings, many of which are normal recurrences in governmental operations. The Attorney General of the FSM National Government is of the opinion that the probable outcome of suits existing at September 30, 2003, is not predictable but could have a material impact on the accompanying financial statements. Such impact has currently been estimated to approximate \$0.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2003

**(8) Contingencies and Commitments, Continued**

Asian Development Bank (ADB) Loans

On January 10, 1997, the FSM National Government entered into a loan agreement (Loan Number 1459 FSM (SF)) with the ADB for the Water Supply and Sanitation Project in the amount of \$10,600,000. The purpose of the loan is to improve water supply and sanitation services in each of the States, which includes on lending a portion of the loan proceeds to the States under separate Financing Agreements. As of September 30, 2003, the FSM National Government had drawn down \$9,115,019 against this loan. On February 4, 2004, this loan account was closed with no further draw downs.

On December 20, 2000, the FSM National Government entered into a loan agreement (Loan Number 1816 FSM (SF)) with the ADB for the Basic Social Services Project in the amount of \$8,019,000. The purpose of the loan is to design and introduce reform in the health and education sectors in the FSM, which will include on lending a portion of the loan proceeds to the States under separate Financing Agreements. As of September 30, 2003, the FSM National Government had no drawn downs against this loan.

On December 12, 2001, the FSM National Government entered into two loan agreements (Loan Numbers 1873 FSM (SF) and 1874 FSM (SF)) with the ADB for the Private Sector Development Project in the amounts of \$5,000,000 and \$8,017,000, respectively. The purpose of these loans is to promote economic growth by expanding the private sector in the FSM, thereby raising domestic employment and incomes and reducing dependence on external assistance, which will include on lending a portion of the loan proceeds to the States under separate Financing Agreements. As of September 30, 2003, the FSM National Government had drawn down \$1,962,578 against these loans. During fiscal year 2006, both of these loan accounts were fully drawn down and closed.

**(9) Individual Deficit Fund Balances/Net Assets**

Specific individual funds that had significant individual deficit fund balances/net assets as at September 30, 2003, are as follows:

Major Governmental Funds

|                               |                   |
|-------------------------------|-------------------|
| Early Retirement Program Fund | \$ <u>139,545</u> |
|-------------------------------|-------------------|

Nonmajor Governmental Funds

|                                       |                   |
|---------------------------------------|-------------------|
| Employees' Health Insurance Plan Fund | \$ <u>234,980</u> |
|---------------------------------------|-------------------|

Component Units

|                                |                     |
|--------------------------------|---------------------|
| National Fisheries Corporation | \$ <u>6,283,094</u> |
|--------------------------------|---------------------|

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Financial Statements  
September 30, 2003

**(10) Subsequent Event**

On November 5, 2004, the FSM National Government entered into two loan agreements (Loan Number 2099 FSM (SF) and Loan Number 2100 FSM (SF)) with the Asian Development Bank in the combined amount of \$19,000,000 for the Omnibus Infrastructure Development Project. The proceeds are to be used to enhance public health and the environment through assistance to improve water supply infrastructure in Kosrae and Yap, and wastewater infrastructure in Pohnpei; and to support economic growth and poverty reduction in Chuuk through improvements to the electrical power sector, which will include on lending a portion of the loan proceeds to the States under separate Financing Agreements.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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**REQUIRED SUPPLEMENTARY INFORMATION-  
OTHER THAN MANAGEMENT'S DISCUSSION AND ANALYSIS**

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**YEAR ENDED SEPTEMBER 30, 2003**

**NATIONAL GOVERNMENT  
FEDERATED STATES OF MICRONESIA**

Schedule of Revenues, Expenditures and Changes in Deficit - Budget and Actual  
General Fund  
Year Ended September 30, 2003

|   | <u>Budgeted Amounts</u> |                      | Actual<br>Amounts    | Variance with<br>Final Budget - |
|---|-------------------------|----------------------|----------------------|---------------------------------|
|   | <u>Original</u>         | <u>Final</u>         |                      | Positive<br>(Negative)          |
| <b>Revenues:</b>                                  |                         |                      |                      |                                 |
| Taxes   | \$ 6,100,000            | \$ 6,100,000         | \$ 6,107,652         | \$ 7,652                        |
| Compact funding                                   | 6,959,993               | 6,959,993            | 6,956,993            | (3,000)                         |
| Fishing rights                                    | 10,500,000              | 10,500,000           | 11,817,041           | 1,317,041                       |
| Postal revenues                                   | 525,000                 | 525,000              | 410,743              | (114,257)                       |
| Investment earnings                               | 500,000                 | 500,000              | 2,663,290            | 2,163,290                       |
| Fees and charges                                  | 200,000                 | 200,000              | 210,669              | 10,669                          |
| Other   | 700,000                 | 700,000              | 118,550              | (581,450)                       |
|   | <u>25,484,993</u>       | <u>25,484,993</u>    | <u>28,284,938</u>    | <u>2,799,945</u>                |
| <b>Expenditures:</b>                              |                         |                      |                      |                                 |
| General government:                               |                         |                      |                      |                                 |
| Executive Branch                                  | 12,561,467              | 12,561,467           | 12,665,100           | (103,633)                       |
| Judicial Branch                                   | 1,129,393               | 1,129,393            | 1,105,405            | 23,988                          |
| Legislative Branch                                | 3,038,947               | 3,038,947            | 2,932,373            | 106,574                         |
| Office of the Public Auditor                      | 433,397                 | 433,397              | 408,527              | 24,870                          |
| Other National Government Programs                | 4,498,059               | 4,498,059            | 3,582,839            | 915,220                         |
| Boards and Commissions                            | 1,354,613               | 1,354,613            | 1,231,994            | 122,619                         |
| Payments to Component Units                       | 3,540,369               | 3,540,369            | 3,527,105            | 13,264                          |
| Other Legislative Appropriations                  | 2,153,001               | 2,153,001            | 3,183,253            | (1,030,252)                     |
| Other   | -                       | -                    | 11,352               | (11,352)                        |
|   | <u>28,709,246</u>       | <u>28,709,246</u>    | <u>28,647,948</u>    | <u>61,298</u>                   |
| Deficiency of revenues under expenditures         | <u>(3,224,253)</u>      | <u>(3,224,253)</u>   | <u>(363,010)</u>     | <u>2,861,243</u>                |
| <b>Other financing sources (uses):</b>            |                         |                      |                      |                                 |
| Operating transfers in                            | 335,040                 | 335,040              | 335,040              | -                               |
| Operating transfers out                           | (821,598)               | (821,598)            | (821,598)            | -                               |
|   | <u>(486,558)</u>        | <u>(486,558)</u>     | <u>(486,558)</u>     | <u>-</u>                        |
| Net change in deficit                             | (3,710,811)             | (3,710,811)          | (849,568)            | 2,861,243                       |
| <b>Other changes in unreserved fund deficit:</b>  |                         |                      |                      |                                 |
| Increase in reserve for related assets            | -                       | -                    | (632,141)            | (632,141)                       |
| Decrease in reserve for continuing appropriations | -                       | -                    | 1,681,724            | 1,681,724                       |
| Unreserved deficit at the beginning of the year   | <u>(2,610,574)</u>      | <u>(2,610,574)</u>   | <u>(2,610,574)</u>   | <u>-</u>                        |
| Unreserved deficit at the end of the year         | <u>\$(6,321,385)</u>    | <u>\$(6,321,385)</u> | <u>\$(2,410,559)</u> | <u>\$ 3,910,826</u>             |

See accompanying notes to basic financial statements.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Required Supplementary Information - Budgetary Reporting  
September 30, 2003

(1) Budgetary Information

The Congress of the Federated States of Micronesia (CFSM) enacts the budget through passage of specific departmental appropriations. Before signing the Appropriations Act, the President may veto or reduce any specific appropriation, subject to Congressional override. Under the Compact of Free Association, which went into effect November 3, 1986, approval of all CFSM Laws is vested with the President of the Federated States of Micronesia.

During fiscal year 2003, supplemental appropriations were also made for both operating and capital purposes, to reflect the evolving priorities of the FSM National Government.

Budgetary control is maintained at the departmental level. Budget revisions during the year, reflecting program changes, may be effected by CFSM approval.

Formal budget integration is employed as a management control device during the year for all funds. The Congress of the FSM has the authority to reprogram budgeted estimates in accordance with the Constitution. All annual appropriations lapse at fiscal year end unless otherwise specified by law. Supplemental appropriations may occur throughout the year. Unexpended encumbrances at each fiscal year end are carried forward until they are expended or canceled without further legislative action.

Accounting principles used in developing data on a budgetary basis differ from those used in preparing the basic financial statements in conformity with GAAP. Amounts included on the Statement of Revenues, Expenditures, and Changes in Deficit - Budget and Actual - General Fund (which are presented on a non-GAAP budgetary basis) are reconciled to unreserved deficit of the Governmental Fund Balance Sheet within the other changes in unreserved deficit section of that statement.

Encumbrance accounting is employed in governmental funds. For budgetary purposes, the encumbrances (i.e., purchase orders, contracts) are considered expenditures when incurred. For GAAP reporting purposes, encumbrances outstanding at year end are reported as reservations of fund balances and do not constitute expenditures or liabilities because the commitments will be reappropriated and honored during the subsequent fiscal year.

For the year ended September 30, 2003, expenditures of the General Fund exceeded budget at the program area level (i.e., the legal level of budgetary control) as follows:

| <u>Program Area</u>                   | <u>Excess</u> |
|---------------------------------------|---------------|
| Office of the President               | \$ 84,081     |
| Department of External Affairs        | \$ 197,834    |
| Department of Justice                 | \$ 9,099      |
| Office of the Public Defender         | \$ 8,972      |
| Public Projects – National Government | \$ 1,030,252  |



**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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**OTHER SUPPLEMENTARY INFORMATION**

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**YEAR ENDED SEPTEMBER 30, 2003**

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

GENERAL FUND

Statement of Revenues, Expenditures by Function by Department, and Changes in Fund Balance  
Year Ended September 30, 2003

|  |                   |
|--|-------------------|
| Revenue:   |                   |
| Compact Funding:   |                   |
| Base amount  | \$ 4,403,160      |
| Inflation adjustment   | 2,553,833         |
|  | <u>6,956,993</u>  |
| Local taxes:   |                   |
| Import   | 1,949,024         |
| Fuel   | 138,328           |
| Income tax, individuals, net of tax refunds                    | 2,318,022         |
| Gross receipts tax, businesses                                 | 1,702,278         |
|  | <u>6,107,652</u>  |
| Fees, licenses, and other                                      |                   |
| Fishing rights fees  | 11,817,041        |
| Postal collections   | 410,743           |
| Business license and firearms fees                             | 123,009           |
| Penalties and interest on delinquent taxes                     | 87,660            |
| Other  | 118,550           |
|  | <u>12,557,003</u> |
| Investments earnings:  |                   |
| Net increase in the fair value of investments                  | 2,522,803         |
| Dividend and interest income                                   | 140,487           |
|  | <u>2,663,290</u>  |
| Total revenues   | <u>28,284,938</u> |
| Expenditures:  |                   |
| Executive Branch:  |                   |
| President's Office   | 688,956           |
| Department of External Affairs and LNO's                       | 3,822,846         |
| Department of Health, Education and Social Affairs             | 937,472           |
| Department of Economic Affairs                                 | 1,151,381         |
| Department of Transportation, Communication and Infrastructure | 729,842           |
| Department of Finance and Administration                       | 2,311,745         |
| Department of Justice  | 2,313,517         |
| Office of the Public Defender                                  | 486,349           |
| Total Executive Branch   | <u>12,442,108</u> |
| Judicial Branch  | <u>1,071,180</u>  |

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

GENERAL FUND

Statement of Revenues, Expenditures by Function by Department, and Changes in Fund Balance, Continued  
Year Ended September 30, 2003

|   |               |
|---|---------------|
| Expenditures, continued:                  |               |
| Legislative Branch:                       |               |
| Office of the Speaker                     | 791,280       |
| Congress staff                            | 1,012,730     |
| Delegation offices                        | 366,274       |
| Members' travel fund                      | 541,823       |
| Legislative committees                    | 136,787       |
| Total Legislative Branch                  | 2,848,894     |
| Office of the Public Auditor              | 372,699       |
| Other National Government Programs        | 3,461,163     |
| Boards and Commissions:                   | 1,186,176     |
| Payments to Component Units:              |               |
| College of Micronesia-FSM                 | 3,250,000     |
| FSM Coconut Development Authority         | 278,533       |
| National Fisheries Corporation OPIC loan  | 145,000       |
|   | 3,673,533     |
| Other Legislative appropriations          | 3,661,196     |
| Other                                     | 11,352        |
| Total expenditures                        | 28,728,301    |
| Deficiency of revenues under expenditures | (443,363)     |
| Other financing sources (uses):           |               |
| Operating transfers in:                   |               |
| Passport Revolving Fund                   | 335,040       |
| Operating transfers out:                  |               |
| Maritime Operations Revolving Fund        | (821,598)     |
| Total other financing sources (uses), net | (486,558)     |
| Net change in fund balance                | (929,921)     |
| Fund balance at the beginning of the year | 19,929,165    |
| Fund balance at the end of the year       | \$ 18,999,244 |

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

GENERAL FUND  
Statement of Revenues, Expenditures and Changes in Fund Balance (Deficit) -  
Budget and Actual, Budgetary Basis  
Year Ended September 30, 2003

|   | Budgeted Amounts  |                   | Actual<br>Amounts | Variance with<br>Final Budget -<br>Positive<br>(Negative) |
|---|-------------------|-------------------|-------------------|---|
|   | Original          | Final             |                   |   |
| Revenues:   |                   |                   |                   |   |
| Compact   | \$ 6,959,993      | \$ 6,959,993      | \$ 6,956,993      | \$ (3,000)  |
| Local taxes   | 6,100,000         | 6,100,000         | 6,107,652         | 7,652   |
| Fishing right fees                                  | 10,500,000        | 10,500,000        | 11,817,041        | 1,317,041   |
| Postal revenues                                     | 525,000           | 525,000           | 410,743           | (114,257)   |
| Investment earnings                                 | 500,000           | 500,000           | 2,663,290         | 2,163,290   |
| Fees and charges                                    | 200,000           | 200,000           | 210,669           | 10,669  |
| Other   | 700,000           | 700,000           | 118,550           | (581,450)   |
| Total revenues                                      | <u>25,484,993</u> | <u>25,484,993</u> | <u>28,284,938</u> | <u>2,799,945</u>  |
| Expenditures-budgetary basis by department:         |                   |                   |                   |   |
| Executive Branch:                                   |                   |                   |                   |   |
| Office of the President                             | 526,419           | 526,419           | 610,500           | (84,081)  |
| Disaster Office                                     | 34,883            | 34,883            | 11,923            | 22,960  |
| Public Information                                  | 134,869           | 134,869           | 104,044           | 30,825  |
| Total   | <u>696,171</u>    | <u>696,171</u>    | <u>726,467</u>    | <u>(30,296)</u>   |
| Department of External Affairs:                     |                   |                   |                   |   |
| Administration                                      | 464,162           | 464,162           | 446,231           | 17,931  |
| Division of APA & Multilateral Affairs              | 86,327            | 86,327            | 77,563            | 8,764   |
| Division of American and European Affairs           | 102,170           | 102,170           | 80,476            | 21,694  |
| FSM Consulate - Guam                                | 264,034           | 264,034           | 275,825           | (11,791)  |
| FSM Consulate - Honolulu                            | 254,750           | 254,750           | 285,894           | (31,144)  |
| FSM Embassy - Tokyo                                 | 920,871           | 920,871           | 862,487           | 58,384  |
| FSM Embassy - Washington D.C.                       | 803,130           | 803,130           | 1,008,488         | (205,358)   |
| FSM Embassy - Fiji                                  | 198,199           | 198,199           | 208,868           | (10,669)  |
| FSM Permanent Mission - New York                    | 649,761           | 649,761           | 695,406           | (45,645)  |
| Total   | <u>3,743,404</u>  | <u>3,743,404</u>  | <u>3,941,238</u>  | <u>(197,834)</u>  |
| Department of Health, Education and Social Affairs: |                   |                   |                   |   |
| Administration                                      | 115,924           | 115,924           | 111,817           | 4,107   |
| Division of Health                                  | 154,542           | 154,542           | 150,084           | 4,458   |
| Division of Education                               | 299,050           | 299,050           | 303,266           | (4,216)   |
| Archive and Historic Preservation Unit              | 116,288           | 116,288           | 111,620           | 4,668   |
| Environmental                                       | 152,972           | 152,972           | 144,590           | 8,382   |
| Women's Interests Unit                              | 32,903            | 32,903            | 29,951            | 2,952   |
| Sports and Youth Unit                               | 81,389            | 81,389            | 83,259            | (1,870)   |
| Total   | <u>953,068</u>    | <u>953,068</u>    | <u>934,587</u>    | <u>18,481</u>   |
| Department of Economic Affairs:                     |                   |                   |                   |   |
| Administration                                      | 142,646           | 142,646           | 96,112            | 46,534  |
| Division of Sectoral Development                    | 104,450           | 104,450           | 92,660            | 11,790  |
| Planning and Economic Management                    | 123,010           | 123,010           | 110,776           | 12,234  |
| Public Enterprise Unit                              | 32,980            | 32,980            | 33,208            | (228)   |
| Statistics  | 336,978           | 336,978           | 324,575           | 12,403  |
| Tourism   | 72,613            | 72,613            | 63,022            | 9,591   |
| Agriculture   | 237,741           | 237,741           | 231,570           | 6,171   |
| Fisheries   | 73,690            | 73,690            | 67,392            | 6,298   |
| Environmental and Sustainable Development           | 88,310            | 88,310            | 83,213            | 5,097   |
| Total   | <u>1,212,418</u>  | <u>1,212,418</u>  | <u>1,102,528</u>  | <u>109,890</u>  |

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

**GENERAL FUND**  
Statement of Revenues, Expenditures and Changes in Fund Balance (Deficit) -  
Budget and Actual, Budgetary Basis, Continued  
Year Ended September 30, 2003

|   | Budgeted Amounts  |                   | Actual<br>Amounts | Variance with<br>Final Budget -<br>Positive<br>(Negative) |
|---|-------------------|-------------------|-------------------|---|
|   | Original          | Final             |                   |   |
| Expenditures-budgetary basis by department, continued:          |                   |                   |                   |   |
| Department of Transportation, Communication and Infrastructure: |                   |                   |                   |   |
| Administration  | 143,756           | 143,756           | 145,999           | (2,243)   |
| Division of Marine Transportation                               | 110,620           | 110,620           | 106,326           | 4,294   |
| Division of Infrastructure                                      | 350,094           | 350,094           | 347,001           | 3,093   |
| Civil Aviation  | 75,652            | 75,652            | 72,779            | 2,873   |
| Communication   | 59,708            | 59,708            | 63,307            | (3,599)   |
| Total   | <u>739,830</u>    | <u>739,830</u>    | <u>735,412</u>    | <u>4,418</u>  |
| Department of Finance and Administration:                       |                   |                   |                   |   |
| Administration  | 331,908           | 331,908           | 323,095           | 8,813   |
| Division of National Treasury and Investment                    | 453,711           | 453,711           | 446,922           | 6,789   |
| Division of Customs and Tax Administration                      | 718,893           | 718,893           | 718,847           | 46  |
| Division of Budget  | 148,248           | 148,248           | 148,164           | 84  |
| Division of Personnel   | 73,467            | 73,467            | 65,806            | 7,661   |
| Recruitment and Repatriation                                    | 100,816           | 100,816           | 127,238           | (26,422)  |
| Staff Housing   | 509,884           | 509,884           | 497,076           | 12,808  |
| Total   | <u>2,336,927</u>  | <u>2,336,927</u>  | <u>2,327,148</u>  | <u>9,779</u>  |
| Department of Justice:  |                   |                   |                   |   |
| Administration  | 202,051           | 202,051           | 200,132           | 1,919   |
| Division of Law   | 146,369           | 146,369           | 131,386           | 14,983  |
| Division of Litigation  | 136,885           | 136,885           | 154,075           | (17,190)  |
| Division of Immigration and Labor                               | 609,373           | 609,373           | 576,213           | 33,160  |
| FSM National Police   | 1,257,450         | 1,257,450         | 1,299,421         | (41,971)  |
| Total   | <u>2,352,128</u>  | <u>2,352,128</u>  | <u>2,361,227</u>  | <u>(9,099)</u>  |
| Office of the Public Defender                                   |                   |                   |                   |   |
|   | <u>527,521</u>    | <u>527,521</u>    | <u>536,493</u>    | <u>(8,972)</u>  |
| Total Executive Branch  | <u>12,561,467</u> | <u>12,561,467</u> | <u>12,665,100</u> | <u>(103,633)</u>  |
| Judicial Branch   |                   |                   |                   |   |
|   | <u>1,129,393</u>  | <u>1,129,393</u>  | <u>1,105,405</u>  | <u>23,988</u>   |
| Legislative Branch:   |                   |                   |                   |   |
| Office of the Speaker   | 857,030           | 857,030           | 852,615           | 4,415   |
| Congress staff  | 1,105,887         | 1,105,887         | 981,768           | 124,119   |
| Delegation offices  | 450,477           | 450,477           | 472,693           | (22,216)  |
| Members' travel fund  | 589,553           | 589,553           | 590,375           | (822)   |
| Legislative committees  | 36,000            | 36,000            | 34,922            | 1,078   |
| Total Legislative Branch  | <u>3,038,947</u>  | <u>3,038,947</u>  | <u>2,932,373</u>  | <u>106,574</u>  |
| Office of the Public Auditor                                    |                   |                   |                   |   |
|   | <u>433,397</u>    | <u>433,397</u>    | <u>408,527</u>    | <u>24,870</u>   |
| Other National Government Programs:                             |                   |                   |                   |   |
| Aid to Nonpublic School   | 500,000           | 500,000           | 500,000           | -   |
| Micronesia Legal Services Corporation                           | 150,000           | 150,000           | 150,000           | -   |
| JCN   | 1,118,916         | 1,118,916         | 926,824           | 192,092   |
| Micronesian Maritime Fisheries                                  | 700,000           | 700,000           | 700,000           | -   |
| NFC EPIC Loan Payment   | 145,000           | 145,000           | 145,000           | -   |
| National Election Director                                      | 489,144           | 489,144           | 486,273           | 2,871   |
| Other   | 1,394,999         | 1,394,999         | 674,742           | 720,257   |
| Total Other National Government Programs                        | <u>4,498,059</u>  | <u>4,498,059</u>  | <u>3,582,839</u>  | <u>915,220</u>  |

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

GENERAL FUND  
Statement of Revenues, Expenditures and Changes in Fund Balance (Deficit) -  
Budget and Actual, Budgetary Basis, Continued  
Year Ended September 30, 2003

|  | Budgeted Amounts      |                       | Actual<br>Amounts     | Variance with<br>Final Budget -<br>Positive<br>(Negative) |
|--|-----------------------|-----------------------|-----------------------|---|
|  | Original              | Final                 |                       |   |
| Expenditures-budgetary basis by department, continued: |                       |                       |                       |   |
| Board and Commissions:                                 |                       |                       |                       |   |
| Micronesia Maritime Authority                          | 412,599               | 412,599               | 369,319               | 43,280  |
| FSM Banking Board                                      | 109,656               | 109,656               | 102,496               | 7,160   |
| Board of Regents - COM                                 | 130,791               | 130,791               | 99,664                | 31,127  |
| Postal services  | 663,567               | 663,567               | 623,235               | 40,332  |
| National Board of Nursing                              | 38,000                | 38,000                | 37,280                | 720   |
| Total Boards and Commissions                           | <u>1,354,613</u>      | <u>1,354,613</u>      | <u>1,231,994</u>      | <u>122,619</u>  |
| Payments to component units:                           |                       |                       |                       |   |
| Copra Subsidy  | 150,000               | 150,000               | 150,000               | -   |
| Coconut Development Authority                          | 140,369               | 140,369               | 127,105               | 13,264  |
| COM-FSM  | 3,250,000             | 3,250,000             | 3,250,000             | -   |
| Total Payments to Component Units                      | <u>3,540,369</u>      | <u>3,540,369</u>      | <u>3,527,105</u>      | <u>13,264</u>   |
| Other legislative appropriations:                      |                       |                       |                       |   |
| Public projects - National Government                  | 2,153,001             | 2,153,001             | 3,183,253             | (1,030,252)   |
| Other  | -                     | -                     | 11,352                | (11,352)  |
| Total expenditures                                     | <u>28,709,246</u>     | <u>28,709,246</u>     | <u>28,647,948</u>     | <u>61,298</u>   |
| Deficiency of revenues under expenditures              | <u>(3,224,253)</u>    | <u>(3,224,253)</u>    | <u>(363,010)</u>      | <u>2,861,243</u>  |
| Other financing sources (uses):                        |                       |                       |                       |   |
| Operating transfers in:                                |                       |                       |                       |   |
| Passport Revolving Fund                                | 335,040               | 335,040               | 335,040               | -   |
| Operating transfers out:                               |                       |                       |                       |   |
| Maritime Revolving Fund                                | (821,598)             | (821,598)             | (821,598)             | -   |
| Total other financing sources (uses), net              | <u>(486,558)</u>      | <u>(486,558)</u>      | <u>(486,558)</u>      | <u>-</u>  |
| Net change in fund deficit                             | (3,710,811)           | (3,710,811)           | (849,568)             | 2,861,243   |
| Unreserved fund deficit at beginning of year           | (2,610,574)           | (2,610,574)           | (2,610,574)           | -   |
| Other changes in unreserved fund deficit:              |                       |                       |                       |   |
| Increase in reserve for related assets                 | -                     | -                     | (632,141)             | (632,141)   |
| Decrease in reserve for continuing appropriations      | -                     | -                     | 1,681,724             | 1,681,724   |
| Unreserved deficit at end of year                      | <u>\$ (6,321,385)</u> | <u>\$ (6,321,385)</u> | <u>\$ (2,410,559)</u> | <u>\$ 3,910,826</u>                                       |

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Combined Balance Sheet  
Nonmajor Governmental Funds  
September 30, 2003

|   | Other<br>Special Revenue | Other<br>Capital Projects | Total                |
|---|--------------------------|---------------------------|----------------------|
| <b><u>ASSETS</u></b>                        |                          |                           |                      |
| Cash and cash equivalents                   | \$ 50,268                | \$ 30,695                 | \$ 80,963            |
| Time certificates of deposit                | 94,896                   | -                         | 94,896               |
| Equity in internal investment pool          | 7,086,026                | 2,561,044                 | 9,647,070            |
| Investments                                 | -                        | 3,833,274                 | 3,833,274            |
| Receivables, net:                           |                          |                           |                      |
| Federal agencies                            | -                        | 726,755                   | 726,755              |
| Loans                                       | -                        | 1,228,636                 | 1,228,636            |
| Accrued interest                            | -                        | 455,812                   | 455,812              |
| Other                                       | 25,073                   | -                         | 25,073               |
| Due from other funds                        | 2,382,222                | -                         | 2,382,222            |
| Advances                                    | 32,033                   | 32,060                    | 64,093               |
| Other assets                                | 274,493                  | -                         | 274,493              |
|   | <u>\$ 9,945,011</u>      | <u>\$ 8,868,276</u>       | <u>\$ 18,813,287</u> |
| Total assets                                |                          |                           |                      |
| <b><u>LIABILITIES AND FUND BALANCES</u></b> |                          |                           |                      |
| Liabilities:                                |                          |                           |                      |
| Accounts payable                            | \$ 531,080               | \$ 185,285                | \$ 716,365           |
| Other liabilities and accruals              | 1,866,794                | -                         | 1,866,794            |
| Due to FSM State Governments                | 924,290                  | 9,455                     | 933,745              |
| Due to other funds                          | 474,145                  | 572,575                   | 1,046,720            |
| Deferred revenue                            | -                        | 509,476                   | 509,476              |
|   | <u>3,796,309</u>         | <u>1,276,791</u>          | <u>5,073,100</u>     |
| Total liabilities                           |                          |                           |                      |
| Fund balances:                              |                          |                           |                      |
| Reserved for:                               |                          |                           |                      |
| Related assets                              | -                        | 5,788,665                 | 5,788,665            |
| Encumbrances                                | 809,477                  | 439,497                   | 1,248,974            |
| Continuing appropriations                   | 2,589,315                | 2,662,052                 | 5,251,367            |
| Compact programs                            | 1,903,532                | -                         | 1,903,532            |
| Unreserved (deficit):                       |                          |                           |                      |
| Special revenue funds                       | 846,378                  | -                         | 846,378              |
| Capital projects funds                      | -                        | (1,298,729)               | (1,298,729)          |
|   | <u>6,148,702</u>         | <u>7,591,485</u>          | <u>13,740,187</u>    |
| Total fund balances                         |                          |                           |                      |
| Total liabilities and fund balances         | <u>\$ 9,945,011</u>      | <u>\$ 8,868,276</u>       | <u>\$ 18,813,287</u> |

See Accompanying Independent Auditors' Report

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Combined Statement of Revenues, Expenditures by Function,  
and Changes in Fund Balances  
Nonmajor Governmental Funds  
Year Ended September 30, 2003

|  | Other<br>Special Revenue | Other<br>Capital Projects | Total         |
|--|--------------------------|---------------------------|---------------|
| Revenues:  |                          |                           |               |
| Compact funding                                  | \$ 4,769,661             | \$ 2,983,841              | \$ 7,753,502  |
| Fees and charges                                 | 4,349,150                | -                         | 4,349,150     |
| Other grants                                     | 135,666                  | -                         | 135,666       |
| Other  | 9,151                    | -                         | 9,151         |
| Total revenues                                   | 9,263,628                | 2,983,841                 | 12,247,469    |
| Expenditures by function:                        |                          |                           |               |
| Current:   |                          |                           |               |
| General government:                              |                          |                           |               |
| Health, education and social affairs             | 7,520,228                | -                         | 7,520,228     |
| Transportation, communication and infrastructure | 450,546                  | -                         | 450,546       |
| Economic affairs                                 | 1,492,024                | -                         | 1,492,024     |
| Justice  | 33,800                   | -                         | 33,800        |
| Payments to component units                      | 475,000                  | 1,000,000                 | 1,475,000     |
| Capital projects                                 | -                        | 1,559,490                 | 1,559,490     |
| Total expenditures                               | 9,971,598                | 2,559,490                 | 12,531,088    |
| Excess of revenues over expenditures             | (707,970)                | 424,351                   | (283,619)     |
| Other financing sources (uses):                  |                          |                           |               |
| Operating transfers in                           | 821,598                  | -                         | 821,598       |
| Operating transfers out                          | (335,040)                | -                         | (335,040)     |
| Total other financing sources (uses), net        | 486,558                  | -                         | 486,558       |
| Net change in fund balances                      | (221,412)                | 424,351                   | 202,939       |
| Fund balances at the beginning of the year       | 6,370,114                | 7,167,134                 | 13,537,248    |
| Fund balances at the end of the year             | \$ 6,148,702             | \$ 7,591,485              | \$ 13,740,187 |

See Accompanying Independent Auditors' Report



**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

**NONMAJOR GOVERNMENTAL FUNDS  
SPECIAL REVENUE FUNDS**

**Combining Balance Sheet  
September 30, 2003**

|  | Section<br>215(a)(2)<br>Communications | Section<br>215(b)(2)<br>Communications | Section<br>216(a)(1)<br>Marine<br>Surveillance | Section<br>216(b)(1)<br>Marine<br>Surveillance | Section<br>216(a)(2)<br>Health and<br>Medical | Section<br>216(a)(3)<br>Post-secondary<br>Education | Section<br>221(b)<br>Special<br>Block Grant | Section<br>214<br>Energy | Section<br>212<br>Special<br>Development | Maritime<br>Operations<br>Revolving |
|--|--|--|--|--|---|---|---|--------------------------|--|-------------------------------------|
| <b>ASSETS</b>                              |  |  |  |  |   |   |   |                          |  |                                     |
| Cash and cash equivalents                  | \$ -                                   | \$ -                                   | \$ -   | \$ -   | \$ -  | \$ -  | \$ -  | \$ -                     | \$ -                                     | \$ -                                |
| Time certificates of deposit               | -                                      | -                                      | -  | -  | -   | -   | -   | -                        | -  | -                                   |
| Equity in internal investment pool         | 1,329,621                              | 450,327                                | 431,518  | 47,487   | 305,485                                       | 1,741,779   | 726,931                                     | 329,106                  | -  | -                                   |
| Receivables, net:                          |  |  |  |  |   |   |   |                          |  |                                     |
| Other                                      | -                                      | -                                      | -  | -  | -   | -   | -   | -                        | -  | 3,102                               |
| Due from other funds                       | -                                      | -                                      | -  | -  | -   | -   | -   | -                        | -  | 353,332                             |
| Advances                                   | -                                      | -                                      | -  | -  | -   | -   | -   | -                        | -  | 10,115                              |
| Other assets                               | -                                      | -                                      | -  | -  | -   | -   | -   | -                        | -  | -                                   |
| <b>Total assets</b>                        | <b>\$ 1,329,621</b>                    | <b>\$ 450,327</b>                      | <b>\$ 431,518</b>                              | <b>\$ 47,487</b>                               | <b>\$ 305,485</b>                             | <b>\$ 1,741,779</b>                                 | <b>\$ 726,931</b>                           | <b>\$ 329,106</b>        | <b>\$ -</b>                              | <b>\$ 366,549</b>                   |
| <b>LIABILITIES AND FUND BALANCES</b>       |  |  |  |  |   |   |   |                          |  |                                     |
| <b>(DEFICITS)</b>                          |  |  |  |  |   |   |   |                          |  |                                     |
| Liabilities:                               |  |  |  |  |   |   |   |                          |  |                                     |
| Accounts payable                           | \$ 1,173                               | \$ 29,455                              | \$ 8,652                                       | \$ -   | \$ 9,996                                      | \$ 253,194  | \$ 91,657                                   | \$ 3,846                 | \$ -                                     | \$ 36,177                           |
| Other liabilities and accruals             | -                                      | -                                      | -  | -  | -   | -   | -   | -                        | -  | 1,652                               |
| Due to FSM State Governments               | -                                      | -                                      | -  | -  | -   | -   | -   | -                        | -  | -                                   |
| Due to other funds                         | -                                      | -                                      | -  | -  | -   | -   | -   | -                        | -  | -                                   |
| <b>Total liabilities</b>                   | <b>1,173</b>                           | <b>29,455</b>                          | <b>8,652</b>                                   | <b>-</b>                                       | <b>9,996</b>                                  | <b>253,194</b>                                      | <b>91,657</b>                               | <b>3,846</b>             | <b>-</b>                                 | <b>37,829</b>                       |
| Fund balances (deficits):                  |  |  |  |  |   |   |   |                          |  |                                     |
| Reserved for:                              |  |  |  |  |   |   |   |                          |  |                                     |
| Encumbrances                               | 54,194                                 | -                                      | 374,386  | -  | 31,351  | 5,000   | 73,923                                      | -                        | -  | 120,288                             |
| Continuing appropriations                  | 1,094,573                              | 154,881                                | -  | -  | -   | 603,586   | 365,037                                     | 303,818                  | -  | -                                   |
| Compact programs                           | 179,681                                | 265,991                                | 48,480   | 47,487   | 264,138                                       | 879,999   | 196,314                                     | 21,442                   | -  | -                                   |
| Unreserved (deficit)                       | -                                      | -                                      | -  | -  | -   | -   | -   | -                        | -  | 208,432                             |
| Total fund balances (deficits)             | <b>1,328,448</b>                       | <b>420,872</b>                         | <b>422,866</b>                                 | <b>47,487</b>                                  | <b>295,489</b>                                | <b>1,488,585</b>                                    | <b>635,274</b>                              | <b>325,260</b>           | <b>-</b>                                 | <b>328,720</b>                      |
| <b>Total liabilities and fund balances</b> | <b>\$ 1,329,621</b>                    | <b>\$ 450,327</b>                      | <b>\$ 431,518</b>                              | <b>\$ 47,487</b>                               | <b>\$ 305,485</b>                             | <b>\$ 1,741,779</b>                                 | <b>\$ 726,931</b>                           | <b>\$ 329,106</b>        | <b>\$ -</b>                              | <b>\$ 366,549</b>                   |

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**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

**NONMAJOR GOVERNMENTAL FUNDS  
SPECIAL REVENUE FUNDS**

**Combining Balance Sheet, Continued  
September 30, 2003**

|                                    | Non-U.S.<br>Grants | Disaster<br>Relief | Passport<br>Revolving | Fisheries<br>Observer<br>Revolving | Medical<br>Revolving | Aquaculture<br>Revolving | Student<br>Loans  | Nurse<br>Board<br>Revolving | Health<br>Insurance<br>Plan | Total               |
|------------------------------------|--------------------|--------------------|-----------------------|------------------------------------|----------------------|--------------------------|-------------------|-----------------------------|-----------------------------|---------------------|
| <b>ASSETS</b>                      |                    |                    |                       |                                    |                      |                          |                   |                             |                             |                     |
| Cash and cash equivalents          | \$ -               | \$ -               | \$ -                  | \$ -                               | \$ -                 | \$ -                     | \$ -              | \$ -                        | \$ 50,268                   | \$ 50,268           |
| Time certificates of deposit       | -                  | -                  | -                     | -                                  | -                    | -                        | -                 | -                           | 94,896                      | 94,896              |
| Equity in internal investment pool | -                  | -                  | -                     | -                                  | -                    | -                        | -                 | -                           | 1,723,772                   | 7,086,026           |
| Receivables, net:                  |                    |                    |                       |                                    |                      |                          |                   |                             |                             |                     |
| Other                              | -                  | -                  | -                     | -                                  | -                    | -                        | -                 | -                           | 21,971                      | 25,073              |
| Due from other funds               | 930,653            | 125,648            | 40,150                | 284,336                            | 4,616                | 35,153                   | 598,239           | 10,095                      | -                           | 2,382,222           |
| Advances                           | 18,677             | -                  | -                     | -                                  | -                    | -                        | -                 | -                           | 3,241                       | 32,033              |
| Other assets                       | -                  | -                  | -                     | -                                  | -                    | -                        | -                 | -                           | 274,493                     | 274,493             |
| <b>Total assets</b>                | <b>\$ 949,330</b>  | <b>\$ 125,648</b>  | <b>\$ 40,150</b>      | <b>\$ 284,336</b>                  | <b>\$ 4,616</b>      | <b>\$ 35,153</b>         | <b>\$ 598,239</b> | <b>\$ 10,095</b>            | <b>\$ 2,168,641</b>         | <b>\$ 9,945,011</b> |

**LIABILITIES AND FUND BALANCES  
(DEFICITS)**

|  |                   |                   |                  |                   |                 |                  |                   |                  |                     |                     |
|--|-------------------|-------------------|------------------|-------------------|-----------------|------------------|-------------------|------------------|---------------------|---------------------|
| <b>Liabilities:</b>                        |                   |                   |                  |                   |                 |                  |                   |                  |                     |                     |
| Accounts payable                           | \$ 24,117         | \$ -              | \$ 150           | \$ 8,329          | \$ -            | \$ -             | \$ -              | \$ -             | \$ 64,334           | \$ 531,080          |
| Other liabilities and accruals             | -                 | -                 | -                | -                 | -               | -                | -                 | -                | 1,865,142           | 1,866,794           |
| Due to FSM State Governments               | 924,290           | -                 | -                | -                 | -               | -                | -                 | -                | -                   | 924,290             |
| Due to other funds                         | -                 | -                 | -                | -                 | -               | -                | -                 | -                | 474,145             | 474,145             |
| <b>Total liabilities</b>                   | <b>948,407</b>    | <b>-</b>          | <b>150</b>       | <b>8,329</b>      | <b>-</b>        | <b>-</b>         | <b>-</b>          | <b>-</b>         | <b>2,403,621</b>    | <b>3,796,309</b>    |
| <b>Fund balances (deficits):</b>           |                   |                   |                  |                   |                 |                  |                   |                  |                     |                     |
| Reserved for:                              |                   |                   |                  |                   |                 |                  |                   |                  |                     |                     |
| Encumbrances                               | 74,968            | -                 | 1,950            | 72,803            | 614             | -                | -                 | -                | -                   | 809,477             |
| Continuing appropriations                  | -                 | 67,420            | -                | -                 | -               | -                | -                 | -                | -                   | 2,589,315           |
| Compact programs                           | -                 | -                 | -                | -                 | -               | -                | -                 | -                | -                   | 1,903,532           |
| Unreserved (deficit)                       | (74,045)          | 58,228            | 38,050           | 203,204           | 4,002           | 35,153           | 598,239           | 10,095           | (234,980)           | 846,378             |
| <b>Total fund balances (deficits)</b>      | <b>923</b>        | <b>125,648</b>    | <b>40,000</b>    | <b>276,007</b>    | <b>4,616</b>    | <b>35,153</b>    | <b>598,239</b>    | <b>10,095</b>    | <b>(234,980)</b>    | <b>6,148,702</b>    |
| <b>Total liabilities and fund balances</b> | <b>\$ 949,330</b> | <b>\$ 125,648</b> | <b>\$ 40,150</b> | <b>\$ 284,336</b> | <b>\$ 4,616</b> | <b>\$ 35,153</b> | <b>\$ 598,239</b> | <b>\$ 10,095</b> | <b>\$ 2,168,641</b> | <b>\$ 9,945,011</b> |

See Accompanying Independent Auditors' Report

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

**NONMAJOR GOVERNMENTAL FUNDS  
SPECIAL REVENUE FUNDS**

**Combining Statement of Revenues, Expenditures by Function,  
and Changes in Fund Balances (Deficits)  
Year Ended September 30, 2003**

|   | Section<br>215(a)(2)<br>Communications | Section<br>216(a)(1)<br>Marine<br>Surveillance | Section<br>216(b)(1)<br>Marine<br>Surveillance | Section<br>216(a)(2)<br>Health and<br>Medical | Section<br>216(a)(3)<br>Post-secondary<br>Education | Section<br>221(b)<br>Special<br>Block Grant | Section<br>214<br>Energy | Section<br>212<br>Special<br>Development | Maritime<br>Operations<br>Revolving |
|---|--|--|--|---|---|---|--------------------------|--|-------------------------------------|
| Revenues:   |  |  |  |   |   |   |                          |  |                                     |
| Compact funding   | \$ 948,000                             | \$ 519,000                                     | \$ 44,900                                      | \$ 125,980                                    | \$ 1,889,700  | \$ 315,000                                  | \$ 295,081               | \$ -                                     | \$ -                                |
| Interest and dividends                                    | -                                      | -  | -  | -   | -   | -   | -                        | -  | -                                   |
| Fees and charges  | -                                      | -  | -  | -   | -   | -   | -                        | -  | 41,712                              |
| Other grants  | -                                      | -  | -  | -   | -   | -   | -                        | -  | -                                   |
| Other   | -                                      | -  | -  | -   | -   | -   | -                        | -  | -                                   |
| Total revenues  | 948,000                                | 519,000  | 44,900   | 125,980                                       | 1,889,700   | 315,000                                     | 295,081                  | -  | 41,712                              |
| Expenditures by function:                                 |  |  |  |   |   |   |                          |  |                                     |
| Current:  |  |  |  |   |   |   |                          |  |                                     |
| General government:                                       |  |  |  |   |   |   |                          |  |                                     |
| Health, education and social affairs                      | -                                      | -  | -  | 152,305                                       | 2,049,239   | 351,320                                     | -                        | -  | -                                   |
| Transportation, communication and infrastructure          | 43,464                                 | -  | -  | -   | -   | -   | -                        | -  | -                                   |
| Economic affairs  | -                                      | 308,211  | -  | -   | -   | -   | 291,345                  | -  | 827,623                             |
| Justice   | -                                      | -  | -  | -   | -   | -   | -                        | -  | -                                   |
| Payments to component units                               | -                                      | -  | -  | -   | 475,000   | -   | -                        | -  | -                                   |
| Total expenditures  | 43,464                                 | 308,211  | -  | 152,305                                       | 2,524,239   | 351,320                                     | 291,345                  | -  | 827,623                             |
| Excess (deficiency) of revenues over (under) expenditures | 904,536                                | 210,789  | 44,900   | (26,325)                                      | (634,539)   | (36,320)                                    | 3,736                    | -  | (785,911)                           |
| Other financing sources (uses):                           |  |  |  |   |   |   |                          |  |                                     |
| Operating transfers in                                    | -                                      | -  | -  | -   | -   | -   | -                        | -  | 821,598                             |
| Operating transfers out                                   | -                                      | -  | -  | -   | -   | -   | -                        | -  | -                                   |
| Total other financing sources (uses), net                 | -                                      | -  | -  | -   | -   | -   | -                        | -  | 821,598                             |
| Net change in fund balances (deficit)                     | 904,536                                | 210,789  | 44,900   | (26,325)                                      | (634,539)   | (36,320)                                    | 3,736                    | -  | 35,687                              |
| Fund balances (deficits) at the beginning of the year     | 423,912                                | 212,077  | 2,587  | 321,814                                       | 2,123,124   | 671,594                                     | 321,524                  | -  | 293,033                             |
| Fund balances (deficits) at the end of the year           | \$ 1,328,448                           | \$ 422,866                                     | \$ 47,487                                      | \$ 295,489                                    | \$ 1,488,585  | \$ 635,274                                  | \$ 325,260               | \$ -                                     | \$ 328,720                          |

See Accompanying Independent Auditors' Report

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

**NONMAJOR GOVERNMENTAL FUNDS  
SPECIAL REVENUE FUNDS**

**Combining Statement of Revenues, Expenditures by Function,  
and Changes in Fund Balances (Deficits), Continued  
Year Ended September 30, 2003**

|  | Non-U.S.<br>Grants | Disaster<br>Relief | Passport<br>Revolving | Fisheries<br>Observer<br>Revolving | Medical<br>Revolving | Aquaculture<br>Revolving | Student<br>Loans | Nurse<br>Board<br>Revolving | Health<br>Insurance<br>Plan | Total            |
|--|--------------------|--------------------|-----------------------|------------------------------------|----------------------|--------------------------|------------------|-----------------------------|-----------------------------|------------------|
| <b>Revenues:</b>   |                    |                    |                       |                                    |                      |                          |                  |                             |                             |                  |
| Compact funding  | \$ -               | \$ -               | \$ -                  | \$ -                               | \$ -                 | \$ -                     | \$ -             | \$ -                        | \$ -                        | \$ 4,769,661     |
| Interest and dividends                                       | -                  | -                  | -                     | -                                  | -                    | -                        | -                | -                           | -                           | -                |
| Fees and charges   | -                  | -                  | 368,840               | 136,875                            | -                    | 1,511                    | -                | 10,250                      | 3,789,962                   | 4,349,150        |
| Other grants   | 135,666            | -                  | -                     | -                                  | -                    | -                        | -                | -                           | -                           | 135,666          |
| Other  | -                  | -                  | -                     | -                                  | -                    | -                        | 1,961            | -                           | 7,190                       | 9,151            |
| <b>Total revenues</b>  | <b>135,666</b>     | <b>-</b>           | <b>368,840</b>        | <b>136,875</b>                     | <b>-</b>             | <b>1,511</b>             | <b>1,961</b>     | <b>10,250</b>               | <b>3,797,152</b>            | <b>9,263,628</b> |
| <b>Expenditures by function:</b>                             |                    |                    |                       |                                    |                      |                          |                  |                             |                             |                  |
| <b>Current:</b>  |                    |                    |                       |                                    |                      |                          |                  |                             |                             |                  |
| General government:  | 135,666            | -                  | -                     | -                                  | -                    | -                        | 480              | -                           | 4,831,218                   | 7,520,228        |
| Health, education and social affairs                         | -                  | -                  | -                     | -                                  | -                    | -                        | -                | -                           | -                           | 450,546          |
| Transportation, communication and infrastructure             | -                  | -                  | -                     | 64,845                             | -                    | -                        | -                | -                           | -                           | 1,492,024        |
| Economic affairs   | -                  | -                  | 33,800                | -                                  | -                    | -                        | -                | -                           | -                           | 33,800           |
| Justice  | -                  | -                  | -                     | -                                  | -                    | -                        | -                | -                           | -                           | 475,000          |
| Payments to component units                                  | -                  | -                  | -                     | -                                  | -                    | -                        | -                | -                           | -                           | -                |
| <b>Total expenditures</b>                                    | <b>135,666</b>     | <b>-</b>           | <b>33,800</b>         | <b>64,845</b>                      | <b>-</b>             | <b>-</b>                 | <b>480</b>       | <b>-</b>                    | <b>4,831,218</b>            | <b>9,971,598</b> |
| Excess (deficiency) of revenues over (under) expenditures    | -                  | -                  | 335,040               | 72,030                             | -                    | 1,511                    | 1,481            | 10,250                      | (1,034,066)                 | (707,970)        |
| <b>Other financing sources (uses):</b>                       |                    |                    |                       |                                    |                      |                          |                  |                             |                             |                  |
| Operating transfers in                                       | -                  | -                  | -                     | -                                  | -                    | -                        | -                | -                           | -                           | 821,598          |
| Operating transfers out                                      | -                  | -                  | (335,040)             | -                                  | -                    | -                        | -                | -                           | -                           | (335,040)        |
| <b>Total other financing sources (uses), net</b>             | <b>-</b>           | <b>-</b>           | <b>(335,040)</b>      | <b>-</b>                           | <b>-</b>             | <b>-</b>                 | <b>-</b>         | <b>-</b>                    | <b>-</b>                    | <b>486,558</b>   |
| <b>Net change in fund balances (deficit)</b>                 | <b>-</b>           | <b>-</b>           | <b>-</b>              | <b>72,030</b>                      | <b>-</b>             | <b>1,511</b>             | <b>1,481</b>     | <b>10,250</b>               | <b>(1,034,066)</b>          | <b>(221,412)</b> |
| <b>Fund balances (deficits) at the beginning of the year</b> | <b>923</b>         | <b>125,648</b>     | <b>40,000</b>         | <b>203,977</b>                     | <b>4,616</b>         | <b>33,642</b>            | <b>596,758</b>   | <b>(155)</b>                | <b>799,086</b>              | <b>6,370,114</b> |
| <b>Fund balances (deficits) at the end of the year</b>       | <b>923</b>         | <b>125,648</b>     | <b>40,000</b>         | <b>276,007</b>                     | <b>4,616</b>         | <b>35,153</b>            | <b>598,239</b>   | <b>10,095</b>               | <b>(234,980)</b>            | <b>6,148,702</b> |

See Accompanying Independent Auditors' Report

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

**NONMAJOR GOVERNMENTAL FUNDS  
CAPITAL PROJECTS FUNDS**

**Combining Balance Sheet  
September 30, 2003**

|   | Compact<br>Capital<br>Projects | OIA<br>Capital<br>Projects | Total               |
|---|--------------------------------|----------------------------|---------------------|
| <b><u>ASSETS</u></b>                            |                                |                            |                     |
| Cash and cash equivalents                       | \$ 30,695                      | \$ -                       | \$ 30,695           |
| Equity in internal investment pool              | 2,561,044                      | -                          | 2,561,044           |
| Investments                                     | 3,833,274                      | -                          | 3,833,274           |
| Receivables, net:                               |                                |                            |                     |
| Federal agencies                                | -                              | 726,755                    | 726,755             |
| Loans   | 1,228,636                      | -                          | 1,228,636           |
| Interest  | 455,812                        | -                          | 455,812             |
| Advances  | 32,060                         | -                          | 32,060              |
|   | <u>\$ 8,141,521</u>            | <u>\$ 726,755</u>          | <u>\$ 8,868,276</u> |
| <br><b><u>LIABILITIES AND FUND BALANCES</u></b> |                                |                            |                     |
| Liabilities:                                    |                                |                            |                     |
| Accounts payable                                | \$ 185,285                     | \$ -                       | \$ 185,285          |
| Due to FSM State Governments                    | 9,455                          | -                          | 9,455               |
| Due to other funds                              | -                              | 572,575                    | 572,575             |
| Deferred revenue                                | 434,118                        | 75,358                     | 509,476             |
| Total liabilities                               | <u>628,858</u>                 | <u>647,933</u>             | <u>1,276,791</u>    |
| Fund balances:                                  |                                |                            |                     |
| Reserved for:                                   |                                |                            |                     |
| Related assets                                  | 5,061,910                      | 726,755                    | 5,788,665           |
| Encumbrances                                    | 439,497                        | -                          | 439,497             |
| Continuing appropriations                       | 2,662,052                      | -                          | 2,662,052           |
| Unreserved (deficit)                            | (650,796)                      | (647,933)                  | (1,298,729)         |
| Total fund balances                             | <u>7,512,663</u>               | <u>78,822</u>              | <u>7,591,485</u>    |
| Total liabilities and fund balances             | <u>\$ 8,141,521</u>            | <u>\$ 726,755</u>          | <u>\$ 8,868,276</u> |

See Accompanying Independent Auditors' Report.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

**NONMAJOR GOVERNMENTAL FUNDS  
CAPITAL PROJECTS FUNDS**

Combining Statement of Revenues, Expenditures by Function,  
and Changes in Fund Balances  
Year Ended September 30, 2003

|  | <u>Compact<br/>Capital<br/>Projects</u> | <u>OIA<br/>Capital<br/>Projects</u> | <u>Total</u>        |
|--|---|-------------------------------------|---------------------|
| Revenues:                                  |   |                                     |                     |
| Compact funding                            | \$ 2,983,841                            | \$ -                                | \$ 2,983,841        |
| Total revenues                             | <u>2,983,841</u>                        | <u>-</u>                            | <u>2,983,841</u>    |
| Expenditures by function:                  |   |                                     |                     |
| Payments to component units                | 1,000,000                               | -                                   | 1,000,000           |
| Capital projects                           | <u>1,559,490</u>                        | <u>-</u>                            | <u>1,559,490</u>    |
| Total expenditures                         | <u>2,559,490</u>                        | <u>-</u>                            | <u>2,559,490</u>    |
| Net change in fund balances                | 424,351                                 | -                                   | 424,351             |
| Fund balances at the beginning of the year | <u>7,088,312</u>                        | <u>78,822</u>                       | <u>7,167,134</u>    |
| Fund balances at the end of the year       | <u>\$ 7,512,663</u>                     | <u>\$ 78,822</u>                    | <u>\$ 7,591,485</u> |

See Accompanying Independent Auditors' Report.

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

Honorable Joseph J. Urusemal  
President  
Federated States of Micronesia:

We have audited the financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Federated States of Micronesia (FSM) National Government as of and for the year ended September 30, 2003, and have issued our report thereon dated July 25, 2006, which report was qualified due to: (1) our inability to determine the propriety of cash and cash equivalents, receivables, advances and amounts due to the FSM State Governments for the governmental activities and the General Fund; receivables and amounts due to the FSM State Governments for the U.S. Federal Grants Fund and the aggregate remaining fund information; and cash and cash equivalents and receivables for the Asian Development Bank Loan Fund, and their effect on the determination of revenues and expenditures/expenses for governmental activities, the General Fund, the U.S. Federal Grants Fund, the Asian Development Bank Loan Fund, and the aggregate remaining fund information; and (2) the lack of audited financial statements of Micronesia Longline Fishing Company, Yap Fishing Corporation, Yap Fresh Tuna, Inc., Chuuk Fresh Tuna, Inc., and Kosrae Sea Venture, Inc. 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.

Internal Control Over Financial Reporting

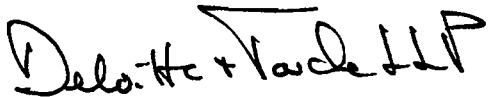
In planning and performing our audit, we considered the FSM National Government's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we considered 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 FSM National Government's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs (pages 81 through 117) as items 2003-05 through 2003-12.

A material weakness is a reportable 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 caused by error or fraud 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 2003-05 through 2003-10 to be material weaknesses.

#### Compliance and Other Matters

As part of obtaining reasonable assurance about whether the FSM National Government's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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 or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Findings and Questioned Costs as items 2003-01 through 2003-04.

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

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

July 25, 2006



**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS  
APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER  
COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133 AND ON THE  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**

Honorable Joseph J. Urusemal  
President  
Federated States of Micronesia:

### Compliance

We have audited the compliance of the Federated States of Micronesia (FSM) National Government 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, 2003. The FSM National Government's major federal programs are identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs (page 81). Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the FSM National Government's management. Our responsibility is to express an opinion on the FSM National Government'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; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the FSM National Government'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 FSM National Government's compliance with those requirements.

As described in items 2003-01 through 2003-04 in the accompanying Schedule of Findings and Questioned Costs, the FSM National Government did not comply with requirements regarding allowable costs/cost principles, cash management, eligibility, and procurement that are applicable to its major programs as described in the Federal Award Findings and Questioned Cost Section of the Schedule of Findings and Questioned Costs (page 82). Compliance with such requirements is necessary, in our opinion, for the FSM National Government to comply with the requirements applicable to those programs.

In our opinion, except for the noncompliance described in the preceding paragraph, the FSM National Government 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, 2003.

## Internal Control Over Compliance

The management of the FSM National Government is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the FSM National Government's internal control over compliance with the requirements that could have a direct and material effect on major federal programs 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.

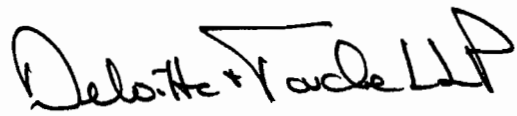
We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the FSM National Government's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. The reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items 2003-01 through 2003-04.

A material weakness is a reportable 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 the applicable requirements of laws, regulations, contracts, and grants caused by error or fraud 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 2003-01 and 2003-02 to be material weaknesses.

## Schedule of Expenditures of Federal Awards

We have audited the financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the FSM National Government as of and for the year ended September 30, 2003, and have issued our report thereon dated July 25, 2006, which report was qualified due to: (1) our inability to determine the propriety of cash and cash equivalents, receivables, advances and amounts due to the FSM State Governments for the governmental activities and the General Fund; receivables and amounts due to the FSM State Governments for the U.S. Federal Grants Fund and the aggregate remaining fund information; and cash and cash equivalents and receivables for the Asian Development Bank Loan Fund, and their effect on the determination of revenues and expenditures/expenses for governmental activities, the General Fund, the U.S. Federal Grants Fund, the Asian Development Bank Loan Fund, and the aggregate remaining fund information; and (2) the lack of audited financial statements of Micronesia Longline Fishing Company, Yap Fishing Corporation, Yap Fresh Tuna, Inc., Chuuk Fresh Tuna, Inc., and Kosrae Sea Venture, Inc. Our audit was performed for the purpose of forming an opinion on the respective financial statements that collectively comprise the FSM National Government's basic financial statements. The accompanying Schedule of Expenditures of Federal Awards (pages 70 through 77) is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. This schedule is the responsibility of the management of the FSM National Government. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to substantiate receivables and amounts due to the FSM State Governments for the U.S. Federal Grants Fund, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

This report is intended solely for the information and use of the FSM National Government, 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 + Touche LLP". The signature is stylized and cursive.

July 25, 2006

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Summary Schedule of Expenditures of Federal Awards, by Grantor  
Year Ended September 30, 2003

| <u>Agency/Program</u>                        | <u>Expenditures</u>      | <u>Amounts<br/>Passed-Through<br/>to<br/>Subrecipients</u> |
|--|--------------------------|--|
| U.S. Department of Agriculture               | \$ 196,878               | \$ 237,603   |
| U.S. Department of Commerce                  | 818,570                  | -  |
| U.S. Department of the Interior              | 15,062,380               | 50,446,200   |
| U.S. Department of Labor                     | 603,678                  | 616,368  |
| U.S. Department of Homeland Security         | 5,346,624                | 1,759,801  |
| U.S. Department of Education                 | 2,233,843                | 2,209,343  |
| U.S. Department of Health and Human Services | <u>2,422,166</u>         | <u>1,008,253</u>   |
| <br>GRAND TOTAL                              | <br><u>\$ 26,684,139</u> | <br><u>\$ 56,277,568</u>                                   |

Note: All grant awards are received from the respective grantor agencies in a direct capacity.

Reconciliation to the basic financial statements:

|   |                      |
|---|----------------------|
| Expenditures for U.S. Federal Grants                    | \$ 13,089,692        |
| Expenditures for Compact Current Account (General Fund) | 6,956,993            |
| Expenditures for Compact CIP Fund                       | 2,559,490            |
| Expenditures rounding for Compact All Other Funds       | 4,077,966            |
| Rounding  | <u>(2)</u>           |
| Total expenditures per financial statements             | <u>\$ 26,684,139</u> |

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Expenditures of Federal Awards  
Year Ended September 30, 2003

| <u>Agency/Program</u>                |        | <u>Federal<br/>CFDA Number</u> | <u>Expenditures</u>      | <u>Amounts<br/>Passed-Through<br/>to<br/>Subrecipients</u> |
|--------------------------------------|--------|--------------------------------|--------------------------|--|
| U.S. DEPARTMENT OF AGRICULTURE       |        |                                |                          |  |
| Cooperative Forestry Assistance      | 343319 | 10.664                         | \$ <u>196,878</u>        | \$ <u>237,603</u>  |
| U.S. DEPARTMENT OF AGRICULTURE TOTAL |        |                                | \$ <u><u>196,878</u></u> | \$ <u><u>237,603</u></u>                                   |

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Expenditures of Federal Awards, Continued  
Year Ended September 30, 2003

| <u>Agency/Program</u>                          | <u>Federal<br/>CFDA Number</u> | <u>Expenditures</u> | <u>Amounts<br/>Passed-Through<br/>to<br/>Subrecipients</u> |
|--|--------------------------------|---------------------|--|
| U.S. DEPARTMENT OF COMMERCE                    |                                |                     |  |
| Anadromous Fish Conservation Act Program       | 11.405                         | \$ -                | \$ -   |
| Special Oceanic and Atmospheric Projects -NOAA | 453897/443898/453899           | 818,570             | -  |
|  |                                | <u>818,570</u>      | <u>-</u>   |
| U.S. DEPARTMENT OF COMMERCE                    |                                | <u>\$ 818,570</u>   | <u>\$ -</u>  |

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Expenditures of Federal Awards, Continued  
Year Ended September 30, 2003

| <u>Agency/Program</u>  | <u>Federal<br/>CFDA Number</u> | <u>Expenditures</u>         | <u>Amounts<br/>Passed-Through<br/>to<br/>Subrecipients</u> |
|--|--------------------------------|-----------------------------|--|
| <b>U.S. DEPARTMENT OF THE INTERIOR</b>   |                                |                             |  |
| Economic, Social and Political Development of the Territories and<br>the Freely Associated States: | 15.875                         |                             |  |
| Compact Current Account  | 7611                           | \$ 6,956,993                | \$ 23,231,329  |
| Compact Capital Account  | 50                             | 2,559,490                   | 10,752,030   |
| Compact Energy Grant   | 27                             | 291,346                     | 3,983,263  |
| Compact Communications-Annual  | 21                             | 43,464                      | -  |
| Compact Communications-One Time  | 22                             | 407,081                     | -  |
| Compact Marine Surveillance-Annual   | 23                             | 308,211                     | -  |
| Compact Health and Medical   | 24                             | 152,306                     | 1,101,506  |
| Compact Post Secondary Education   | 25                             | 2,524,239                   | 1,021,606  |
| Compact Special Block Grant  | 15                             | 351,320                     | 8,055,117  |
| Compact Special Development  |                                | -                           | 1,026,997  |
| Technical Assistance:  | 373616-377349                  |                             | 1,115,888  |
| OMIP Chuuk Hospital  |                                | 349,614                     |  |
| Other Technical Assistance   |                                | <u>1,062,355</u>            |  |
| Total CFDA #15.875   |                                | 15,006,419                  | 50,287,736   |
| Historic Preservation Fund Grants-In-Aid   | 377535/377536                  | 15.904                      | <u>55,961</u>  |
|  |                                |                             | <u>158,464</u>   |
| <b>U.S. DEPARTMENT OF THE INTERIOR TOTAL</b>   |                                | <b>\$ <u>15,062,380</u></b> | <b>\$ <u>50,446,200</u></b>                                |

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Expenditures of Federal Awards, Continued  
Year Ended September 30, 2003

| <u>Agency/Program</u>  | <u>Federal<br/>CFDA Number</u> | <u>Expenditures</u>   | <u>Amounts<br/>Passed-Through<br/>to<br/>Subrecipients</u> |
|--|--------------------------------|-----------------------|--|
| <b>U.S. DEPARTMENT OF LABOR</b>  |                                |                       |  |
| Employment Services and Job Training Pilots -<br>Demonstrations and Research | 17.249                         | \$ -                  | \$ -   |
| Job Training Partnership Act   | 17.250                         | -                     | (962)  |
| WIA Administration <span style="float: right;">323194</span>                 | 17.255                         | 603,678               | 51,374   |
| WIA Adult Program  | 17.258                         | -                     | 165,816  |
| WIA Youth Activities   | 17.259                         | -                     | 157,615  |
| WIA Dislocated Worker  | 17.260                         | -                     | 242,525  |
| <br><b>U.S. DEPARTMENT OF LABOR TOTAL</b>                                    |                                | <br><u>\$ 603,678</u> | <br><u>\$ 616,368</u>                                      |

See accompanying notes to Schedule of Expenditures of Federal Awards.



**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Expenditures of Federal Awards, Continued  
Year Ended September 30, 2003

| <u>Agency/Program</u>                       | <u>Federal<br/>CFDA Number</u> | <u>Expenditures</u> | <u>Amounts<br/>Passed-Through<br/>to<br/>Subrecipients</u> |
|---|--------------------------------|---------------------|--|
| <b>U.S. DEPARTMENT OF HOMELAND SECURITY</b> |                                |                     |  |
| Public Assistance Projects                  | 83.516                         | \$ -                | \$ 1,174,838   |
| El Nino HMGP Projects                       | 443815 97.067                  | 2,473               | 530  |
| Typhoon Fern HMGP/Subgrantee                | 443886 83.544                  | 8,469               | -  |
| FY03 Counseling Program                     | 443888 97.032                  | 41,004              | -  |
| IFG   | 443889 83.543/97.035           | 4,906,783           | -  |
| FEMA 1427-DR-FSM/Public Assistance          | 443889 97.036                  | 232,537             | 583,483  |
| FEMA 1427/IFG Admin. Cost                   | 443892 97.049 & 97.050         | 153,760             | 950  |
| FEMA 1449 DR-FM Grantee Admin               | 443893 97.036                  | 1,598               | -  |
| U.S. Department of Homeland Security        |                                | <u>\$ 5,346,624</u> | <u>\$ 1,759,801</u>  |

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Expenditures of Federal Awards, Continued  
Year Ended September 30, 2003

| <u>Agency/Program</u>                    |               | <u>Federal<br/>CFDA Number</u> | <u>Expenditures</u> | <u>Amounts<br/>Passed-Through<br/>to<br/>Subrecipients</u> |
|--|---------------|--------------------------------|---------------------|--|
| U.S. DEPARTMENT OF EDUCATION             |               |                                |                     |  |
| Special Education - Grants to States     | 303041/303054 | 84.027B                        | \$ 1,633,571        | \$ 2,208,749   |
| Public Library Services (LSCA - Title I) | 303048        | 84.034                         | 19,453              | -  |
| Adult Education-State Grant Program      | 303040/303053 | 84.002A                        | 61,602              | -  |
| Byrd Honors Scholarship                  | 307747        | 84.185A                        | 38,250              | -  |
| Bilingual Education                      | 313050        | 84.195                         | 24,994              | -  |
| Goal 2000 Program                        | 303051        | 84.276A                        | 5,425               | 594  |
| Career Res. Ntwk State Grants            | 303052        | 84.346A                        | 9,182               | -  |
| Teacher Quality Enhancement Grants       | 303056        | 84.336A                        | <u>441,366</u>      | <u>-</u>   |
| U.S. DEPARTMENT OF EDUCATION TOTAL       |               |                                | <u>\$ 2,233,843</u> | <u>\$ 2,209,343</u>  |

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Expenditures of Federal Awards, Continued  
Year Ended September 30, 2003

| <u>Agency/Program</u>   |                             | <u>Federal<br/>CFDA Number</u> | <u>Expenditures</u>      | <u>Amounts<br/>Passed-Through<br/>to<br/>Subrecipients</u> |
|---|-----------------------------|--------------------------------|--------------------------|--|
| <b>U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES</b>   |                             |                                |                          |  |
| State System Development Initiative   | 417549                      | 93.110                         | \$ 77,027                | \$ -   |
| Project Grants and Cooperative Agreements for Tuberculosis  |                             |                                |                          |  |
| Control Programs  | 417542                      | 93.116                         | 151,237                  | 69,457   |
| AIDS Surveillance   | 417543                      | 93.118                         | 6,071                    | -  |
| FY03 School Health (YRBS HIV Prevention)  | 303060                      | 93.126                         | 31,967                   | -  |
| Hansen's Disease National Ambulatory Care Program   |                             | 93.215                         | -                        | 1,070  |
| Family Planning   | 417557                      | 93.217                         | 211,737                  | 98,946   |
| Community Health Centers  |                             | 93.224                         | -                        | 139,943  |
| Vaccination and Immunization for Children Grants  | 413575                      | 93.268                         | 521,827                  | 129,342  |
| Tobacco Use Prevention  | 417537                      | 93.283                         | 75,392                   | 24,117   |
| HIV Care Project  | 417556                      | 93.917                         | 32,063                   | 2,960  |
| HIV Prevention Activities-Health Department Based (HIV<br>Prevention Program)                                 | 417551                      | 93.940                         | 207,607                  | 30,677   |
| Block Grants for Community Mental Health Services (CMHS<br>Block Grant)                                       | 417645                      | 93.958                         | 138,148                  | -  |
| Block Grants for Prevention and Treatment of Substance Abuse<br>(Prevention and Treatment (SAPT) Block Grant) | 413566/417535/417550        | 93.959                         | 265,418                  | 275,218  |
| Preventive Health Services - Sexually Transmitted Diseases<br>Control Grants                                  | 417653                      | 93.977                         | 48,467                   | 9,684  |
| Cooperative Agreements for State-Based Diabetes Control Programs<br>and Evaluation of Surveillance Systems    | 417559                      | 93.988                         | 73,271                   | 26,931   |
| Preventive Health and Health Services Block Grant   | 413792/413538               | 93.991                         | 41,089                   | 454  |
| Maternal and Child Health Services Block Grant to the States  | 417547,417558,417000,417533 | 93.994                         | 275,124                  | 199,454  |
| Public Health Prep/Bioterrorism   | 413537                      | 93.283                         | 213,982                  | -  |
| Grants to Provide Outpatient Early Intervention Services with<br>respect to HIV Disease                       | 417661                      | 93.918                         | 51,739                   | -  |
| <b>U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES TOTAL</b>   |                             |                                | <b>\$ 2,422,166</b>      | <b>\$ 1,008,253</b>  |
| <br><b>GRAND TOTAL</b>  |                             |                                | <br><b>\$ 26,684,139</b> | <br><b>\$ 56,277,568</b>                                   |

See accompanying notes to Schedule of Expenditures of Federal Awards.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Schedule of Expenditures of Federal Awards  
Year Ended September 30, 2003

1. Scope of Audit

The Federated States of Micronesia (FSM) is a governmental entity governed by its own Constitution. All significant operations of the FSM 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 FSM's cognizant agency for Single Audit. All programs are received in a direct capacity from the specified grantor agency.

a. Programs Subject to Single Audit

- U.S. Department of Agriculture
- U.S. Department of Education
- U.S. Department of Health and Human Services
- U.S. Department of the Interior
- U.S. Department of Labor
- U.S. Department of Homeland Security
- U.S. Department of Commerce

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. The Schedule of Expenditures of Federal Awards is prepared on the accrual basis of accounting.

B. Reporting Entity

The FSM National Government, 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. Indirect Cost Allocation

The FSM National Government did not receive an indirect cost allocation and did not charge indirect costs against federal programs in fiscal year 2003.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Notes to Schedule of Expenditures of Federal Awards  
Year Ended September 30, 2003

2. Summary of Significant Accounting Policies, Continued

D. Subgrantees

Certain program funds are passed through the FSM National Government to subrecipients. The Schedule of Expenditures of Federal Awards does not contain separate schedules disclosing how all subgrantees outside of the FSM National Government's control utilize these funds. However, the FSM National Government's primary subrecipients are its four component states. Per the recommendation of the U.S. Department of the Interior, Office of Inspector General (OIG), the federal expenditures of these entities that were passed through from the FSM National Government are incorporated in the accompanying Schedule of Expenditures of Federal Awards. Direct U.S. federal awards received by the four States are not included in the accompanying Schedule. The OIG recommendation also extended to include subrecipient findings related to funds passed through by the FSM National Government to its four States. Therefore, such findings have been extracted from the four separate State A-133 Single audits and are included in the accompanying Schedule of Findings and Questioned Costs.

Single Audit Excluded Funding

For purposes of the Single Audit, Compact Section 211(a) Current Account Funding and Compact Section 215 Current Account Funding have been excluded from the dollar threshold used to distinguish between Type A and Type B programs. The requirement to exclude such funding was recommended by the U.S. Department of the Interior, Office of the Inspector General (OIG). The OIG took this position since there are no compliance requirements imposed on the abovementioned funds.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Schedule of Programs  
Selected for audit in accordance with  
OMB Circular A-133  
Year Ended September 30, 2003

| <u>Grantor</u>                                | <u>Description</u>  | <u>CFDA<br/>No.</u> | <u>Amount<br/>of 2003<br/>Expenditures</u> |
|---|---|---------------------|--|
| U.S. Dept. of<br>the Interior:                | Compact of Free Association:<br>211(a) Capital Account  | 15.875              | \$ 2,559,490                               |
|   | OMP Chuuk Hospital  | 15.875              | 349,614                                    |
| U.S. Dept. of<br>Labor                        | WIA Administration  | 17.255              | 603,678                                    |
| U.S. Dept. of<br>Education                    | Special Education – Grants to States  | 84.027              | 1,633,571                                  |
|   | Teacher Quality Enhancement Grants  | 84.336A             | 441,366                                    |
| U.S. Dept. of<br>Health and Human<br>Services | Centers for Disease Control and Prevention -<br>Investigations and Technical Assistance                               | 93.283              | 289,374                                    |
|   | Immunization Grants   | 93.268              | 521,827                                    |
| U.S. Dept. of<br>Homeland<br>Security         | IFG   | 83.543/97.035       | <u>4,906,783</u>                           |
|   | Total program expenditures selected   |                     | \$ <u>11,305,703</u>                       |
|   | Total U.S. Federal Program expenditures<br>excluding Compact Section 211(a)<br>Current Account                        |                     | \$ <u>19,727,146</u>                       |
|   | % of Total U.S. Federal expenditures<br>covered by major programs excluding<br>Compact Section 211(a) Current Account |                     | <u>57%</u>                                 |

Note: Total U.S. Federal program expenditures exclude Compact Section 211(A) Current Account expenditures as no compliance requirements pertain to those funds and inclusion of that amount in the base would exclude other U.S. federal program funds from Single Audit coverage.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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

**Part I - Summary of Auditors' Results**

1. The Independent Auditors' Report on the basic financial statements expressed a qualified opinion due to (1) our inability to determine the propriety of cash and cash equivalents, receivables, advances and amounts due to the FSM State Governments for the governmental activities and the General Fund; receivables and amounts due to the FSM State Governments for the U.S. Federal Grants Fund and the aggregate remaining fund information; and cash and cash equivalents and receivables for the Asian Development Bank Loan Fund, and their effect on the determination of revenues and expenditures/expenses for governmental activities, the General Fund, the U.S. Federal Grants Fund, the Asian Development Bank Loan Fund, and the aggregate remaining fund information; and (2) the lack of audited financial statements of Micronesia Longline Fishing Company, Yap Fishing Corporation, Yap Fresh Tuna, Inc., Chuuk Fresh Tuna, Inc., and Kosrae Sea Venture, Inc.
2. Reportable conditions in internal control over financial reporting were identified, some of which were considered to be material weaknesses.
3. Instances of noncompliance considered material to the basic 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, some of which were 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 FSM National Government's major programs were:

| <u>Name of Federal Program or Cluster</u>   | <u>CFDA Number</u> |
|---|--------------------|
| Economic Social and Political Development of the Territories<br>and the Freely Associated States: |                    |
| 211(a) Capital Account  | 15.875             |
| OMIP Chuuk Hospital   |                    |
| WIA Administration  | 17.255             |
| Special Education: Grants to States   | 84.027             |
| Teacher Quality Enhancement Grants  | 84.336A            |
| Centers for Disease Control and Prevention – Investigations and<br>Technical Assistance           | 93.283             |
| Immunization Grants   | 93.268             |
| IFG   | 83.543/97.035      |

8. A threshold of \$591,814 was used to distinguish between Type A and Type B programs as those terms are defined in OMB Circular A-133.
9. The FSM National Government did not qualify as a low-risk auditee as that term is defined in OMB Circular A-133.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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

**Part II - Financial Statement Findings Section**

| <u>Reference No.</u> | <u>Findings</u>                   | <u>Questioned Costs</u> |
|----------------------|-----------------------------------|-------------------------|
| 2003-05              | ADB Loans Receivable              | \$ -                    |
| 2003-06              | Advances to State Governments     | \$ -                    |
| 2003-07              | Unreimbursed Federal Expenditures | \$ -                    |
| 2003-08              | Unreimbursed CFMSM Projects       | \$ -                    |
| 2003-09              | Account Reconciliation            | \$ -                    |
| 2003-10              | Accounts Payable                  | \$ -                    |
| 2003-11              | Fixed Assets                      | \$ -                    |
| 2003-12              | Encumbrances                      | \$ -                    |

**Part III - Federal Award Findings and Questioned Cost Section**

| <u>Reference No.</u> | <u>CFDA #</u> | <u>Findings</u>                                 | <u>Questioned Costs</u> |
|----------------------|---------------|---|-------------------------|
| 2003-01              | 15.875        | Procurement                                     | \$827,448               |
| 2003-02              | 17.255/93.283 |   |                         |
|                      | 93.268/15.875 | Cash Management                                 | \$ -                    |
| 2003-03              | 93.283        | Procurement                                     | \$ 50,069               |
| 2003-04              | 83.543/97.035 | Allowable Costs/Cost Principles and Eligibility | \$201,997               |



**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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

Federal Award Findings and Questioned Costs Section

Finding No.: 2003-01  
CFDA No.: 15.875 Economic, Social and Political Development of the Territories and the Freely Associated States  
Grantor Agency: U.S. Department of the Interior, Office of Insular Affairs  
Grant: Compact of Free Association, Section 211(a), Capital Account  
Program/Area: Procurement  
Questioned Costs: \$827,448

Criteria: Compact Capital funds should be expended in accordance with the intent of the requirements of the Compact of Free Association and its subsidiary agreements and in accordance with FSM laws and regulations.

Condition:

- For six of eleven (54%) transactions tested, there was no evidence of competitive bidding, which is required per FSM National Government rules and regulations.

| <u>Ck #</u> | <u>APV #</u> | <u>APV Amt.</u>  |
|-------------|--------------|------------------|
| 14825       | 301551901    | \$ 78,091        |
| 12570       | 301089901    | 42,355           |
| 5221        | 300219201    | 37,610           |
| 3007472     | 301212201    | 489,392          |
| 3785        | 300065701    | 90,000           |
|             | 300066501    | <u>90,000</u>    |
| Total       |              | <u>\$827,448</u> |

The payment for \$489,392 was for dry docking and there was no evidence that such was not a payment related to ordinary repairs and maintenance. There was no evidence on file substantiating the capital nature of this expenditure.

- In addition, we found that the following construction contract, which is included in the detail above, was awarded to a bidder not ranked as the best company to carry out the project.

| <u>Ck #</u> | <u>APV #</u> | <u>APV Amt.</u> |
|-------------|--------------|-----------------|
| 5221        | 300219201    | \$37,610        |

Cause: There appears to be lack of management review of transactions for compliance with FSM laws and regulations.

Effect: The effect of this condition is questioned costs of \$827,448 and noncompliance with local regulations.

Recommendation: We recommend that the FSM National Government comply with the requirements of the Compact of Free Association and its subsidiary agreements and with local laws and regulations.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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

Federal Award Findings and Questioned Cost, Continued

|                   |   |
|-------------------|---|
| Finding No.:      | 2003-01, Continued  |
| CFDA No.:         | 15.875 Economic, Social and Political Development of the Territories and the Freely Associated States |
| Grantor Agency:   | U.S. Department of the Interior, Office of Insular Affairs  |
| Grant:            | Compact of Free Association, Section 211(a), Capital Account  |
| Program/Area:     | Procurement   |
| Questioned Costs: | \$827,448   |

Auditee Response and Corrective Action Plan: We agree with this finding. Check 3785 was a payment for services for the Chuuk State Multipurpose Gym. Presidential exemption from bidding was given because of the sole source nature of the services. However documentary evidence of the sole source nature was not filed. Department of TC&I will be requested to provide the necessary documentary evidence no later than May 31, 2006. Future cases where Presidential exemption is given will be supported by appropriate documentary evidence.

Check 5221 was payment for Houk Airstrip project. Documentary evidence showing details of unsuccessful bidders was not available. Department of TC&I have been requested to provide the necessary documentary evidence no later than May 31, 2006. In future details of all bids will be filed.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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

Finding No.: 2003-02  
CFDA No.: 17.255 WIA Administration, 93.283 CDC and Prevention – Investigations and Technical Assistance, 93.268 Immunization Grants, and 15.875 OMIP Chuuk Hospital  
Grantor Agency: U.S. Department of Labor, U.S. Department of Health and Human Services, and U.S. Department of the Interior  
Program/Area: Cash Management  
Questioned Costs: \$0

Criteria: Draw downs of Federal cash are to be restricted to immediate needs, and recipients should also reimburse subrecipients only for immediate cash needs.

Condition: The FSM National Government's financial statements reflect a significant amount of cash draw downs in excess of recorded expenditures amounting to \$1 million for federal programs granted under the U.S Department of Labor, and \$2 million for federal programs granted under the U.S. Department of Health and Human Services. It is also not possible to perform required cash management lists due to inadequacies in the FSM National Government's cash management system.

Cause: The cause of this condition is that cash draw downs have not been based on official accounting records. Instead, a stand-alone system is utilized to accumulate FSM National Government expenditures with those of its subrecipients. Draw downs of cash from the U.S. Treasury appear to be based on this stand-alone system and not on the official accounting records. Draw downs are performed in total and there did not appear to be detail supporting the amount per program or per federal agency. These amounts appear to have been allocated on the books in a manner that is not documented. Moreover, subrecipient expenditures and the related payables to the States are not always recorded in the official accounting records. Upon cash drawdown, the payable to the States is not necessarily liquidated, which means that federal expenditures at the subrecipient level are not always timely liquidated. Additionally, if subrecipient activity is not being recorded, draw downs do not always occur, which adversely impacts subrecipient cash flows.

Effect: The effect of this condition is apparent noncompliance with cash management regulations and inadequate maintenance of the FSM National Government's accounting records. This condition does not necessarily indicate that an incorrect drawdown of federal funds has occurred, but does indicate that the drawn down cash is not being remitted to the States and is not being used to timely liquidate subrecipient payables. Additionally, it is not currently possible to determine the basis in which these balances have been recorded in the financial statements and in the underlying basis and accounts. Therefore, it is not possible to tie the receipt of federal cash to attendant payments.

Prior Year Status: This condition was reported as a finding in the Single Audit of the FSM National Government for fiscal year 2002.

Recommendation: We recommend that management review work performed by its accounting staff to ensure that the FSM National Government complies with cash management requirements, that expenditures and payables to the States are timely recorded in the official accounting records, and that cash is timely remitted to subrecipients. We believe the substantial change to the existing system is warranted and believe that external assistance may be required to address this matter.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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

|                   |  |
|-------------------|--|
| Finding No.:      | 2003-02, Continued   |
| CFDA No.:         | 17.255 WIA Administration, 93.283 CDC and Prevention – Investigations and Technical Assistance, 93.268 Immunization Grants, and 15.875 OMIP Chuuk Hospital |
| Grantor Agency:   | U.S. Department of Labor, U.S. Department of Health and Human Services, and U.S. Department of the Interior  |
| Program/Area:     | Cash Management  |
| Questioned Costs: | \$0  |

Auditee Response and Corrective Action Plan: We agree with this finding. In October 2005, new procedures were introduced which meant that draw downs are now based on expenditures incurred by both the States and the National Government. Amounts due to States are now recorded in the official accounting records as well as the amount due from the Grantor Agency. In order to ensure that cash is received by the States in a timely manner, payment is made directly to the States at which time the amounts due and payable are reversed in the official accounting records.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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

Finding No.: 2003-03  
 CFDA No.: 93.283 CDC and Prevention – Investigations and Technical Assistance  
 Grantor Agency: U.S. Department of Health and Human Services  
 Program/Area: Procurement  
 Questioned Costs: \$50,069

Criteria: Procurements shall provide full and open competition among vendors, and any allowable exceptions must be properly documented and approved, and such approvals should be documented in the procurement file.

Condition: For 2 of 23 (9%) non-payroll expenditures tested, the FSM National Government did not have evidence of formal and informal competitive bidding documents on file to support the award of the following:

| <u>Acct</u> | <u>Date</u> | <u>Contract/JV/TA#</u> | <u>APV#</u> | <u>Check #</u> | <u>Amount</u>   |
|-------------|-------------|------------------------|-------------|----------------|-----------------|
| 8501        | 5/23/03     | M36976                 | 300890801   | 10812          | \$42,000        |
| 8210        | 10/30/03    | L3031601               | 301560401   | 15314          | <u>5,144</u>    |
|             |             |                        |             |                | <u>\$47,144</u> |

For 1 of 23 (4%) non-payroll expenditures tested, the FSM National Government did not select the lowest bidder, and there was no written rationale for such selection.

| <u>Acct</u> | <u>Date</u> | <u>Contract/JV/TA#</u> | <u>APV#</u> | <u>Check #</u> | <u>Amount</u>   |
|-------------|-------------|------------------------|-------------|----------------|-----------------|
| 8210        | 10/30/03    | L3029701               | 301561101   | 15314          | <u>\$ 2,925</u> |

The amount questioned represents the difference between the lowest acceptable bidder (\$24,375) and the contract award (\$27,300).

Cause: There appears to be weak controls over ensuring that competition remains open among vendors.

Effect: The effect of this condition is questioned costs.

Recommendation: We recommend that the FSM National Government comply with federal procurement guidelines.

Auditee Response and Corrective Action Plan: The two payments where there was no evidence of full and open competition were instances where documentary evidence of bidding was not available. The procurement section has been instructed to ensure that evidence of bidding is obtained and filed with the payment records.

The payment under check 15314 relate to the purchase of computing equipment from a bidder other than the lowest bidder. The reason for the next lowest bidder being selected was the delivery time offered by the selected bidder. The reason was not documented. We agree with the finding and have instructed our procurement section to ensure that, where a bidder other than the lowest bidder is selected, justification for the selection is documented and filed with the payment voucher.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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

Finding No.: 2003-04  
CFDA No.: 83.543/97.035 FEMA IFG  
Grantor Agency: U.S. Department of Homeland Security  
Program/Area: Allowable Costs/Cost Principles and Eligibility  
Questioned Costs: \$201,997

Criteria: Expenditures should have underlying documents to support that goods were received and services were provided and that the expenditure is reasonable for the program needs. Furthermore, case files should be maintained to substantiate the eligibility of Program beneficiaries.

Condition: For 44 of 44 (100%) expenditures tested, no documents were on file to support that goods were received and services were provided, that the expenditure is reasonable for the program needs, or that program beneficiaries are eligible. We understand that eligibility may have been determined by the Federal Emergency Management Agency (FEMA) and the FSM was then to provide the payment service on behalf of FEMA. Therefore, our expectation is that there would be documentation on file to evidence FEMA approval. No such documentation was provided to us. Also, the FSM National Government originally was of the opinion that the award was not to be included in its Schedule of Expenditures of Federal Awards. The audit of this program was severely delayed while that matter was resolved.

Total expenditures tested: \$201,997  
Total program expenditures: \$4,906,783

Cause: There appears to be a lack of control over record keeping.

Effect: The effect of this condition is questioned costs.

Recommendation: We recommend that the FSM National Government ensure compliance with allowable costs/cost principles requirements and eligibility requirements.

Auditee Response and Corrective Action Plan: We agree with the finding. The National Government agreed to assist FEMA by accepting the financial support for hurricane relief as a Federal Grant, and for the financial support provided to families under the program to be disbursed by the National Government. Disbursements were made as authorized by FEMA officials. The authorization did not provide documentary evidence of the services provided other than details of the recipient of the relief.

FEMA will be requested to provide exemption from the requirement for documentary evidence for expenditure of this type.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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

Finding No. 2003-05 - ADB Loans Receivable/Payable/Proceeds

Criteria: ADB loan proceeds received during the year should be properly supported.

Condition: During the fiscal year ended September 30, 2003, the FSM National Government requested an additional \$2.8 million in loan proceeds, which were paid directly to sub-borrowers. The FSM National Government was not able to provide details of loan proceeds amounting to \$2.4 million. Therefore, we were not able to verify ADB loans receivable from sub-borrowers and the ADB loan proceeds recorded in the Special Revenue Fund.

Cause: The cause of this condition was that copies of the cash drawdown requests were not retained. Therefore, management was not able to reconcile general ledger accounts relating to the ADB loan proceeds. Additionally, the amount of drawn cash that has not been disbursed to the States was not recorded in the books. This matter was ultimately resolved through the audit process.

Effect: The effect of this condition is a qualification of opinion on loans receivable, loans payable and loan proceeds.

Prior Year Status: This condition was reported as a finding in the Single Audit of the FSM National Government for fiscal year 2002.

Recommendation: We recommend that FSM Finance retain copies of ADB loan cash drawdown requests and record such in the accounting system in a timely manner.

Auditee Response and Corrective Action Plan: We agree with this finding. The failure to record details of ADB loans in the accounting system was due to a lack of proper information flow within the FSM National Government. This information flow shortcoming has now been rectified. This will enable the recommendations to be implemented in fiscal year 2006.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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

Finding No. 2003-06 - Advances to State Governments

Criteria: The FSM National Government should ensure that details for Advances to State Governments (General Fund) be evidenced by supporting subsidiary ledgers.

Condition: Our evaluation of Advances to State Governments as of September 30, 2003, indicated that the following account balances were not supported by subsidiary ledgers and are over twelve months past due.

| <u>Account Title</u> | <u>Doubtful Balance</u> |
|----------------------|-------------------------|
| Kosrae State         | \$ 524,054              |
| Pohnpei State        | 96,073                  |
| Chuuk State          | 71,940                  |
| Yap State            | <u>(23,852)</u>         |
| Total                | \$ <u>668,215</u>       |

Cause: The cause of this condition is the lack of high level review by management.

Effect: The effect of this condition is that these uncollectible amounts have been reserved for in the General Fund fund balance as related assets as of September 30, 2003, and a qualification of opinion on the financial statements.

Prior Year Status: The lack of supporting subsidiary ledgers evidencing Advances to State Governments was reported as a finding in the Single Audit of the FSM National Government for fiscal years 2002 and 2001.

Recommendation: We recommend that details of all advances to State Governments be maintained and substantiated.

Auditee Response and Corrective Action Plan: We agree that details of all advances to State Governments should be maintained and substantiated.

In 2005, as part of the process of reconciling intergovernmental account balances, a letter was issued to each State asking for details in their books of amounts due to and from the National Government to ascertain whether the amounts agreed with those on the books of the National Government. Unfortunately the letters were not followed up. Accordingly amounts shown as advances to State Governments (with the exception of a small decrease in the amount due to Chuuk) are the same as those shown at September 20, 2002.

Details are on hand for the \$524,054 due from Kosrae State. FSM National Government and Kosrae State will confer to ensure that the balance is either repaid, or, if applicable, expensed in the books of the National Government. The other three amounts due predate the current Focus accounting system and will be more difficult to reconcile with the States but will be considered as part of the overall intergovernmental debt reconciliation.



**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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

Finding No. 2003-07 - Unreimbursed Federal Expenditures

Criteria: A functioning system of internal control requires that details of unreimbursed expenditures payable to the State Governments be reconciled on a periodic basis.

Condition: Intergovernmental payables to State Governments for unreimbursed federal grant expenditures were lower than related subrecipient balances as of September 30, 2003.

| <u>States</u>               | <u>Balance</u>      |
|-----------------------------|---------------------|
| Kosrae                      | \$ 1,670,789        |
| Chuuk                       | 1,069,409           |
| Pohnpei                     | 1,245,390           |
| Yap                         | <u>754,910</u>      |
| Total                       | \$ <u>4,740,498</u> |
| Per FSM National government | \$ <u>1,338,136</u> |
| Difference                  | \$ <u>3,402,362</u> |

Cause: The cause of this condition is the lack of high level review of account balances by management.

Effect: The effect of this condition is a qualification of opinion on the financial statements.

Prior Year Status: Untimely reconciliation of intergovernmental payables was reported as a finding in the Single Audit of FSM National Government for fiscal years 2002 and 2001.

Recommendation: We recommend that the FSM National Government ensure that intergovernmental payables are properly reconciled.

Auditee Response and Corrective Action Plan: We agree that governmental accounts should be properly reconciled. In 2005, as part of the process of reconciling intergovernmental account balances, a letter was issued to each State asking for details in their books of amounts due to and from the National Government to ascertain whether the amounts agreed with those on the books of the National Government. Unfortunately the letters were not followed up.

Discussions have taken place in February 2006 with the representatives of Pohnpei State to reconcile intergovernmental balances. Significant progress has been made in identifying intergovernmental differences. Similar discussions will take place with the other three States during 2006.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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

Finding No. 2003-08 - Unreimbursed CFSM Projects

Criteria: A functioning system of internal control requires that details of unreimbursed expenditures payable to the State Governments be reconciled on a periodic basis.

Condition: Intergovernmental payables to the State Governments for unreimbursed Congress of the Federated States of Micronesia (CFSM) project expenditures were lower than the total subrecipient balances as of September 30, 2003.

| <u>States</u>           | <u>Balance</u>      |
|-------------------------|---------------------|
| Kosrae                  | \$ 475,140          |
| Chuuk                   | 70,503              |
| Pohnpei                 | 136,368             |
| Yap                     | <u>2,311,574</u>    |
| Total                   | \$ <u>2,993,585</u> |
| FSM National government | \$ <u>1,394,701</u> |
| Difference              | \$ <u>1,598,884</u> |

Cause: The cause of this condition is the lack of high level review of account balances by management.

Effect: The effect of this condition is a qualification of opinion on the financial statements.

Prior Year Status: Untimely reconciliation of intergovernmental payables was reported as a finding in the Single Audit of the FSM National Government for fiscal years 2002 and 2001.

Recommendation: We recommend that intergovernmental payables be properly reconciled.

Auditee Response and Corrective Action Plan: We agree that governmental accounts should be properly reconciled. In 2005, as part of the process of reconciling intergovernmental account balances, a letter was issued to each State asking for details in their books of amount due to and from the National Government to ascertain whether the amounts agreed with those on the books of the National Government. Unfortunately the letters were not followed up.

Discussions have taken place in February 2006 with the representatives of Pohnpei State to reconcile intergovernmental balances. Significant progress has been made in identifying intergovernmental differences. Similar discussions will take place with the other three States during 2006.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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

Finding No. 2003-09 - Account Reconciliation

Criteria: Analysis of significant general ledger balances should be performed on a regular basis.

Condition: Preparation of detailed supporting schedules and/or reconciliation to supporting subsidiary ledgers was not performed for the following general ledger accounts.

| <u>Account Name</u>                 | <u>Account No.</u> | <u>Balance</u>             |
|-------------------------------------|--------------------|----------------------------|
| <b>Accrued Liabilities:</b>         |                    |                            |
| General Fund:                       |                    |                            |
| Outstanding                         | 10-517             | \$ 618,713                 |
| MMA Fishing                         | 10-535             | 279,500                    |
| Other Payable                       | 10-802             | 645,726                    |
| Other Payable                       | 11-802             | <u>(27,690)</u>            |
|                                     |                    | <b>\$ <u>1,516,249</u></b> |
| Non-major Special Revenue Fund:     |                    |                            |
| Retained EA                         | 52-569             | \$ 1,652                   |
| Notes Payable                       | 83-506             | <u>50,575</u>              |
|                                     |                    | <b>\$ <u>52,227</u></b>    |
| General Receivables – General Fund: |                    |                            |
| A/R FSM Health                      | 10-253             | \$ 172,784                 |
|                                     | 10-256             | 1,618                      |
| A/R Miscellaneous                   | 10-257             | 58,405                     |
| A/R Chuuk Trust                     | 10-258             | 373,583                    |
| A/R Customer                        | 10-278             | 57,999                     |
| A/R Customer                        | 10-279             | (67,524)                   |
| A/R Customer                        | 10-262             | (39,517)                   |
| A/R Other grants                    | 10-308             | <u>12,000</u>              |
| Total General Receivables           |                    | <b>\$ <u>569,348</u></b>   |
| Cash and Equivalents:               |                    |                            |
| General Fund:                       |                    |                            |
| Cash                                | 10-131             | 37,113                     |
| Cash                                | 10-140             | (806)                      |
| ADB Loan Fund:                      |                    |                            |
| Cash                                | 59-131             | 178,367                    |
| Cash                                | 59-191             | 531,387                    |

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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

Finding No. 2003-09 - Account Reconciliation, Continued

|                                  |        |                     |
|----------------------------------|--------|---------------------|
| Cash and Equivalents, Continued: |        |                     |
| Early Retirement Fund:           |        |                     |
| Cash                             | 83-142 | 640,000             |
| Health Insurance:                |        |                     |
| Cash                             | 80-101 | 1,014               |
| Cash                             | 80-103 | 3,543               |
| Cash                             | 80-106 | 5,704               |
| Cash                             | 80-127 | <u>39,807</u>       |
| Total Cash and equivalents       |        | \$ <u>1,436,129</u> |

Cause: The cause of this condition is the lack of high level review of account balances by management.

Effect: The effect of this condition is that the above general receivables totaling \$561,017, have been reserved for as related assets in the General Fund as of September 30, 2003, and qualification of opinion on the financial statements resulted.

Prior Year Status: This condition was reported as a finding in the Single Audit of the FSM National Government for fiscal year 2002.

Recommendation: Management should establish policies and procedures requiring responsible personnel to analyze all general ledger accounts at month-end. Such policies and procedures should include performing roll forwards of balances, indicating beginning balances, transaction detail for the period, and ending balances. Additionally, reconciliation of all subsidiary ledgers to the general ledger should be performed. Finally, high-level reviews of balances should be performed by knowledgeable individuals to determine the reasonableness of such balances.

Auditee Response and Corrective Action Plan: We agree with the finding. Account 10-533 is a long outstanding account, which will be cleared in fiscal year 2005. \$340,375.72 of Account 10-802 was cleared in fiscal year 2004 and the remainder will be cleared in fiscal year 2006 as part of the bank reconciliation process. A schedule providing the makeup of Account 10-253 will be provided as part of the fiscal year 2005 single audit. Accounts 10-256, 10-257, and 10-258 have been cleared in fiscal year 2005. The Department of Economic Affairs will be requested to provide information to enable Account 59-131 to be reconciled.

The Health Insurance Chief Finance Officer has been directed to reconcile the unreconciled variances between the general ledger and the supporting schedules, and the bank reconciliation manager has been instructed to clear unreconciled items and reconcile cash on a monthly basis.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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

Finding No. 2003-10 – Accounts Payable

Criteria: The FSM National Government should ensure that it does not accrue to itself any payables at each fiscal year end.

Condition: The accounts payable subledger at September 30, 2003, included certain accounts payable designated to Cash - FSM Trust Funds, Embassies/Consulate Office Imprest Accounts, and Custom & Revenue Accounts, which in actuality are payables to the FSM National Government.

Cause: The cause of this condition results from a lack of high level review of account balances by management.

Effect: The effect of this condition is an overstatement of payables and of cash and equivalents.

Prior Year Status: This condition was reported as a finding in the Single Audit of the FSM National Government for fiscal year 2002.

Recommendation: We recommend that an aged schedule of all APVs (Accounts Payable Vouchers) payable to the FSM Trust Fund-Chuuk, FSM Trust Fund-Yap, FSM Trust Fund-Kosrae, Embassies/Consulate Offices Imprest Accounts, and Custom & Revenue Accounts be generated for removal or reclassification of such payables from the APV system at the end of the fiscal year.

Auditee Response and Corrective Action Plan: We agree with the finding. The overstatement of payables and cash and equivalents will be removed from the financial statements in fiscal year 2005. Further, with the closure of the Chuuk and Yap Trust Funds in fiscal year 2006, the cause of the overstatements will be removed.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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

Finding No. 2003-11 – Fixed Assets

Criteria: A functioning system of internal control requires periodic reconciliation of the fixed assets subsidiary ledger for the physical existence of assets.

Condition: While performing fixed asset existence tests, we noted that several items were on the fixed asset register that should have been excluded. The FSM National Government purchases various items and distributes them to its departments and branches. These organizations are supposed to notify Finance if they dispose of an asset or if it is not working. Generally, this does not appear to happen and certain exceptions came to our attention, as follows:

| <u>ASSET #</u> | <u>DESCRIPTION</u>  | <u>ACQ. COST</u> | <u>PURCHASE DATE</u> |
|----------------|---------------------|------------------|----------------------|
| 5662           | Copier Canon        | \$23,381         | 7/12/1992            |
| 6676           | Building 2 Storey   | \$99,100         | 6/10/1994            |
| 7591           | Dump Truck, Briskin | \$40,000         | 13/08/1997           |

The copier was at Congress and had been disposed of. The two-story building was demolished approximately two years ago. It appears that management was aware of this, but had not written it off. The dump truck was not in working order, and we were unable to locate it.

Cause: The cause of this condition is a lack of timely reconciliation processes.

Effect: The effect of this condition was a misstatement of fixed assets at September 30, 2003 that was adjusted through the audit process.

Recommendation: Departments should notify the FSM Department of Finance when assets are either disposed of or not in working order.

Auditee Response and Corrective Action Plan: We agree with the finding. The items identified will be removed from the fixed assets register in fiscal year 2006 in accordance with the National Governmental asset disposal policies and procedures.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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

Finding No. 2003-12 – Encumbrances

Criteria: A functioning system of internal control requires obligations of funds to be recorded in the general ledger in a timely manner.

Condition: For five of eight encumbrances tested, which were processed at the FSM Finance-Chuuk Branch, there was no evidence that these transactions had been recorded in the accounting system.

Cause: The cause of this condition is the lack of inter-office reconciliation of encumbrances.

Effect: The effect of this condition is an internal control weakness of the fund's obligation process.

Recommendation: We recommend that the FSM Department of Finance implement procedures and guidelines to ensure the recordation of inter-office transactions in the accounting system.

Auditee Response and Corrective Action Plan: We agree with the finding. The closure of the Chuuk and Yap Trust Funds in fiscal year 2006 will also provide for the timely inclusion of field office encumbrances in the general ledger.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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

**Federal Findings and Questioned Costs - Monitoring Subrecipients - Subrecipient - Chuuk**

Finding No.: C2003-01  
CFDA No.: 15.875  
Agency: U.S. Department of the Interior  
Program Name: Compact of Free Association  
Requirement: Section 211A Capital Funds  
Questioned Costs: \$389,496

Criteria: Compact Capital expenditures should be adequately supported to indicate conformance with eligible use criteria incorporated in to the Compact of Free Association.

Condition: We tested 48 payments made by the State and charged to the Compact Capital account. The majority of these payments relate to the acquisition of land at the airport complex. However, we were unable to locate actual payment agreements for thirteen payments aggregating \$259,496. Additionally, we located payments made for airport land acquisition that were not listed on the State's official debt listing, which itemized payments and the balance owing to the respective landowners.

| <u>CK #</u> | <u>Check<br/>Amount</u> |
|-------------|-------------------------|
| 32012       | \$20,000.00             |
| 32013       | 15,000.00               |
| 32016       | 25,000.00               |
| 32018       | 23,463.00               |
| 32023       | 15,428.58               |
| 32027       | 25,000.00               |
| 32032       | 13,674.00               |
| 32052       | 23,463.00               |
| 32068       | 20,000.00               |
| 32086       | 25,000.00               |
| 32106       | 23,466.50               |
| 32110       | 20,000.00               |
| 32122       | 14,000.00               |

We additionally noted two payments aggregating \$130,000 (check numbers 32214 and 32215) made for leases that appear operating in nature and do not appear to conform to the underlying Compact Capital criteria. These lease payments relate to the lease of the Attorney Generals' office and of the Courthouse.

Cause: The cause of this condition appears to be deficiencies in the State's recordkeeping and noncompliance with Compact Capital requirements.

Effect: The effect of this condition is questioned costs in the amount of \$389,496.

Recommendation: The State should ensure that it maintains adequate documentation in support of its expenditures and that Compact Capital expenditures conform to the terms of the subsidiary agreements.

Auditee Response and Corrective Action Plan: Most of the documents mentioned above (10 APVs package) were already moved to the storage room of Supplies Office, which made it difficult to retrieve certain documents. Filing system has been improved to solve this problem in the future. Effective FY 2006, every document being taken out from the storage room has to be properly accounted for. A log book will be maintained to monitor the users of the documents.



**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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

**Federal Findings and Questioned Costs - Monitoring Subrecipients - Subrecipient - Chuuk**

Finding No.: C2003-02  
CFDA No.: 15.875  
Agency: U.S. Department of the Interior  
Program Name: Compact of Free Association  
Requirement: Special Revenue Funds, Special Block Grant and Health and Education  
Questioned Costs: \$167,798

Criteria: The State should be able to locate payment documentation supporting the use of Federal funds.

Condition: For eight of twenty-five expenditures tested, the State was unable to provide us with detail supporting the basis of the expenditure. These amounts aggregate \$167,798.

| <u>CK #</u> | <u>Check<br/>Amount</u> |
|-------------|-------------------------|
| 64077       | \$29,807.00             |
| 59432       | 24,228.61               |
| 60788       | 24,205.52               |
| 61894       | 21,632.07               |
| 61894       | 21,406.00               |
| 59680       | 15,865.00               |
| 61892       | 15,653.20               |
| 59160       | 15,000.00               |

Cause: The State is not able to locate the accounts payable vouchers for the applicable payments.

Effect: The effect of this condition is questioned costs due to the State's inability to support actual payments made.

Recommendation: The State should ensure that adequate support is maintained on file to support expenditures of federal funds.

Auditee Response and Corrective Action Plan: Most of the documents mentioned above were already transferred to the storage room of Supplies Office, which makes it difficult to retrieve certain documents. Filing system has been improved to solve this problem in the future. Effective FY 2006, every document being taken into and out of the storage room has to be properly accounted for. A log book will be maintained to monitor the users of the documents.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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

**Federal Findings and Questioned Costs - Monitoring Subrecipients - Subrecipient - Chuuk**

Finding No.: C2003-03  
CFDA No.: 83.544  
Agency: U.S. Department of Homeland Security  
Program Name: Typhoon Chataan  
Requirement: Procurement, Suspension & Debarment  
Questioned Costs: \$583,483

Criteria: The State should conform to federal procurement requirements and should not record expenditures until underlying goods or services have been received.

Condition: Questioned costs of \$583,483 exist due to the absence of competitive procurement and due to the expenditures being recorded prior to a contract being entered into and any actual goods or services being received. Based on our analysis, it appears that underlying contracts/agreements were entered into in fiscal year 2004 and therefore, it is inappropriate to record these expenditures in fiscal year 2003.

Cause: The cause of this condition appears to be an absence of compliance with federal rules or regulations. Additionally, it appears that the State advanced these funds to vendors to ensure that related materials could be ordered as it was represented that otherwise, local vendors would not have the capacity to order requested materials.

Effect: The impact of this condition is questioned costs in the amount of \$583,483.

Recommendation: The State should examine the reason that these expenditures were recorded and paid prior to any goods or services being received and prior to actual contracts being entered into.

Auditee Response and Corrective Action Plan: Most local vendors do not accept Chuuk State Purchase Orders without advance payment because of Chuuk State's inability to pay these vendors on time. For many years in the past, our local vendors were not paid on time. As a result, many local vendors no longer accept Chuuk State Purchase Orders. Chuuk State Financial Management Act allows the Director of Finance or his designee to approve advance payment on a purchase order when a vendor requires advance payment and refuses to accept PO and the item being purchased is not available anywhere. (Part 6.9.c). However, with the new Compact II as amended, advance payment is limited only to procurement of pharmaceutical products purchased abroad.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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

**Federal Findings and Questioned Costs - Monitoring Subrecipients - Subrecipient - Chuuk**

Finding No.: C2003-04  
CFDA No.: 15.875  
Agency: U. S. Department of the Interior  
Program Name: Section 211 (A) – Compact Capital Funds  
Requirement: Activities Allowed or Unallowed  
Questioned Costs: \$545,052

Criteria: Compact Capital Funds should be expended in accordance with applicable criteria set forth in the Fiscal Procedures Agreement.

Condition: The following expenditures, which were paid for by the FSM National Government on behalf of the State of Chuuk, under a memorandum of understanding, do not appear to conform to the requirements of the Fiscal Procedures Agreement.

| <u>Check Date</u> | <u>Check Number</u> | <u>Amount</u> | <u>Comments</u>  |
|-------------------|---------------------|---------------|--|
| 2/9/2004          | 10043               | \$5,453       | For Polle Municipality:  |
|                   |                     | 62            | Staples  |
|                   |                     | 16            | Stapler  |
|                   |                     | 6             | Puncher  |
|                   |                     | 50            | Fasteners  |
|                   |                     | 197           | Pens   |
|                   |                     | 32            | Pencils  |
|                   |                     | 334           | Letter size papers   |
|                   |                     | 450           | Legal size papers  |
|                   |                     | 5             | Glue   |
|                   |                     | 423           | Bond paper   |
| 2/9/2004          | 10044               | 2,000         | Rakes, machetes, saws, etc   |
| 2/12/2004         | 10048               | 289           | Worker's stipend for Chuuk State Health Care Plan                                  |
| 2/12/2004         | 10050               | 368           | Worker's stipend for Chuuk State Health Care Plan                                  |
| 2/12/2004         | 10049               | 69            | Worker's stipend for Chuuk State Health Care Plan                                  |
| 2/12/2004         | 10051               | 822           | Worker's stipend for Chuuk State Health Care Plan                                  |
| 2/26/2004         | 10073               | 822           | Worker's stipend for Chuuk State Health Care Plan                                  |
| 2/26/2004         | 10072               | 230           | Worker's stipend for Chuuk State Health Care Plan                                  |
| 2/26/2004         | 10070               | 305           | Worker's stipend for Chuuk State Health Care Plan                                  |
| 10/17/2003        | 9850                | 101           | Health deductions re. Health Care Plan people                                      |
| 11/7/2003         | 9877                | 822           | Chuuk State Health Care Plan (CSHCP)<br>(Gross pay = \$2,077.06) for PPE 11/16/03) |
| 11/14/2003        | 9884                | 729<br>2,077  | Gas & fuel - for office use only<br>PPE 11/16/03 - CSHCP                           |
| 12/4/2003         | 9877                | 525           | Fuel for Municipal vehicles  |
| 7/18/2003         | Enc #L53186         | 16,610        | Charged 10% sales tax - Legal sales tax is 5%                                      |
| 9/30/2003         | 9820                | 485           | Fuel for CSH Care Plan vehicles  |
| 9/30/2003         | 9825                | 3,600         | Rent for CSH Care Plan (Oct - March 2003)  |
| 8/12/2003         | 9717                | 147           | Propeller  |
| 8/12/2003         | 9722                | 265           | Gas for Uman Municipality vehicles   |
| 9/11/2003         | 9746                | 783           | Phone bills of CSH Care Plan   |
| 9/11/2003         | 9747                | 282           | Supplies - no invoices attached  |
| 9/11/2003         | 9748                | 245           | Labor & for CSH Care Plan & photo copies   |

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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

**Federal Findings and Questioned Costs - Monitoring Subrecipients - Subrecipient - Chuuk**

Finding No.: C2003-04, Continued  
 CFDA No.: 15.875  
 Agency: U. S. Department of the Interior  
 Program Name: Section 211 (A) – Compact Capital Funds  
 Requirement: Activities Allowed or Unallowed  
 Questioned Costs: \$545,052

**Condition, Continued:**

| <u>Check Date</u> | <u>Check Number</u> | <u>Amount</u> | <u>Comments</u>  |
|-------------------|---------------------|---------------|--|
| 5/16/2003         | 9630                | \$ 1,626      | This is a municipal employee - labor costs, no taxes withheld? (paid out of 1.5% admin. Fee) |
| 5/30/2003         | 9644                | 30,000        | Lease/Purchase for Municipal use operation   |
| 6/5/2003          | 9650                | 296           | Telephone bills - Jan to April '03   |
| 4/29/2003         | 9607                | 843           | Contract payment   |
| 4/30/2003         | 9611                | 371           | WH Tax - CSH Care Plan   |
| 7/18/2003         | 9694                | 16,610        | Weno Municipal Court House Renovation  |
| 7/18/2003         | 9699                | 3,118         | Weno Municipal Court House Renovation  |
| 7/18/2003         | 9701                | 375           | Purchased fish   |
| 7/18/2003         | 9703                | 555           | Purchased fish   |
| 7/18/2003         | 9704                | 3,457         | Oneisom Jailhouse lease agreement  |
| 4/4/2003          | 9460                | 2,500         | Includes 1 coffee pot @ \$120  |
| 4/25/2003         | 9581                | 843           | Supported by timesheet only (Agriculture contract)   |
| 4/25/2003         | 9582                | 796           | Supported by timesheet only (Agriculture contract)   |
| 4/25/2003         | 9583                | 843           | Supported by timesheet only (Agriculture contract)   |
| 4/25/2003         | 9584                | 843           | Supported by timesheet only (Agriculture contract)   |
| 4/25/2003         | 9586                | 843           | Supported by timesheet only (Agriculture contract)   |
| 4/25/2003         | 9588                | 843           | Supported by timesheet only (Agriculture contract)   |
| 3/17/2003         | 7549                | 228           | Appears to be fuel for Uman Municipality operating expenses                                  |
| 3/17/2003         | 7551                | 1,000         | Weno Court Rental to Municipality  |
| 3/27/2003         | 7558                | 3,843         | Ordinary repair & maintenance, hull repair for MS Fuun                                       |
| 3/27/2003         | 7559                | 3,000         | Labor cost for landfill  |
| 3/27/2003         | 7561                | 700           | Meeting allowance for Chuuk State Health Care Plan board                                     |
| 3/27/2003         | 7563                | 500           | Check - no invoices  |
| 3/27/2003         | 7565                | 995           | Reef fish and other food   |
| 3/28/2003         | 7573                | 1,650         | CSH Care Plan says house rental for Mr. Leis Archy (07/02-10/02)                             |
| 3/28/2003         | 7574                | 3,600         | CSH Care Plan rental - April to September '03  |
| 6/17/2003         | 9662                | 5,000         | Revolving fund to sell fish  |
| 2/21/2003         | 7466                | 1,520         | Leases for Murilo Elem School site?  |
| 2/21/2003         | 7467                | 1,520         | Elementary School Building   |
| 2/21/2003         | 7468                | 1,520         | Elementary School Building   |

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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

**Federal Findings and Questioned Costs - Monitoring Subrecipients - Subrecipient - Chuuk**

Finding No.: C2003-04, Continued  
CFDA No.: 15.875  
Agency: U. S. Department of the Interior  
Program Name: Section 211 (A) – Compact Capital Funds  
Requirement: Activities Allowed or Unallowed  
Questioned Costs: \$545,052

**Condition, Continued:**

| <u>Check Date</u> | <u>Check Number</u> | <u>Amount</u> | <u>Comments</u>  |
|-------------------|---------------------|---------------|--|
| 2/21/2003         | 7469                | \$ 500        | Only \$348 seems to be for Fishing Project, the rest seems to be for operations  |
| 2/21/2003         | 7471                | 1,500         | Murilo Elementary School leases  |
| 2/21/2003         | 7472                | 1,500         | Murilo Elementary School leases  |
| 2/21/2003         | 7473                | 1,500         | Murilo Elementary School leases  |
| 2/21/2003         | 7474                | 500           | Payment of octopus & fish  |
| 2/21/2003         | 7475                | 60            | CSH Care Plan (food)   |
| 1/31/2003         | 5099                | 80,000        | This is advance payment-no competitive procurement on file. Indicates is for a replacement part & engine, pls refer to check. # 4582, as also paid for replacement parts for this vessel |
| 1/31/2003         | 5106                | 75,000        | Appears to have been approved by FSM Nat. Govt. and this is a subrecipient (Weno Housing Authority)  |
| 2/18/2002         | 2716                | 3,830         | Contract payment for Ruo Meeting Hall, no invoice, contract, or contract certificate on file.  |
| 12/18/02          | 2717                | 1,520         | Contract certificate not on file.  |
| 12/27/2002        | 3041                | 25,000        | Fanapangas Municipal lease agreement (2/92-12/02)  |
| 1/17/2003         | 4582                | 23,853        | Drydocking of Fuun Metaw including engine parts & repair (see above check # 5099).   |
| 1/17/2003         | 4863                | 25,000        | Shall be deposited in a bank checking account strictly for copra purchases in the name of Chuuk Coconut Authority, a defunct component unit).  |
| 1/17/2003         | 4864                | 15,000        | Says "Fefen Municipality sand mining & damage payable to lessor.   |
| 1/17/2003         | 4865                | 20,000        | Says "Fefen Municipality sand mining & damage payable to lessor.   |
| 12/3/2002         | 1880                | 1,405         | CSH Care Plan billings   |
| 12/3/2002         | 1886                | 500           | CSH Care Plan billings (Vehicle repairs, gas & services)   |
| 12/3/2002         | 1889                | 505           | CSH Care utility cost  |
| 12/3/2002         | 1892                | 72,772        | Municipal lease for payment on land when airport has not been constructed and also it appears a lot is due. Court judgment payment   |
| 12/3/2002         | 2311                | 3,000         | Payment to individual Murilo Municipal employees   |
| 12/31/2002        | 2703                | 5,901         | (\$2,651.32). Weno youth beautification project (bush cutter, rakes, etc).   |
| 12/31/2002        | 2706                | 14,995        | Land acquisition of \$150k, says must all be paid within 3 years of 11/19/02 and no indication such occurred.  |
| 12/13/2002        | 2707                | 46            | Uman Municipality  |
| 10/30/2002        | 442                 | 29,720        | Court judgment & interest - Approved by Contracting Officer for FSM National Government. Uman Municipal Lease Rental.  |
| 10/18/2002        | 146                 | 13,000        | Payment of Apartment rental for 2002 - 2004 rental (2 years & 2 months)  |

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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

**Federal Findings and Questioned Costs - Monitoring Subrecipients - Subrecipient - Chuuk**

Finding No.: C2003-04, Continued  
CFDA No.: 15.875  
Agency: U. S. Department of the Interior  
Program Name: Section 211 (A) – Compact Capital Funds  
Requirement: Activities Allowed or Unallowed  
Questioned Costs: \$545,052

Cause: The cause of this condition is noncompliance with the terms of the Compact Capital requirements.

Effect: The effect of this condition is questioned costs of \$545,052.

Recommendation: The above items should be reviewed and discussed with the FSM National Government to resolve the abovementioned items.

Auditee Response and Corrective Action Plan: Discussion with the FSM National Government is being undertaken to resolve the issue. FSM National Government has ceased the disbursements of Compact Capital Funds effective September 30, 2005.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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

**Federal Findings and Questioned Costs - Monitoring Subrecipients - Subrecipient - Chuuk**

Finding No.: C2003-06  
CFDA No.: 15.875  
Agency: U.S. Department of the Interior  
Program Name: Scholarship Program  
Requirement: Special Terms and Conditions  
Questioned Costs: \$32,500

Criteria: All scholarship checks should be made out jointly to the institution and the awardee.

Condition: For 12 of 28 items tested, the scholarship check was not made out jointly to the College/University and the student. This is contrary to required policy.

| <u>Last Name</u> | <u>First Name</u> | <u>Amount<br/>Awarded</u> |
|------------------|-------------------|---------------------------|
| Jacob            | Joanna            | \$ 5,000                  |
| Paul             | Enriena           | 3,500                     |
| Beverly          | Simina            | 3,500                     |
| Lokopwe          | Toren             | 3,500                     |
| Yesiki           | Iris              | 3,000                     |
| Selifis          | Chen              | 2,000                     |
| Tilim            | Cynthia           | 2,000                     |
| Trifonovi        | Jay               | 2,000                     |
| Andon            | Jenryna           | 2,000                     |
| Michiu           | Johnny            | 2,000                     |
| Tipekis          | Joyny             | 2,000                     |
| Sabas            | Kenally           | 2,000                     |
|                  |                   | <u>\$ 32,500</u>          |

Cause: The State failed to make the scholarship payment jointly to the student and the applicable institution of higher learning.

Effect: The impact of this matter is noncompliance with Scholarship requirements and questioned costs of \$32,500.

Recommendation: All scholarship checks should be made out jointly to the institution and the awardee.

Auditee Response and Corrective Action Plan: We acknowledge that due to the volume of checks issued, there was an oversight in ensuring that all checks complied with this requirement. To avoid this kind of oversight in the future, the checks are being double-checked by different individuals prior to releasing them to the awardees.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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

**Federal Findings and Questioned Costs - Monitoring Subrecipients - Subrecipient - Kosrae**

Finding No.: K2003-02  
CFDA No.: 84.027  
Agency: U.S. Department of Education  
Program Name: Special Education Program for Pacific Island Entity  
Area: Procurement  
Questioned Costs: \$39,811

Criteria: Procurement actions should be documented in the procurement files.

Condition: Of 14 transactions tested aggregating \$132,449, we found five instances where price solicitation was not evidenced in the procurement files. In addition, APV300145901 lacked evidence of goods being received.

| <u>APV</u> | <u>Amount.</u> | <u>Org</u> | <u>Cost Center</u> |
|------------|----------------|------------|--------------------|
| 300722201  | \$15,090       | 301410     | KA2090             |
| 300315301  | \$8,890        | 301410     | KA2090             |
| 300242401  | \$5,800        | 301410     | KA2090             |
| 300025501  | \$5,781        | 301410     | KA2090             |
| 300145901  | \$4,250        | 301410     | KA2090             |

Cause: The cause of this condition is the absence of documentation to substantiate the basis for sole-source procurement.

Effect: The effect of this condition is questioned costs.

Recommendation: The Director of Administration should specify the responsibility for performing competitive procurement activities.

Auditee Response and Corrective Action Plan: We agree to this finding, however, we will revisit the established policies and procedures to resolve this problem.



**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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

**Federal Findings and Questioned Costs - Monitoring Subrecipients - Subrecipient – Pohnpei**

Finding No.: P2003-1  
CFDA No.: 15.875 – Hospital Renovation Grant  
Grantor Agency: U.S. Department of the Interior  
Program/Area: Procurement and Suspension and Debarment  
Questioned Costs: \$0

Criteria: Federal procurement standards require that any procurement greater than the threshold be conducted in a manner providing full and open competition.

Condition: For 4 of 7 transactions tested aggregating \$119,491 (out of a total population of \$123,510), Pohnpei State did not follow applicable competitive procurement requirements.

| <u>Contract</u> | <u>Voucher No.</u> | <u>Amount</u> |   |
|-----------------|--------------------|---------------|---|
| C2060401        | 781169             | 17,157        | Federal competitive bidding was superseded by a local procurement guideline disqualifying any bidder with unfinished construction work with the government from bidding |
| C2060401        | 782471             | 10,343        | Federal competitive bidding was superseded by a local procurement guideline disqualifying any bidder with unfinished construction work with the government from bidding |
| C2060401        | V30160             | 29,067        | Federal competitive bidding was superseded by a local procurement guideline disqualifying any bidder with unfinished construction work with the government from bidding |
| C2060401        | V30194             | 19,698        | Federal competitive bidding was superseded by a local procurement guideline disqualifying any bidder with unfinished construction work with the government from bidding |

Cause: The cause of this condition is that local procurement guidelines were used to limit competition since, as a result of the local guideline, only one submitting vendor qualified for the work.

Effect: The effect of this condition is noncompliance with federal procurement standards. However, no questioned costs result from this finding as the grantor agency has accepted the underlying costs as meeting grant intent.

Recommendation: We recommend that management ensure compliance with competitive procurement requirements.

Auditee Response and Corrective Action: The grantor agency resolved the questioned costs and therefore no other action is required. The Department of Treasury and Administration will ensure that the grantor agency's recommendation to follow the applicable competitive procurement will be strictly implemented. The Chief of Finance will provide copy of the grantor agency's letter to the Head of the Office of Transportation and Infrastructure for proper implementation of the competitive bidding.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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

**Federal Findings and Questioned Costs - Monitoring Subrecipients - Subrecipient - Pohnpei**

Finding No.: P2003-2  
CFDA No.: 15.875 – Compact of Free Association, Section 211(a), Capital Account  
Grantor Agency: U.S. Department of the Interior  
Program/Area: Allowable Costs/Cost Principles  
Questioned Costs: \$0

Criteria: Compact funds should be expended in accordance with underlying terms and conditions of the treaty.

Condition: We were not able to determine how the following disbursement qualifies as a capital improvement project as such appears to be of a general operating nature.

| <u>Doc. No.</u> | <u>Amount</u> | <u>Account</u>  |
|-----------------|---------------|---|
| V30259          | \$80,000      | 6122-8399 Payment to U.S Farmer's Home for delinquent personal loans charged as miscellaneous expense |

Cause: The cause of this condition is that adequate documentation was not prepared to justify this expenditure as Compact Capital account related.

Effect: The effect of the above condition does not result in questioned costs since, in fiscal year 2004, the Compact Capital Projects Fund was reimbursed by the General Fund in the amount of \$80,000.

Recommendation: We recommend that Pohnpei State Government ensure adherence to the criteria.

Auditee Response and Corrective Action Plan: The Department of Treasury and Administration will ensure that compact funds will be expended in accordance with the terms and condition of the Compact. This will be a continuous task for the Chief of Finance.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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

**Federal Findings and Questioned Costs - Monitoring Subrecipients - Subrecipient - Pohnpei**

Finding No.: P2003-9  
Area: Equipment and Real Property Management

Criteria: A functioning system of internal control requires that a summary schedule of fixed asset details be produced by the automated fixed asset subsystem, and be further classified by major asset category.

Condition: During the year ended September 30, 2003, a summarization of assets from the automated fixed assets subsystem was not updated. Additionally, a physical inventory of property was not performed as required by the Common Rule.

Cause: The cause of this condition is a lack of periodic update of the fixed asset subsystem.

Effect: The effect of this condition is that noncompliance with the Common Rule occurred in 2003 and the State did not have a functioning fixed asset system during that year. However, during fiscal year 2004, the Finance Division was able to reconcile its fixed asset subsystem, conduct the required inventory and produce required reports.

Recommendation: We recommend that the Finance Office continue to ensure that the fixed assets subsystem is updated on a regular basis.

Auditee Response and Corrective Action Plan: The Procurement and Property Accountability staff will continue to update the fixed assets master file to ensure that all fixed assets are recorded and properly valued particularly infrastructure in order to meet the GASB 34 requirement in fiscal year 2007.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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

**Federal Findings and Questioned Costs - Monitoring Subrecipients - Subrecipient -- Yap**

Finding No.: Y2003-01  
CFDA No.: 84.027B Special Education  
Grant ID: 3256 A01-0004-02  
Grantor Agency: U.S. Department of Education  
CFDA No.: 83.516  
Grantor Agency: U.S. Federal Emergency Management Agency  
Program/Area: Equipment and Real Property Management  
Questioned Costs: \$0

Criteria: Fixed assets should be properly identified.

Condition: Fixed assets greater than \$5,000 per unit were unable to be identified.

Cause: There is no current system in place that appears to assign identification tags to individual fixed assets. We understand that the State will be subsequently defining fixed assets at a higher threshold (\$5,000) and this action should assist in resolving this finding.

Effect: The inability to properly identify fixed assets may increase the risk of not identifying potential problems or abuse in a timely manner.

Prior Year Status: This matter was reported in the 2002 Single Audit Report.

Recommendation: The Federated States of Micronesia as a whole has moved to adopting the federal equipment standard and this process should assist the State in its fixed asset inventory management.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. The inventory and tagging of fixed assets is being performed by the Division of Procurement & Property Management and will be completed by December 31, 2005. A fixed asset register is being concurrently prepared with this inventory. Additionally, the Director, Office of Administrative Services will submit promulgate proposed changes to amend the Yap State Procurement Code to raise the capitalization threshold of capital assets to \$5,000, in line with the FSM and federal equipment standards. These amendments will be proposed no later than November 30, 2005.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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

**Federal Findings and Questioned Costs - Monitoring Subrecipients - Subrecipient – Yap**

Finding No.: Y2003-02  
CFDA No.: 15.875 Post Secondary Education Program  
Grantor: U.S. Department of Education  
Area: Allowable Costs/Cost Principles  
Questioned Costs: \$27,000

Criteria: Scholarship Awards are restricted to students with at least 12 credits per semester and who are enrolled in U.S. or FSM universities.

Condition: Scholarships were granted to students who had less than 12 credits per semester or who attended non-US and non-FSM universities.

Student with less than 12 credits per semester:

| <i>Transaction #</i> | <i>Date</i>      | <i>Questioned Cost</i> |
|----------------------|------------------|------------------------|
| 1306T-0000001        | February 4, 2003 | \$3,000                |

Student who attended non-US/non-FSM universities

|    | <i>Transaction #</i> | <i>Date</i>        | <i>Questioned Cost</i> |
|----|----------------------|--------------------|------------------------|
| 1) | 2494T-0000001        | April 17, 2003     | \$ 4,000               |
|    | 5371T-0000008        | September 26, 2003 | 4,000                  |
| 2) | 2494T-0000002        | April 17, 2003     | 4,000                  |
|    | 5371T-0000007        | September 26, 2003 | 4,000                  |
| 3) | 2494T-0000003        | April 17, 2003     | 4,000                  |
|    | 5371T-0000033        | September 26, 2003 | 4,000                  |

Cause: The cause of the description is that awards were granted outside of the Compact requirements.

Effect: Questioned costs result from the condition.

Recommendation: We recommend implementation of strict policy relative to granting scholarships to only qualified students. Management shall design measures that will monitor compliance with program requirements.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. The policy promulgated by the Yap State Scholarship Board and enforced by the Student Assistance Program Coordinator, puts students on probation if they have an inadequate GPA or are taking less than 12 credits per semester. They are allowed two consecutive semesters of probation before they are terminated from the scholarship program. The finding concerning awards to students attending non-U.S. schools was an oversight resulting from new program management in the scholarship office: in prior fiscal years, two sources of funding were available for scholarships---Compact 216 monies and general fund appropriations. Students attending non-U.S institutions were paid from the general fund. No general funds were appropriated for FY-03 so payments were inappropriately charged against the Compact monies. This concern was corrected as of FY-04, where the YSL 6-21 appropriated some general funds for Yap Scholarship. These funds are awarded to students attending non-US affiliated universities. The Scholarship Coordinator is now strictly monitoring compliance with program requirements.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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

**Federal Findings and Questioned Costs - Monitoring Subrecipients - Subrecipient – Yap**

Finding No.: Y2003-03  
CFDA No.: 83.516 Federal Emergency Management Agency Grant  
Grantor: U.S. Federal Emergency Management Agency  
Area: Allowable Costs/Cost Principles  
Questioned Costs: \$20,846

Criteria: Expenditures charged to Federal Emergency Management Agency (FEMA) funds should only be those that fall under a specific advice of allotment.

Condition: Retroactive pay was provided to two employees designated as the Public Assistance Coordinator and as the Public Assistance Officer. The retroactive pay was not supported by an advice of allotment and the pay was not processed through the required State process. As a result, the payment does not appear to conform to either State or federal requirements.

|                               | Employee No. | CK No. | Retroactive Pay |
|-------------------------------|--------------|--------|-----------------|
| Public Assistance Coordinator | 703424       | 15227  | \$ 9,432        |
| Public Assistance Officer     | 44662        | 11971  | <u>11,414</u>   |
|                               |              |        | <u>\$20,846</u> |

Cause: The cause of this condition is that required federal and State procedures were not followed in the preparation of the retroactive pay.

Effect: Use of funds outside FEMA and State requirements results in questioned costs.

Recommendation: We recommend that management review the abovementioned disbursements and determine whether the funding program should be reimbursed.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. The payment of retroactive FEMA disaster allowances through the general bank account rather than through properly approved payroll personnel action forms was a breach of Department of Finance normal operating procedures. The eligibility and payment of some OPB and Public Works inspectors' differentials had been verbally approved by FEMA but it is not clear why some were paid through payroll and others not. This practice was discontinued by June 2003 and since then all employees working for the auspices of FEMA programs have employee contracts which detail their responsibilities under the FEMA programs and in which their pay rate, inclusive of all differentials, is stated in the contract. The Yap State FEMA Public Assistance Officer is now responsible to ensure all FEMA program payroll payments are supported by personnel contracts.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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

**Federal Findings and Questioned Costs - Monitoring Subrecipients - Subrecipient – Yap**

Finding No.: Y2003-04  
CFDA No.: 15.875 Special Block Grant  
Grantor: U.S. Department of the Interior  
CFDA No.: 84.027B Special Education  
Grant ID: 3256 A01-0004-02  
Grantor: U.S. Department of Education  
Area: Allowable Costs/Cost Principles  
Questioned Costs: \$18,265

Criteria: Payments to vendors should be supported by invoices for goods/services provided.

Condition: No invoices were provided for the following disbursements:

| <u>Date</u>                                 | <u>Check #</u> | <u>Check<br/>Amount</u> | <u>Unsupported<br/>Amount</u> |
|---|----------------|-------------------------|-------------------------------|
| <u>Compact Special Block Grant – 15.875</u> |                |                         |                               |
| 12/12/2002                                  | 1413           | \$ 8,000                | \$ 6,000                      |
| <u>Special Education Fund</u>               |                |                         |                               |
| 12/12/2002                                  | 1446           | -                       | 4,065                         |
| 10/18/2002                                  | 225            | -                       | 8,200                         |

Cause: The cause of the condition is that the underlying invoices could not be located.

Effect: Questioned costs result from this condition.

Recommendation: We recommend that all vendor payments be supported by invoices and that these invoices are maintained on file.

Auditee Response and Corrective Action Plan: The finding is partially correct and we agree with the recommendation. Of the instance cited, the check under the Compact Special Block Grant is supported by vendor invoices. Check 1413 was in payment of an invoice for freight of DOE supplies send to Outer Island schools.

Of the two checks referred to under the Special Education Fund, check 1446 was for a travel advance to an early childhood program conference in Washington D.C (T.A. on file), and check 225 was for payment to a Special Consultant to Education.

It has always been established procedure that the Department of Education will not approve, and the Department of Finance not authorizes vendor payments without supporting invoices. The Chief of Finance is responsible to ensure that supporting documents for payments be maintained and secured properly.

**FEDERATED STATES OF MICRONESIA  
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Schedule of Findings and Questioned Costs, Continued  
Year Ended September 30, 2003

**Federal Findings and Questioned Costs - Monitoring Subrecipients - Subrecipient – Yap**

|                   |                                 |
|-------------------|---------------------------------|
| Finding No.:      | Y2003-04, Continued             |
| CFDA No.:         | 15.875 Special Block Grant      |
| Grantor:          | U.S. Department of the Interior |
| CFDA No.:         | 84.027B Special Education       |
| Grant ID:         | 3256 A01-0004-02                |
| Grantor:          | U.S. Department of Education    |
| Area:             | Allowable Costs/Cost Principles |
| Questioned Costs: | \$18,265                        |

Auditor Response: With respect to the Compact Special Block Grant invoice, there is a blank statement that indicates payment is due. However, there is no indication of the detail of the items shipped or delivered and no indication of the applicability of the charge to the program.



**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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

**Federal Findings and Questioned Costs - Monitoring Subrecipients - Subrecipient – Yap**

Finding No.: Y2003-05  
CFDA No.: 84.048B PVEIP  
Grantor: U.S. Department of Education  
CFDA No.: 84.027B Special Education  
Grantor: U.S. Department of Education  
Area: Allowable Costs/Cost Principles  
Questioned Costs: \$35,447

Criteria: Employees who travel off-island should submit a travel authorization form, boarding passes and trip reports to support actual attendance at conferences and other training venues.

Condition: Of twenty travel transactions tested totaling \$49,233, nine were noted for unsubmitted travel authorization forms and trip expense reports, two did not have boarding passes on file and one was not provided for review.

The following travel authorization forms and trip expense reports were not made available for our review.

|           |                 |                   |
|-----------|-----------------|-------------------|
| #A2003120 | \$ 2,837        | Special Education |
| #A2003055 | 4,066           | Special Education |
| #A2003009 | <u>2,906</u>    | Special Education |
|           | <u>\$ 9,809</u> |                   |
|           |                 |                   |
| #A2003254 | \$ 1,680        | PVEIP             |
| #A2003255 | 1,680           | PVEIP             |
| #A2003118 | 2,203           | PVEIP             |
| #A2003119 | 5,805           | PVEIP             |
| #A2003117 | 2,203           | PVEIP             |
| #A2003121 | <u>3,837</u>    | PVEIP             |
|           | <u>\$17,408</u> |                   |

No boarding passes were on file for the travel expense report of the following:

|           |          |       |
|-----------|----------|-------|
| #A2003121 | \$ 2,962 | PVEIP |
| #S2003072 | \$ 2,404 | PVEIP |

Travel expense report A2003325 was not provided to us for our review. Total travel costs of \$2,864 (PVEIP) were unsupported

Cause: The cause of the condition is that the above documents have yet to be located.

Effect: The effect of the above condition is the risk of disbursing funds without adequate support and questioned costs.

Recommendation: We recommend strict implementation of the submission of travel expense reports, including attaching the necessary documents to support actual trips.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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

**Federal Findings and Questioned Costs - Monitoring Subrecipients - Subrecipient – Yap**

|                   |                                 |
|-------------------|---------------------------------|
| Finding No.:      | Y2003-05, Continued             |
| CFDA No.:         | 84.048B PVEIP                   |
| Grantor:          | U.S. Department of Education    |
| CFDA No.:         | 84.027B Special Education       |
| Grantor:          | U.S. Department of Education    |
| Area:             | Allowable Costs/Cost Principles |
| Questioned Costs: | \$35,447                        |

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. Although all the travel authorization forms mentioned were for authorized travel for DOE employees, in most cases subsequent expense vouchers had not been filed and consequently trip reports and boarding passes were not available. Effective in FY-04, the Department of Education began strictly enforcing a policy requiring timely filing of travel vouchers upon completion of travel that will include trip reports and boarding passes. Those employees who have lost required documents must file an affidavit attesting to this loss. Effective December 2005, the travel accountant in Finance will begin payroll check deductions for outstanding advances as well.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

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

**Federal Findings and Questioned Costs - Monitoring Subrecipients - Subrecipient – Yap**

Finding No.: Y2003-06  
CFDA No.: 84.027B Special Education  
Grantor: U.S. Department of Education  
Area: Procurement and Suspension and Debarment  
Questioned Costs: \$0

Criteria: Procurement should provide for full and open competition and be performed in accordance with the Government requirements.

Condition: Even though Yap State Government's internal policy does not require personnel contracts to be competitively procured, we recommend that the Government consider adopting a formal policy requiring documentation of procurement rationale.

Cause: There appears to be weak internal controls over ensuring that full and open competition is obtained in procurement.

Effect: No material effect on the financial statements occurs as a result of this condition. The absence of compliance with competitive procurement may increase the risk of not identifying potential problems or abuse in a timely manner.

Recommendation: The Yap State Government should reevaluate its current procurement policies for personnel contracts.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. The finding in question refers to the previous practice (now discontinued) of Department of Education using temporary personnel contracts to pay for what were in fact temporary consulting services that had not been publicly announced or competitively procured. A review of the payments in question indicates that all individuals were performing services to DOE and were qualified to do such work. Moreover, there are circumstances where local procurement of such services is necessary and desirable and where, because of the unique skills and experience of the consultant in question, the DOE may find it desirable to make such procurements exempt from competitive procurement policies. The problem being cited was the incorrect usage of personnel contracts when more complete consultancy contracts with clearly defined scopes of services should have been used; with any exemption from normal procurement practices documented and approved. Effective with the appointment of a new Director, DOE in FY-04, the use of personnel contracts in lieu of proper consulting services contracts was discontinued.

**FEDERATED STATES OF MICRONESIA  
NATIONAL GOVERNMENT**

Unresolved Prior Years' Questioned Costs  
Year Ended September 30, 2003

The following is a summary of unresolved federal questioned costs for the FSM National Government.

|                                   | Questioned Costs<br>Set Forth in<br>Prior Audit Report<br><u>2002</u> | Questioned<br>Costs Resolved<br>in Fiscal Year<br><u>2002</u> | Questioned Costs at<br><u>September 30, 2003</u> |
|-----------------------------------|---|---|--|
| Unresolved Questioned Costs FY 99 | \$ 57,860   | \$ -  | \$ 57,860  |
| Unresolved Questioned Costs FY 00 | 75,221  | -   | 75,221   |
| Unresolved Questioned Costs FY 01 | 141,625   | -   | 141,625  |
| Unresolved Questioned Costs FY 02 | 582,927   | -   | 582,927  |
| Unresolved Questioned Costs FY 03 | <u>-</u>  | <u>-</u>  | <u>1,079,514</u>                                 |
|                                   | <u>\$ 857,633</u>   | <u>\$ -</u>   | <u>\$ 1,937,147</u>                              |